8. Summary, Ofgem's views and future work

8.1. This chapter summarises the main findings of this review of the progress of domestic gas and electricity competition. It explains what views Ofgem has drawn from the findings and links these to the future work that Ofgem will carry out.

8.2. The review has considered in detail a number of indicators of domestic electricity and gas supply competition:

- domestic customers' experiences of various aspects of competition
- customers' switching behaviour, including why some customers may choose not to switch
- the variety of price and non-price offers that domestic suppliers provide
- an assessment of different indicators of supplier profitability and their implications for Ofgem's assessment of competition
- the structure of the domestic supply market and what that might mean for competitive intensity, and
- the impact that barriers to entry and expansion might have on the domestic supply market.

Overall findings

8.3. The review has highlighted a number of positive conclusions about the development of competition in domestic supply and its impact on customers:

- customers from every demographic group are benefiting from domestic competition, even though competition is not yet mature. In both gas and electricity, across most of the country, customers in all social groups, across all incomes and of all ages are switching supplier at rates at or near the national average of 51 per cent in electricity and 47 per cent in gas

- ♦ competition is continuing to develop and the market continues to mature – this is indicated by high levels of switching activity by customers, steady erosion of the market share of the incumbent suppliers and a variety of price and non-price offers available to customers

- ♦ for customers who have not switched, savings are available in all regions for gas, electricity and dual fuel for customers who pay by direct debit and standard credit (other than those using very small quantities). Two tier pricing is far more varied in its incidence and extent than is often implied

- ♦ the differential between standard credit and prepayment prices continues to decrease in both gas and electricity. After taking into account recent announcements of price increases for both payment types, the median differential in gas is around 9 per cent (compared to 14 per cent in April 2002 when price controls were lifted) and in electricity it is also around 9 per cent (compared to 13 per cent in April 2002), and

- ♦ at current price levels there appears to be headroom for profitable new entry in both the gas and electricity supply sectors.

8.4. However there are some areas of concern:

- ♦ many customers still find it difficult to compare prices and most get pricing information from a supplier. Whilst this does not imply that the information is inaccurate, it is unlikely to identify the maximum savings that could be made by the customer

- ♦ it appears that suppliers that maintain their discount to BGT's gas price and the region's ex-PES electricity price can expect to attract switchers irrespective of their actual price

- ♦ in some regions suppliers appear to be competing less actively for electricity prepayment customers, however those who have not switched can still save by doing so

- ♦ in the North of Scotland, fewer customers have switched electricity supplier than in any other region in Great Britain (82 per cent are still with the ex-PES compared to the average of 61 per cent), despite savings being available for all payment types. Only 36 per cent of customers in the North of Scotland have switched supplier. This contrasts with the South of Scotland where customers switch at the same rate as in England and Wales. However the south of Scotland has fewer suppliers, each with a larger proportion of customers, than many regions in England and Wales

- dynamic teleswitched customers still have no real option to switch supplier because the type of meter that they have in their homes differs from those that most suppliers' systems can support

- Ofgem's analysis to date has found that there is a weak relationship between changes in the forward wholesale electricity price and changes in domestic retail prices (the relationship appears to be much stronger for gas), and

- information that new entrants need to develop business plans and entry strategies may not be readily available, even though it is in the public domain.

Customers' experiences

Summary

8.5. All customers show very high levels of awareness of competition over time, across regions and across all customer groups. Awareness in Scotland for gas and electricity is slightly less than for England and Wales but there is no significant difference between the north and the south of Scotland. Prepayment gas and electricity customers are less aware than average. Pensioner awareness is near the national average and pensioners are almost as likely to have switched as the average (42 per cent in gas and 49 per cent in electricity). However other work that Ofgem has published shows that 22 per cent of pensioners are in fuel poverty and this remains an area of concern[1].

8.6. Customer satisfaction with gas and electricity suppliers remains high although switchers tend to be slightly less satisfied than non-switchers. Levels of dissatisfaction are very low but are increasing.

8.7. The majority of customers who have switched found the process 'very easy' or 'fairly easy'. Most customers who have not switched perceive the switching process to be straightforward.

8.8. Price is the main reason for switching in both gas and electricity. Very few customers cite better customer service as a reason for switching. Customers who have not switched also cite price as the main reason in their decision. However for non-switchers, not wanting to switch is also a significant factor. Non-switchers also cite the quality and reliability of supply as a reason for not switching, even though quality and reliability are determined by the network operators and are not within their supplier's control.

