

**A Review of the Development of
Competition in Industrial and
Commercial Electricity Supply**

December 2000

Summary

This document is a report on Ofgem's 2000 review of the development of competition in Industrial and Commercial (I & C) electricity supply*. Ofgem has considered a number of indicators of the development of competition such as entry and exit of suppliers, price offers and market share. Ofgem's review suggests that competitive forces continue to develop.

There has been a modest reduction over the last two years in the number of companies actively supplying I & C electricity customers. Following the exit of Independent Energy in September 2000, there are now 14 independent suppliers in England and Wales, with around 11 in Scotland. Of the suppliers in Scotland, only about 5 are actively seeking custom.

The market share of incumbent Public Electricity Suppliers (PESs) continues to fall. Incumbent PESs' market share in Scotland continues to be significantly higher than in England and Wales. Taking Scotland alone, the two Scottish PESs' retained about three quarters of the over 100 kW sector by volume between 1998/99 and 1999/00.

Evidence available for Scotland concerning the number of active suppliers, market share and pricing suggests evidence of weaker competitive forces in Scotland compared with England and Wales.

Price offers available suggest that customers who shop around can get reasonable price deals. There is also some evidence to suggest that suppliers are responding to competitive pressures by making more competitive price offers.

Ofgem notes however that there remain potential barriers to entry for suppliers. These are related to the separation of PES distribution and supply businesses, the administrative burden of market entry, concerns over notice periods for distribution and transmission use of system charges, concerns over the slow introduction by suppliers of new customer databases, and the lack of a consistent set of electricity trading arrangements that cover the whole of Great Britain.

* This is the supply of electricity to all customers with a maximum demand in excess of 100 kW.

Addressing concerns over barriers to entry

Ofgem is continuing with a number of initiatives designed to facilitate the potential entry of suppliers to I & C electricity supply. Ofgem has undertaken a considerable volume of work to ensure that PESs fully separate their distribution and supply businesses. Ofgem has recently consulted on the issue of improving customer transfers, which suggests a number of improvements that may benefit potential suppliers. Ofgem is shortly to consult on Distribution Use of System issues. Proposed new standard licence conditions for transmission licences address concerns over the notice period for transmission use of system charges. Ofgem has taken steps to encourage suppliers to complete the introduction of new customer databases (the 'PES Registration System' (PRS)). Ofgem is also presently reviewing electricity trading arrangements in Scotland with a view to introducing consistent electricity trading arrangements across the whole of Great Britain.

Ofgem's future monitoring of I & C electricity supply

The Electricity Act 1989, as amended by the Utilities Act 2000, gives Ofgem a principal objective to protect the interests of consumers, wherever appropriate by promoting effective competition. This review of I & C supply has concluded that customers are benefiting from the operation of an increasingly competitive market. However, there remain concerns over barriers to entry.

It will remain appropriate therefore, and consistent with Ofgem's principal objective, to continue to keep competition in I & C electricity supply under review. This will continue to take the form of monitoring market data, including considering any complaints or issues that may arise from customers or suppliers.

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1. Introduction

Purpose of this document

- 1.1 This document is a report on Ofgem's 2000 review of Industrial and Commercial (I&C) electricity supply. Ofgem has for present purposes defined I & C electricity supply as constituting all customers with a maximum demand for electricity in excess of 100 kW. The review considers the development of competition to date and analyses the prospects for its further development. It also considers whether there are any issues that need to be addressed to promote effective competition. The conclusions of this review take account of responses to Ofgem's survey of all electricity distributors, suppliers and customer representatives to obtain quantitative and qualitative information about the development of competition.¹

Background

- 1.2 The Public Electricity Suppliers' (PES) statutory monopoly to supply electricity to customers in above 1MW market was removed in April 1990. The threshold for the competitive market was reduced to include customers in the 100kW to 1MW market from April 1994. From 1990 Offer monitored the development of competition in these markets and published a summary of its conclusions in its annual report. The 1998 annual report² showed that PESs first tier market shares in both the above 1MW and the 100kW to 1MW markets continued to decline, as new entrants established themselves in the market. In the above 1MW market, PESs had a 33% market share by sites supplied and a 20% market share by volume supplied.

¹ "1999 Industrial and Commercial Electricity Market Survey", Ofgem, April 2000.

² "Office of Electricity Regulation, Annual Report 1998", Ofgem, 1999.

Related issues

Ofgem's 1999 review of the development of competition in the industrial and commercial gas supply market

1.3 Ofgem has recently published the conclusions of a review of competition in the industrial and commercial gas supply market.³ The review concluded that:

- ◆ competition in the industrial and commercial gas sector as a whole, and most sub-sectors, was developing very well;
- ◆ there were about 30 or more active shippers and suppliers competing;
- ◆ BGT had a market share of about 20% of gas shipped, with three other suppliers with a market share of more than 10%;
- ◆ there was evidence in a number of sub-sectors of the market that customers were changing supplier in response to changes in suppliers' relative prices, which is the type of customer behaviour that would be expected in a well developed competitive market; and
- ◆ there were few complaints about barriers to entry during the review and there did not appear to be any significant barriers to suppliers making, and customers receiving, potentially competitive offers.

