

October 2000

**Energy Efficiency Standards
(2000 – 2002)**

**Guidance to gas and
electricity companies on
competition issues**

Consultation proposals

Summary

Ofgem has set Energy Efficiency Standards for gas and electricity companies for 2000-2002 (SOP3). The Standards require companies to bring forward projects to improve the efficient use of gas and electricity with a strong emphasis on the needs of disadvantaged customers. SOP3 builds on the previous Standards set for Public Electricity Suppliers, which, the National Audit office concluded, had achieved a net present value saving of £ 250 million and comfort improvements worth £ 80 million between 1994 and 1998. Ofgem expects SOP3 to continue to deliver important energy efficiency improvements for customers.

This consultation paper seeks views on guidance which Ofgem proposes to issue to companies on competition issues relating to SOP3. Ofgem is keen to see the Standards carried out in ways which support the development of competition. The proposed guidance is intended to help companies develop and implement their SOP3 programmes consistent with this objective. The guidance covers:

- how SOP3 projects are marketed and offered to customers;
- how far projects may be linked to energy supply contracts;
- how to ensure that projects provide good value for customers and are run competitively.

We would welcome comments from companies and others on the general issues and the specific proposals set out in this document by 28 November.

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1. Introduction and background

- 1.1 Gas and electricity supply companies are subject to Energy Efficiency Standards of Performance set by Ofgem. The present Standards came into effect on 1 April and require the companies by 30 March 2002 to carry out projects which will achieve specific improvements in the efficient use of gas and electricity for customers. In order to achieve the Standards, investment of around £150 m is expected to be required. These funds will be raised mainly from gas and electricity customers. Companies are responsible, subject to Ofgem's approval, for decisions regarding the selection of projects, and for how projects are organised and managed.
- 1.2 Ofgem's responsibilities for protecting the interests of customers and promoting competition in gas and electricity supply require us to take appropriate steps to ensure that companies implement the Standards in ways which support competition and protect customers' interests. The present document proposes guidance aimed at achieving these objectives.
- 1.3 In our Decision document on SOP3, issued in March, we indicated that we were concerned to ensure that in delivering the Standards dominant suppliers did not act in ways which adversely affected competition in supply. We also indicated that we were keen to see schemes promoted and offered to customers in ways which widened customer choice and promoted the development of competition. Broadly speaking, the schemes brought forward so far by companies have not raised major competition concerns. However, in the light of our experience so far with SOP3, we believe that it would be helpful to issue further guidance on competition matters for companies developing and carrying out their SOP3 programmes.
- 1.4 This present document therefore sets out for consultation proposed guidance on competition issues which are arising in implementing SOP3. This guidance is relevant to gas and electricity companies who

have to meet SOP3 targets and will also be of interest to customer and energy efficiency groups and a wide range of energy efficiency service providers. We should welcome comments on this consultation document, and will then finalise this guidance.

1.5 This guidance relates to SOP3. As regards the Energy Efficiency Standards of Performance (to be known as 'Energy Efficiency Commitment') which the Government proposes to set for 2002-05, Ofgem will in spring 2001 be consulting companies, consumer bodies and others on our proposals for administering and overseeing the operation of the 2002-05 scheme, including competition issues. If however respondents have any immediate comments on competition issues covered in this draft guidance, as regards the 2002-05 scheme, they may wish to include them in responses. Ofgem will consider them in developing its consultation proposals on EEC 2002-05.

1.6 Responses to this consultation on SOP3 should be sent by 28 November 2000 to:

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1.7 Responses will normally be made available in the Ofgem library unless there are good reasons why they must remain confidential. Consultees should mark the part of their response (or the whole response) which is to remain confidential if this is the case, and where possible should consign any confidential material to appendices.

2. General approach

- 2.1 Broadly, Ofgem is concerned more with the effects on competition of suppliers' actions than with seeking to impose restrictions on defined categories of behaviour. This is consistent with the Competition Act 1998, where it is the effect rather than the form of behaviour that is assessed.
- 2.2 Ofgem's approach to assessing the effect on competition of SOP3 programmes is similar to our approach to considering other new market initiatives and offers. This approach was first set out by Ofgas in the decision document on BGT's Goldfish credit card scheme, and was most recently set out in Ofgem's 1999 review of the development of competition in the domestic gas supply market.¹
- 2.3 Ofgem would wish to encourage suppliers to pursue incognitive ways of delivering energy efficiency in order to increase customer choice and provide direct benefits to customers.

¹ "A Review of the Development of Competition in the Domestic Gas Market", Ofgem, December 1999.

3. Marketing: own-supply and other customers

- 3.1 Ofgem indicated in October last year in our initial decisions on SOP3 that we expected that in most cases companies would concentrate SOP3 schemes on their existing supply customers. However, we did not rule out companies providing assistance to gas and electricity users whom they did not supply. In fact, we indicated that it would be inconsistent with the aim of the Standards for a supply company to refuse assistance to a household solely on the grounds that the household did not take a gas or electricity supply from that company. **Ofgem continues to expect suppliers to make schemes as widely available as possible.**