8.9. On average 47 per cent of gas customers and 51 per cent of electricity customers have switched (at least once). Switchers are spread fairly evenly across all demographic groups. However far fewer prepayment customers have switched – only 32 per cent in gas and 39 per cent in electricity.

8.10. In both gas and electricity, more than two thirds of customers find it 'very easy' or 'fairly easy' to compare prices. However nearly a third of customers find price comparisons 'not very easy' or 'not at all easy'. Most customers get price information from doorstep sales agents. Although the percentage has fallen, over one fifth of gas customers and a quarter of electricity customers get pricing information direct from a supplier. The internet is increasing in importance as the way in which customers get pricing information.

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[1] UK Fuel Poverty Strategy, November 2001: Detailed breakdowns of fuel poverty in England in 2001. Further fuel poverty statistics can be found at www.dti.gov.uk/energy/consumers/fuel_poverty/england2001analysis.pdf.

Ofgem's view

8.11. Overall, customers have positive experiences of competition across a wide range of indicators.

8.12. There may be several reasons why prepayment customers' awareness of competition is lower than other groups and is falling:

- the analysis of suppliers' prices (see Chapter 4) shows that there is less price competition for prepayment customers across all regions, and

- although only 14 per cent of electricity PPM customers and 36 per cent of gas customers are in debt, until February 2004, their existing suppliers could have blocked their switch because of debt. In addition, because of misdirected prepayment payments many prepayment customers are regarded by suppliers as in debt when they have paid up fully and they may therefore have been (incorrectly) blocked from switching. These customers may therefore have assumed that they cannot switch and this could have influenced the responses to the survey question

8.13. Comparing prices still presents difficulties for a large number of customers. This may deter many customers from switching. It is also likely to increase the reliance on information gained on the doorstep (indeed, those customers who say they can compare prices easily may be relying on information gained from doorstep sales agents). The fact that so many customers have switched to BGT for dual fuel even though it is the most expensive dual fuel supplier for many regions may also be evidence of customers' reliance on sales agents for pricing information. This fact could add weight to the suggestion that customers are not necessarily concerned about how much they will save, just that they will save something and are therefore likely to switch to the first supplier that offers a saving.

8.14. Although levels of dissatisfaction are small, they are increasing. This may be an indication that customers' expectations about service quality are being raised, thus helping to place some additional competitive pressures on suppliers.

8.15. There may be branding issues which leads non-switchers to assume that responsibility for the quality and security of their gas or electricity supply is their supplier's rather than Transco, National Grid or the electricity distribution companies.

Switching assessment

Summary

8.16. Around 60 per cent of switchers are switching for the first time. However in both gas and electricity multiple switchers account for a growing share of total switchers (around 38 per cent of all gas switchers and around 34 per cent of all electricity switchers). There are therefore a proportion of households who are willing to change supplier more frequently.

8.17. The rate of erosion of incumbents' market shares (in gas BGT has 61 per cent and in electricity ex-PESs have an average 59 per cent) masks high levels of switching activity. BGT is more successful at winning back gas customers than ex-PES incumbents are at winning back electricity customers.

8.18. A significant amount of transfers occur between non-incumbent suppliers (around 28 per cent in gas and around 32 per cent in electricity).

8.19. Most customers switch to cheaper offers, but not necessarily to the cheapest offer. This is highlighted by the fact that although BGT has the highest number of dual fuel customers it is the most expensive dual fuel supplier in many regions for direct debit and standard credit (although for a non-switcher it is cheaper than not switching at all).

8.20. The analysis of switching behaviour did not find any significant relationship between social group and a decision to switch.

8.21. In both gas and electricity, some suppliers benefit significantly from 'non-price factors' such as brand value, marketing activity or features such as single bills or electronic billing. The suppliers that benefit from non-price factors are less reliant on price to acquire customers and, if all suppliers' prices were the same, customers would switch to them rather than a supplier that did not benefit from these factors.