1.4 As a result of these conclusions, Ofgem believed that competition was sufficiently developed in I & C gas supply that it proposed that in future years it would not carry out detailed reviews of competition in this sector. Instead, Ofgem will monitor competition by considering the trends of any complaints received from customers and reviewing the market reviews published by a number of other organisations. The conclusions of Ofgem's monitoring will be set out in its annual report. Ofgem also formally proposed to remove Special Condition 5A of BGT's gas suppliers' licence, which restricts the terms and conditions BGT can include in contracts with customers in the industrial and commercial gas supply market.

³ "A Review of the Development of Competition in the Industrial and Commercial Gas Supply Market", Ofgem, August 2000.

Supply 'non-discrimination' licence conditions

- 1.5 In July 2000 Ofgem published a consultation proposing to remove the supply 'non-discrimination' licence conditions from the gas and electricity supply licences.⁴ The non-discrimination conditions prohibit 'dominant' suppliers in the domestic and I & C markets from exercising undue discrimination, showing undue preference or engaging in predatory or unduly onerous pricing. The prohibition on dominant suppliers becomes less restrictive as competition develops.
- 1.6 Ofgem put forward three options for change. Option 1 was to retain the current non-discrimination conditions. Option 2 was to amend these conditions in the light of recent market developments. Option 3 was to remove the conditions and use if appropriate the Competition Act 1998 to address anti-competitive behaviour.
- 1.7 Ofgem received 25 responses to this consultation paper. No respondent specifically supported the option of retaining the present conditions unamended. Fifteen respondents favoured the option of removing the non-discrimination conditions from the licence.
- 1.8 In October 2000, Ofgem published a final consultation on Standard Conditions for all electricity and gas licences⁵. In volume 1 of this document, Ofgem set out its reasoning and conclusions on the treatment of the non-discrimination conditions, including a summary of responses to Ofgem's July 2000 consultation. Ofgem proposed to choose Option 3, that is, that the non-discrimination conditions be removed and to use the Competition Act 1998 to address anti-competitive behaviour.
- 1.9 In brief, Ofgem concluded that this option would be the best way to protect customers from anti-competitive behaviour and to align electricity and gas regulation. Ofgem also noted that it would reduce compliance costs by removing duplication.

⁴ "Gas and electricity supply licences, Proposals for standard non-discrimination licence conditions", Ofgem, July 2000.

⁵ "Utilities Act Standard licence conditions Final Proposals' Volumes 1 – 8 October 2000

Structure of this document

- 1.10 Chapter 2 explains the regulatory framework against which competition is developing. Chapter 3 explains Ofgem's approach to assessing the development of competition and the factors that have been taken into account. The remaining chapters of the document look at each of these factors in turn.
- 1.11 Chapter 4 considers how the number of competitors in the market has changed since October 1998. Chapter 5 analyses the market share of electricity suppliers by volumes and sites supplied, and considers the trends since October 1998. Chapter 6 analyses the price offered by suppliers at different consumption levels, considers how prices have changed since October 1998 and the possible reasons for these changes. It also considers the movement of customers between suppliers and how these movements appears to have been affected by changes in the prices offered by suppliers since October 1998. Chapter 7 considers the qualitative responses to Ofgem's survey and what, if any, action is required to address remaining barriers to entry into the market. Chapter 8 summarises the conclusions of Chapters 4 to 7.

2. Background

2.1 This chapter explains the regulatory framework against which this review is taking place.

Regulatory framework

2.2 We have set out below the legislative duties and powers that are particularly relevant to this review. These duties and powers are contained within:

- ◆ the Electricity Act 1989 (as amended by the Utilities Act 2000);
- ◆ the electricity supply licences; and
- ◆ the Competition Act 1998.

The Electricity Act 1989 (as amended by the Utilities Act 2000)

2.3 On 28 July 2000 the Utilities Act received Royal Assent. The Act substantially amended the Electricity Act 1989 and created the 'Gas and Electricity Markets Authority'. The Authority will replace the Director General of Electricity Supply in December 2000. The Authority's duties include a principal objective to protect the interests of consumers, wherever appropriate by promoting effective competition.

The electricity supply licences

2.4 The Electricity Act 1989 provides for the licensing of electricity suppliers. The 14 PESs operating within their previous franchise areas have Public Electricity Supply (PES) licences. Other suppliers have, and PESs operating outside their franchise areas also have, Private Electricity Supply licences. The PES licences contain conditions which are not in the Private Electricity Supply licences. These include restrictions on the prices that can be charged to certain domestic customers and a requirement to provide regulatory accounts on an annual basis.