4. Linking SOP3 offers to energy supply contracts

- 4.1 Ofgem welcomes the fact that, so far, companies are not generally insisting that, to qualify for assistance under SOP3, a customer must enter into an energy supply contract with the company. However, there have been a few schemes where companies have marketed specific SOP3 projects linked to the household remaining or becoming an energy customer. So long as customers willingly, and knowingly, enter into such arrangements, schemes marketed on this basis could well have a role to play in contributing to the achievement of companies' SOP3 targets and in developing experience of Energy Service Companies (ESCOs).
- 4.2 Ofgem is keen to see suppliers consider the scope for ESCOs, whether these are offered within companies' main supply areas or outside. However, the following safeguards need to apply, particular in the case of schemes offered by dominant suppliers:
- the customer should be made aware of his right to switch supplier on 28 days' notice;
 - schemes where energy efficiency assistance is linked to the household remaining or becoming a supply customer of the supplier should not account for an undue proportion of any company's SOP3 programme and the household should not be given to understand that assistance under SOP3 is available only on the condition that it remains or becomes a supply customer of the supplier;
 - in the case of dominant suppliers, the licence conditions on non-discrimination and publication of terms of supply apply;
 - if a supplier intends to link a SOP3 scheme to a particular tariff this should be made clear in the SOP submission and

that submission should be made along with any necessary tariff notification procedure to Ofgem.

5. Customer tie-ins

- 5.1 In order to safeguard competition in supply, under the existing licence conditions, suppliers cannot contractually tie-in customers such as to abridge their right to change supplier on 28 days' notice. As indicated above, the terms on which companies offer assistance under SOP3 need to be consistent with this requirement. We have previously confirmed that where suppliers provide evidence that the 28 day rule proves to be a barrier to the development of energy services, we would review it for such contracts.
- 5.2 In addition, dominant suppliers should avoid offering assistance which may have the effect, or risk, of tying in the customer, even though the customer remains contractually free to switch. In particular, a customer who has received assistance under a SOP3 project should be in the same position as any other customer when deciding whether to switch supplier (though in line with the licence conditions the supplier may seek reasonable security in respect of any loans advanced for energy efficiency improvements which may be outstanding).
- 5.3 Any termination fees payable by the customer should be notified to the customer when he enters into the contract and must be made transparent. Termination fees have to be set at a reasonable level and should not exceed the benefits which the customer might have gained from the contract.

6. Methods for targeting customers

- 6.1 It is not possible for all households to be offered assistance or practicable for suppliers simply to respond to customer requests. Ofgem therefore accepts that it is necessary for suppliers proactively to target particular households or customer groups. However, this targeting should be carried out in ways which do not restrict competition.
- 6.2 In their project submissions, dominant suppliers should set out the criteria and methods used for targeting customers to whom assistance is proposed to be offered. For example, if customer names and addresses are extracted from customer databases, what are the criteria used to select those customers? Most suppliers have continued to run schemes where the choice of the households who benefit is effectively made by a third party such as a social housing provider or charity. Such an approach is less likely to have adverse effects for the development of competition.
- 6.3 As indicated above, customers of other suppliers who respond to a company's adverts or enquire about the possibility of assistance should not automatically be turned down, but should be considered on their merits.

7. Repeat grants etc

- 7.1 There are no fixed restrictions on the same customer, or category of customer, receiving repeated or multiple assistance from a supplier. Indeed, in order to deal effectively with fuel poverty it may be necessary to offer a range of measures to individual households. Equally, it may not be practicable to prevent individual customers taking up offers of assistance on a repeat basis. However, dominant suppliers should give details in their project submissions if they propose to follow a deliberate strategy of offering repeated assistance to particular customers or groups of customers, and provide justification for this.

8. Ensuring good value

- 8.1 Under SOP3, companies have an incentive to achieve their energy savings targets at the lowest cost, and have to meet the requirement that at least 65% of their expenditure goes to help disadvantaged customers. Also the methodology for accrediting energy savings encourages companies to get customers to take up schemes with the minimum level of grant assistance. Companies should ensure that schemes are designed and managed to ensure good value for customers, not least where customers or their landlords are meeting some of the costs. This has implications for how schemes are run and offered to customers.
- 8.2 In terms of the running of schemes, Ofgem experts that the selection of scheme installers and key product providers should always be subject to competitive tender. Where this is not proposed, this should be indicated in the project submission and a convincing explanation should be provided. In specifying tenders, companies should not introduce requirements which favour affiliated organisations. The use of affiliated companies, eg retail or contracting arms, is not necessarily excluded, but must be justified on value for money grounds, particularly where their exclusive use is involved. Companies should also bear in mind that the leveraging of a company's market dominant position in energy supply into other markets may raise Competition Act issues.
- 8.3 In terms of how assistance is offered to customers, companies should ensure that where customers contribute directly to the cost of a scheme this represents good value for the customer. This should apply to the total package which the customer is acquiring and not just the energy efficiency performance of that package, eg the appliance or heating system as a whole should represent good value for the customer. In designing schemes, companies should consider opportunities for incorporating customer choice, for example in terms of the products, or even installers, used. This is particularly important

when decisions about the relative priority customers attach to price and quality trade offs are significant.

9. Approval procedures

- 9.1 Ofgem's approval certificates for SOP3 projects indicate that approval is for the purpose of the Standards only. Approval in no way implies exemption or clearance under the Competition Act. The onus is therefore on companies to ensure that their SOP3 arrangements are fully compliant with the Competition Act.
- 9.2 Ofgem reserves the right to investigate the effects on competition in the gas and electricity supply markets of any approved SOP3 project and if necessary to take action under the Competition Act; or to refer cases to OFT. Companies which have concerns or queries on competition issues should raise these with Ofgem, rather than with the Energy Saving Trust.