Ofgem's view

8.22. Ofgem's analysis and review has led it to conclude that:

- the fact that customers continue to switch supplier in large numbers and that most switchers are doing so for the first time indicates:
  - good levels of awareness of competition, and
  - customers are not strongly segmented between 'switchers' and 'non-switchers'.
- the analysis does not enable a conclusion to be drawn about whether suppliers that have significant fixed effects acquired these competitively or whether they are a legacy of a former monopoly position, and
- although customer survey data consistently indicates that customers do not consider non-price factors to be significant when making the decision to switch, Frontier's research clearly shows that these factors have an important influence on what customers actually do. This information, together with the importance of doorstep selling as a source of switching and price comparison information, and the fact that customers are switching in large numbers to the most expensive dual fuel supplier (BGT) (although they will make a saving if switching from the double incumbent), suggests that some suppliers may be relying on non-price factors and so not reducing prices to the maximum extent possible. This may indicate inadequate incentives to constrain the prices of those suppliers with the strongest fixed effects.

Price and non-price offers

Summary

8.23. The results of the analysis that Ofgem has carried out to date indicate that there is no clear link between changes in electricity wholesale prices and domestic prices; there is a much stronger link between wholesale and domestic gas prices.

8.24. Two tier pricing arises as a result of suppliers' commercial decisions to charge customers who do not switch more than customers who do. There are no regulatory requirements for them to do so. However two-tier pricing is far more varied in its incidence and extent than is often implied, with some suppliers lowering differentials while others are increasing them. Most suppliers' prepayment charges are less in-area than out of area.

8.25. For standard credit and direct debit customers (other than those who have extremely low levels of consumption) competitive offers are available in all regions, for gas, electricity and dual fuel. The ex-PES is always the most expensive single fuel electricity supplier and BGT is always the most expensive single fuel gas supplier. BGT is often the most expensive dual fuel supplier. The average standard credit customer switching for the first time can save between £79 and £126 by switching to dual fuel, £92 by switching gas supplier and between £20 and £47 by switching electricity supplier, providing they shop around and switch to the cheapest supplier in their area.

8.26. Non-price offers are an indication that gas and electricity suppliers are seeking to differentiate functionally identical products. Many customers have benefited from non-price offers, particularly dual fuel.

Ofgem's view

8.27. On the basis of the analysis carried out to date it appears that there is a complex relationship between movements in wholesale and retail prices that is not captured solely by movements in the forward wholesale price. There may be a number of explanations including:

- suppliers do not price solely according to forward prices but are also influenced by other factors. This includes the fact that the different balancing regimes in gas and electricity may strongly influence overall contract structures
- vertical integration may dilute domestic price responsiveness
- suppliers think that domestic customers do not like price volatility and therefore 'smooth' changes in prices

- ‘shocks’ (such as the introduction of NETA) have come too close together, relative to the pace at which one would expect prices to revert to pattern and it might simply be too soon to assess the relationship, and

- suppliers price relative to each other with some price leadership by larger suppliers.

8.28. Although two tier pricing means that customers who remain with (or switch back to) their incumbent supplier pay higher prices, this does not necessarily mean that supply markets are not competitive. Customers who switch will necessarily gain a larger share of the benefits of supply competition than non-switchers. In the transition from monopoly to mature competition this difference in the share of benefits, reflected in the two-tier price, provides for the dynamic incentive for customers to switch away from their ex-PES. It may be indicative of suppliers’ different competitive approaches, either through building a national brand or because customer losses are reaching a point where suppliers’ in-area pricing strategies have to change.

8.29. Although non-price offers may provide savings and increased choice they may also reduce incentives for customers to switch.

Profitability assessment

Summary

8.30. Suppliers’ margins are only one indicator of the competitive environment. Caution is needed when interpreting or analysing margins and profits that are high relative to historic levels do not necessarily indicate that competition is weak or failing.

8.31. The evidence from the headroom analysis suggests that entrants could still profitably enter the retail supply market although supply margins for a new entrant are relatively low for smaller suppliers, particularly in gas. New entry may require access to existing distribution and marketing channels and/or an established brand unless the new entrant can lower costs through innovation below those assumed in this analysis.

8.32. Published sources suggest that supply businesses may be earning profit margins of between 5 and 8 per cent. This implies customer valuations lower than those paid in more recent merger transactions involving domestic supply businesses. This may be because the price paid in mergers takes account of a wide range of factors which may account for approximately a third of the price paid.

Ofgem's view

8.33. Ofgem recognises that there are different types of potential profitable new entrants. Obviously further new entry into the gas and electricity supply sector would increase competitive pressures on existing suppliers and provide further evidence that the competition in the domestic supply market continues to develop.

Concentration and indicators of competitive intensity

Summary

8.34. The product analysis indicates that there is little co-movement between gas and electricity prices indicating that different competitive pressures appear to influence the prices of these products. The regional analysis indicates that competitive pressures, as reflected in prices, tend to be more uniform across regions for gas than for electricity. This is consistent with, but not proof of, regional markets for electricity and a national market for gas. However this analysis has not been conducted to the extent necessary for any Competition Act investigation.

8.35. BGT supplies 61 per cent of gas customers in Great Britain. On average an ex-PES supplies around 59 per cent of customers in its region. However Scottish Hydro supplies around 82 per cent of electricity customers in its region. This is reflected in the high concentration index for that area. For Scottish Power's area the concentration index, while not the lowest, is similar to areas in England and Wales. This is likely to reflect a similar structure, with British/Scottish Gas as the second largest electricity supplier after the ex-PES in each region.

8.36. Despite often being the most expensive dual fuel supplier, BGT supplies 44 per cent of all dual fuel customers.

8.37. There are nine active domestic gas suppliers and 11 active domestic electricity suppliers. Ofgem has information about 16 different brands/offers from these suppliers. These do not include the various affinity deals that a number of suppliers offer through third parties.

Ofgem's view

8.38. Incumbents' market shares continue to erode. However the rate of erosion in the North of Scotland is extremely slow, despite the fact that Ofgem's price analysis shows that savings are available for customers who have not switched.

8.39. Although concentration in both sectors is high, a variety of different offers is available to customers indicating a degree of product innovation and differentiation. Ofgem's analysis of margins and barriers to entry indicates that new entry is possible in both sectors.

8.40. Although some features of both sectors could indicate that they could be susceptible to co-ordination, Ofgem has found no evidence to suggest that this is taking place.

Barriers to entry and expansion

Summary

8.41. This review has discussed a number of areas where progress has been made by Ofgem and the industry on reducing barriers to entry and expansion, in particular removing suppliers' ability to prevent many prepayment customers from switching because of debt. In other areas such as the customer transfer process, work is continuing through established industry fora. However there still remain some areas of concern:

- dynamic teleswitched heating loads where the majority of customers with these types of meter have been unable to switch supplier, although they have seen similar price changes to other customers
- prepayment infrastructure facilities, which may be a barrier to entry and expansion

- the current credit cover requirements

8.42. For new entrant suppliers without an incumbent customer base, there are a number of difficulties in obtaining information necessary to develop business plans and to enter the market, even though the information itself is not confidential.

Ofgem's view

8.43. Ofgem considers that there is some scope for the industry (and in particular the network operators and service providers) to consider how best to co-ordinate and provide the information needed by new entrants.

Ofgem's future work

Customer issues

8.44. Accurate, independent and up to date information about the choices open to customers is an essential factor in making competition work effectively. Ofgem and energywatch will launch an information campaign to try to ensure that effective information is provided to customers. The monitoring and research information that Ofgem has, some of which has been presented in this review, will allow this campaign to be targeted appropriately.

8.45. By the end of June 2004, Ofgem will publish proposals on improving the information available to customers to help them make the best choice if they decide to switch. This is likely to include consideration of the role of information on customers' bills and meter reading.

8.46. Ofgem is particularly concerned about customers in fuel poverty. It will therefore consider whether there are barriers to suppliers offering particular tariffs to vulnerable customers.

8.47. As part of its work on the Social Action Plan, Ofgem will continue to work with industry parties to try to identify and remove barriers to the introduction of more efficient prepayment meters. Ofgem will monitor closely the development of a new, competitive PPMiP provider.

8.48. In Scotland the introduction of BETTA will introduce the same trading conditions across Great Britain. Ofgem will work with energywatch to provide the best possible information for customers, particularly in the North of Scotland. For customers with DTS meters, Ofgem will continue to work with the industry, in particular it proposes to hold a seminar to discuss whether there are any information or other issues that are impeding progress in this area.

8.49. Ofgem's Corporate Plan for 2004 - 2007[2] proposes to complete research on the role of brand independence in securing effective separation of supply and distribution services. Ofgem wants to assess whether common brands for retail and network businesses are reinforcing customers' beliefs that the affiliated retail business will provide a more reliable service. This research will help to inform Ofgem whether there is a need for further work on this issue. Ofgem will also consider whether additional information should be provided to customers about the separation of supply and distribution/transportation.

8.50. This review highlights the importance of accurate and up to date information about retail prices, market share and other information. Ofgem will therefore continue to monitor this information in order to further its analysis of the various indicators of the progress of competition. However Ofgem recognises that providing this information places a cost on industry parties. It will therefore consider the appropriateness of information it currently gets and revise this if necessary. Ofgem will consider what further information it should publish on these indicators. Ofgem will also review its requirements for customer survey information to ensure that any sources are relevant to Ofgem's needs and provide good value for money.

8.51. In December 2003, Ofgem put forward proposals for changes to the licence condition that controls most suppliers' marketing activities[3]. The proposals included prohibitions (for example to prevent suppliers giving misleading information or selling to minors) and obligations (such as providing an accurate information for customers and a 14-day cancellation period). Although customer groups were happy with the proposals, other responses suggested that more

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[2] Ofgem Proposed Corporate Plan 2004-2007. Ofgem 59/04 March 2004
[3] "Making markets work for consumers. The regulation of gas and electricity sales and marketing: proposals for the amendment of standard licence condition 48: A consultation document", December 2003, Ofgem.

work is needed on the relationship between licence enforcement and self-regulation. Ofgem has therefore decided to roll over the existing condition for a further two years March 2006 and in the meantime to seek to identify a practical solution that delivers real customer benefit.

8.52. In April 2003, Ofgem and energywatch challenged suppliers to identify solutions to the problems surrounding customer transfer and to implement measures that would provide a step change in performance for customers. A report is expected in April 2004 that identifies the problems with the transfer process. Stage 2 of the exercise will be to identify solutions to those problems.

Industry issues

8.53. Ofgem is likely to carry out more detailed analysis of the issue of the movements in wholesale and retail prices which would include inviting suppliers and other interested parities to offer alternative explanations and/or data to explain this issue.

8.54. Ofgem is likely to carry out a more detailed analysis of issues surrounding supplier profitability. In particular it will continue to analyse changes to the margins being earned in the supply sector.

8.55. Ofgem will use its Competition Act, licence enforcement and other customer protection powers when necessary to investigate and, if appropriate, tackle anti-competitive or other detrimental behaviour.

8.56. Ofgem's Corporate Plan for 2004 - 2007 proposes to review the supply licence conditions with the objective of improving the targeting and effectiveness of regulation and to reduce barriers to entry. It is likely that part of this review will include consideration of the impact of these additional requirements on new entrants and existing suppliers. Ofgem will also assess whether more information should be made available to prospective new entrants.

8.57. Ofgem will conduct further research into the role of non-price competition, including assessing whether there are barriers to increasing the diversity of contract structures and types.

8.58. Given the importance of fixed effects and their potential to insulate BGT and some other suppliers from competitive pressures, Ofgem is carrying out more analysis in this area. This will include consideration of the extent to which reductions in market share may have a role in influencing price levels and supplier responsiveness to competition in the supply sector generally.

8.59. Ofgem will publish conclusions and proposals about credit cover requirements in due course.

Glossary

This section explains the key words and phrases that are used in this document. Each chapter also contains a more detailed explanation of some of the relevant terminology for the chapter.

28 day rule– all domestic supply contracts must, except in certain circumstances, be able to be terminated by giving at least 28 days' notice.

Active supplier– a gas or electricity supplier supplying customers.

Affinity partnerships – partnerships between incumbent suppliers and new entrants to the energy sector.

Annual bill- The sum of a monthly or quarterly gas and/ or electricity bills over one year.

Anti-competitive behaviour- Behaviour that contravenes the Competition Act 1998. This could fall under Chapter I, which deals with anti-competitive agreements, or Chapter II, which deals with the abuse of a dominant position.

Average costs- A firm's total costs divided by its output.

BGT- British Gas Trading Ltd, formerly part of British Gas plc, now part of Centrica plc.

BSC- The electricity balancing and settlement code.

Barrier to expansion– a factor that may limit an entrant's ability to increase in size.

BSUoS - Balancing Service Use of System Charges include: the costs of the Balancing Mechanism, Balancing Services Contract costs, National Grid incentive payment (or receipt) and internal costs of the System Operator, National Grid.

CRO- Customer Requested Objection.

CUSC- The electricity connection use of system code.

Churn- The difference between gross switching and net switching, consisting of customers who have switched more than once, including those who have returned to their incumbent supplier.

Contractual costs– A type of switching cost incurred where, for example, in switching suppliers, the customer forgoes any loyalty or rebates that have been acquired under the existing supply arrangements. In addition, a customer may also have to incur some form of penalty for breaking the supply agreement early.

Coordinated effects– Given certain market conditions firms may realise that it is in their mutual best interest to 'cease to compete' and sustain high prices today rather than face the threat of fierce competition tomorrow. If this behaviour is maintained without explicit agreement between firms then the resulting impact on competition is called 'coordinated effects'. The term comes from merger analysis were the 'effects' of a merger are considered

Correlation coefficient- This is a number ranging between -1 and 1 that indicates how much a change in one variable may explain a change in another. The correlation coefficient is a statistical measure of interdependence of two or more random variables. It indicates the degree of association between two variables but does not imply that a change in one variable causes a change in the other. A coefficient of -1 implies that as one variable increases the other decreases at the same rate (perfect negative correlation), a coefficient of 1 implies that as one variable increases the other also increases at the same rate (perfect positive correlation), and a coefficient of zero implies no correlation (although it does not necessarily imply that variables are independent)[4].

DNO- Distributor Network Operatives. Also referred to as ex-PES Distributors and distribution companies.

DTS- Dynamic Teleswitching – a particular type of electricity meter that allows the supplier (or distribution company) to switch supply remotely. A dynamically teleswitched meter is a domestic meter where the tariffs have a control unit that switches the metered supply remotely by radio teleswitch without the customer being notified by the supplier. The Radio Teleswitching Access Provider controls the radio switches, and so heating load following instructions from the host supplier.

DUoS– Distribution Use of System charges – the charges paid by electricity suppliers to distribution companies.

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[4] "Quantitative techniques in competition analysis", OFT, October 1999, page 53

DUoSA- Electricity Distribution Use of System Agreements – governing the relationship between electricity distribution companies and electricity suppliers.

Deregulation- The UK energy market was deregulated in 1998. Gas and electricity companies may supply energy to all areas of England, Scotland and Wales.

Direct debit- A type of payment where a fixed amount is taken from a bank account each month, quarter or year.

Dominance- '…A position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of customers'[5]

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

Economies of scale- Where average costs fall as output increases.

Economies of scope- Where average costs are lower if two or more products are produced jointly (eg by the same undertaking) opposed to separately (eg by two separate undertakings).

Elexon- the Balancing and Settlement Code Company (BSCCo) created by the Balancing and Settlement Code (BSC). Elexon procures, manages and operates services and systems, which enable the balancing and imbalance settlement of the wholesale electricity market and retail competition in electricity supply.

Energy Efficiency- Using energy efficiently can save money by reducing your fuel bills as well as helping the environment. Further information on energy efficiency programmes is available from the Energy Savings Trust (www.est.org.uk), or from your local Energy Efficiency Advice Centre on 0800 512 012.

energywatch- The customer watchdog for gas and electricity markets in the UK. Energywatch can be contacted via their website at www.energywatch.org.uk, or by calling their helpline number on 08459 06 07 08.

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[5] Definition used by the European Court in Case 27/76 United Brands v EC Commission [1978] ECR 207, [1978] 1 CMLR 429; and in other cases.

Entrant– An entrant in the gas supply sector refers to all non-BGT suppliers, including the ex-PESs. In the electricity sector, where each region was supplied by a single supplier (PES) prior to market opening, all suppliers other than the local ex-PES are defined as entrants, including BGT and the ex-PESs of other regions. See also 'New entrant'.

Entry capacity- The amount of gas Transco's terminals can flow on to the NTS system at any one time.

Ex-PES- Public Electricity Supplier is the former term for the 14 companies in England, Wales and Scotland that from privatisation in 1990 until 1998 had a monopoly of electricity supply and distribution in their designated areas. Local distribution is still a monopoly regulated by Ofgem, however, competition has been introduced in supply, and so these 14 suppliers are know as ex-PES suppliers.

Fixed costs- Costs that do not vary with output.

Gains and losses- provide a more detailed understanding of switching activity since they identify the magnitude of customer movement to, as well as away from a supplier. The result of these customer flows is a net fall or rise in customer numbers with a supplier over a period of time. Underlying gains and losses can therefore indicate market activity not apparent from other aggregate measures.

Gas transporter (GT) - A holder of a public gas transporter's licence, issued by Ofgem, is able to operate a pipeline system for the conveyance of gas. A public gas transporter cannot hold a licence as a shipper or supplier of gas.

Gas shipper- Shippers arrange with a gas transporter for gas to be introduced into the transporter's pipes so that it can be supplied to premises.

Green tariffs- Many suppliers now offer a 'green tariff', whereby they promise to buy renewable energy equal or proportionate to your gas or electricity bill.

Gross switching- The proportion of customers who have switched at least once. Gross switching has been used in previous reviews and measured the total number of switches, including multiple switches. In this review multiple switching is used because there has been an increase in multiple switching.

HHI- (Herfindahl Hirschman Index) A measure of market concentration calculated by adding up the squared values of market shares for each firm in the market. It is influenced both by the number of firms in the market and differences in their relative sizes. The value of the HHI decreases as the number of firms in a market rises. Similarly the value of the HHI will be greater the larger the degree of inequality in firm size. This measurement is often used in merger analysis and in American anti-trust assessment but it is also a useful general indicator of market structure.

Headroom- the discount that a new entrant can offer relative to the incumbent supplier.

IIP- Ofgem's Information and Incentives Project which aims to encourage ex-PESs to compete against each other continually to achieve efficiency savings, as well as improving the quality of supply and networks.

iGT- Independent Gas Transporter- gas transportation networks operated by companies other than Transco, such as Independent Pipe lines.

I&C- Industrial and Commercial - I&C refers to the non-domestic sector in general rather than any specific group of customers.

In-area- An ex-PES supplier's supply services region(s).

Incumbent- A former monopoly supplier- ex-Public Electricity Suppliers (in the electricity market) and British Gas (in the gas market).

Joint Dominance- Also known as 'collective' or 'oligopolistic' dominance. This term is used to refer to separate legal entities that together hold a dominant position on the relevant market.

kWh- kilowatt-hour- used as a unit to measure energy consumption in both electricity and gas.

Legacy customer- a 'non-switcher.'

MPAN- Meter Point Administration Number- every electricity meter has a unique MPAN, also known as a supply number. It can be found on your electricity bill.

MPAS - Meter Point Administration Services- operated and maintained by DNOs. An MPAS holds data necessary to facilitate supply by any electricity supplier to all premises connected to the distribution system. The MPAS includes an enquiry service that provides relevant data to customers or electricity suppliers.

MPRN- Meter Point Reference Number- every gas meter has a unique MPRN, which can be found on your gas bill.

MRA- The electricity Master Registration Agreement

MRASCo- The MRA Service Company- established by MRA signatories, and manages the operation and development of the MRA and its supporting documentation. MRASCo is the custodian of the retail design for the electricity market in the UK that sets out the operational and contractual framework for registration of metering points by licensed market participants.

Market definition- Market definition delineates the relevant economic market in which a company competes through a product, geographic and possibly temporal dimension.

Market power- Describes a situation where the constraints which would usually ensure that an undertaking behaves in a competitive manner are not working effectively[6].

Market Share- A measure of industry concentration that shows the proportion of sales of a good or service held by individual companies within a market.

Median- The middle value of a list of figures organised in order of magnitude. The median may be used in preference to an average since it is not as likely to be distorted by very high or very low outlying values in the range.

Multiple switching- Refers to those customers who have changed supplier more than once. This indicator is a means of assessing the extent to which customers are willing to continue to seek savings through switching.

NETA- New Electricity Trading Arrangements.

Net switching- The proportion of customers no longer with their ex-PES within that region (for electricity supply) or nationally with BGT (for gas supply). This indicator provides a measure of progress of competition. However, it does understate the progress of competition as it does not account for customers regained by BGT or the ex-PESs.

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[6] OFT 415, Assessment of Market Power, September 1999, page 2.

The inverse of net switching is the BGT or ex-PES market share for gas and electricity respectively

New entrant - in this chapter this means an entrant that does not have an incumbent customer base in either gas or electricity

NBP- National Balancing Point- A notional position used as point of reference for pricing. It is not necessarily a physical location, but a hypothetical position which can be used as reference. In the case of Natural gas the NBP is the National Transmission System (NTS). This price is therefore is inclusive of entry (terminal) charges.

NTS- National Transmission System. The high pressure part of the BG Transco's system.

Non-coordinated effects- Also referred to as 'unilateral effects', this concept occurs where a single firm is able to exercise market power independently of other firms in the market, eg by maintaining high prices. This may occur as a result of a merger.

Non-price offers– For the purposes of this review, this term refers to a broad range of inducements offered by a supplier seeking to alter a customers' valuation of functionally identical products, ie gas and electricity.

Non-switcher- Customers who have never switched from their ex-PES in electricity or BGT in gas.

Prepayment- A payment method covering prepayment meters and paying yearly or monthly in advance.

Price controls- These set the amount of money monopoly businesses, eg the companies that own the pipes and wires can earn.

Psychological costs– A type of switching cost that exists where there is no clearly identifiable 'economic' reason for the customer to be a loyal to an existing supplier, but where the customer perceives that the switching of suppliers will involve a change to his or her relative utilities for the two products. For example, in the retail energy sector customers may perceive a loss of 'trust' when switching from an existing to a new supplier.

RO- Renewables Obligation.

ROCs- Renewables Obligation Certificates.

Regional tariff- Electricity tariffs tend to vary between regions, reflecting differences in distribution charges. Gas tariffs however tend to offer the same prices in each region.

SUS- Shared Unmetered Supplies.

Search costs– A type of switching cost involved in finding an appropriate product from an alternative supplier, and in the case of energy might include the time and effort incurred in collecting and assessing information regarding the different tariffs, rates and contracts offered by competing suppliers.

Shipper- A gas shipper's license enables the holder to arrange with a transporter for gas to be introduced into, conveyed and taken out of the pipeline system. Shippers must balance their input and customer off take from the National Transmission System (NTS) each day. Ofgem licences all shippers.

Shopping costs– A type of switching cost that includes the time and effort spent when purchasing different goods from various suppliers. These costs can be minimised through concentrating the purchase of different products through just one supplier. An obvious example of this in the retail energy sector may be the reduction in real or perceived shopping costs obtained through dual fuel offers, an issue which is examined in more detail below.

Standard credit- A payment method covering cash, cheque, credit card, prompt pay, and some forms of PC and telebanking. Usually involves paying after the receipt of gas or electricity as opposed to prepayment.

Substitute- A good or service that is a possible alternative for the customer so that a change in price for good A will have an impact on demand for good B.

Supplier- Companies who sell to and bill customers, such as Southern Electric or Scottish Power.

Switchers- Customers who have changed gas and/ or electricity supplier at least once.

Switching costs- An economic concept that refers to the costs incurred by customers in finding and switching supplier. Switching costs are classified into a variety of categories, including: transaction costs, contractual costs, uncertainty costs, psychological costs, shopping costs and search costs. In addition to the above types of customer switching costs, firms can also incur costs when customers switch supplier.

Synergy- A mutually beneficial agreement where two or more suppliers join forces so that their combined impact is more effective than the sum of their individual impact.

TNUoS–Transmission Use of System charges – the charges paid by electricity suppliers to National Grid Transco for use of the transmission system.

Transaction costs– A type of switching cost including, for example, the costs for the customer in providing identification and other documents when switching supplier. This could also include the costs of transferring direct debit or other financial arrangements between the two competing suppliers.

Transco- An operating division of Lattice Group which owns and operates most of the gas pipeline systems throughout England, Scotland and Wales. It is regulated by Ofgem, and is responsible for handling any gas emergencies in the UK. Transco can be contacted on 0800 111 999.

Transmission- The movement of electricity at high voltage from a generator to a substation. High voltage cables are normally suspended from pylons.

Transmission Uplift - A pre-NETA cost related to the maintenance of the electrical stability of the national electricity grid, where generation output has to be matched with demand and voltage and frequency must be contained within prescribed limits. Transmission uplift costs include: costs of maintaining system security and quality of supply, the costs of paying for plant made available to NGC but not used and the costs associated with providing sufficient capability for restoring the system following a blackout.

Two-tier pricing- The commercial decision taken by ex-PESs to charge lower prices for customers out-of-area than in-area.

Uncertainty costs– A type of switching cost that may arise where the customer is uncertain regarding the quality of the product or service offered by competing suppliers. In this case the switching cost represents the maximum insurance premium that the customer would be willing to pay to ensure that the value of the product provided by the untested supplier is the same as the value of the product of the existing supplier. In the energy sector these uncertainty costs might also include the risk perceived by some customers regarding the future financial viability of a potential supplier.

VAT- Value Added Tax- This is added to both gas and electricity domestic bills at 5 per cent.

Variable costs- Costs which vary with output.