2.5 As a result of the Utilities Act 2000 the distinction between Public and Private licences will be removed. Supply licences will contain standard conditions for all types of electricity suppliers and where appropriate, special conditions. PES distribution businesses will be separately licensed.

The Competition Act 1998

- 2.6 On 1 March 2000 substantive parts of the Competition Act 1998 came into force. This replaced most of the Competition Act 1980, the Restrictive Trade Practices Acts 1976 and 1977, and the Resale Prices Act 1976. The Competition Act 1998 contains two prohibitions. The Chapter I prohibition prohibits agreements between undertakings, decisions by associations or undertakings and concerted practices that have as their object or effect the restriction, distortion or prevention of competition within the United Kingdom. The Chapter II prohibition prohibits abuse of a dominant position by an undertaking within the United Kingdom. Any undertaking found to have breached either of the prohibitions of the Competition Act 1998 may face a fine of up to 10% of its turnover for each year of the breach up to a maximum of three years.
- 2.7 Ofgem has concurrent powers with the Office of Fair Trading (OFT) to apply the Competition Act 1998 to the gas and electricity sectors in Great Britain. The Authority's principal objective and duties do not apply to the concurrent exercise of powers under the Competition Act 1998. The OFT, along with Ofgem and other sector regulators, has issued advice and information in accordance with Section 52 of the Competition Act 1998, explaining how the Act will be implemented. These guidelines are available on OFT's website at www.offt.gov.uk.
- 2.8 Ofgem and OFT have recently formally consulted on the advice and information they intend to issue on how the Act will be applied to the gas and electricity sectors.⁶ This consultation ended in July 2000 and Ofgem presently anticipates that a final guideline will be issued by the OFT in January 2001.

⁶ "Competition Act 1998, Application to the Energy Sector, Formal Consultation Draft", Ofgem and OFT, May 2000.

3. Approach

3.1 This chapter sets out the approach that Ofgem has taken in assessing the development of competition in I & C electricity supply.

Assessing the development of competition

3.2 Ofgem believes that, consistent with the new principal objective under the Utilities Act 2000, consumers' interests, in terms of price and quality and variety of service on offer, will be most effectively protected in I & C electricity supply by effective competition between suppliers.

3.3 A number of important conditions, if met, will tend to promote effective competition. These include :

- ◆ the prevention of the abuse of market power, if it exists;
- ◆ customers are aware of a range of competitive offers from suppliers; and
- ◆ new undertakings are able to enter and challenge the market.

3.4 The abuse of market power may be one of the factors that prevents effective competition developing. Hence it is important that any such abuse is prevented. If there is effective competition, over time, competition can be expected to lead to innovation – since successful innovation will be properly rewarded – and to improved economic efficiency.

3.5 The development of competition is a dynamic process, characterised by constantly changing structures, behaviour and performance. The development of competition cannot be measured clearly against a single simple set of indicators, for example market shares. The functioning of the market depends upon the combined effects of the actions of the incumbent distributors and suppliers, competitors and customers, as well as the structural conditions in which they all operate.

3.6 Bearing in mind the dynamic nature of competition, Ofgem has considered a range of indicators of the development of competition in this review, which reflect the importance of considering customer, distributor and supplier

behaviour, and also the market conditions in which they operate. The approach Ofgem has adopted for this review is similar to the approach adopted for previous competitive market reviews, including the recent review of the I & C gas market and the December 2000 review of domestic gas and electricity supply⁷. The factors Ofgem has considered are set out below, along with the chapter in which the factor is discussed:

- ◆ the extent of entry and exit by suppliers (Chapter 4);
- ◆ suppliers' performance, including their market shares (Chapter 5);
- ◆ suppliers' price offers, customer switching behaviour, and in particular, how customer choices reflect changes in suppliers' relative offers (Chapter 6); and
- ◆ barriers to entry in the market (Chapter 7).

Ofgem's 2000 industrial and commercial electricity market survey

3.7 Taking account of the approach set out above to review competition, Ofgem sent a survey to all electricity distribution companies, industrial and commercial suppliers, and customer representatives, in April 2000, requesting quantitative and qualitative information about the development of competition. Distribution companies were asked to provide information on the total number of sites and volumes supplied, split into different market segments defined by maximum demand sizes, within the distributor's area for October 1998 to March 2000. Suppliers were asked to provide information about:

- ◆ the ownership structure of each supplier;
- ◆ the number of sites supplied in each PES area on 1 October 1998, 1 April 1999, 1 October 1999 and 1 April 2000, split by volume bands and by whether the contract is for a single or multi site contract;
- ◆ the volume of electricity supplied in each PES area between 1 October 1998 and 31 March 1999, 1 April 1999 to 31 September 1999 and 1

⁷ "A review of the development of competition in domestic gas and electricity supply" December 2000

October 1999 to 31 March 2000, split by volume bands and by whether the contract is for a single or multi site contract; and

- ◆ indicative average prices in each PES area at October 1998, April 1999, October 1999 and April 2000, split by volume bands and by whether the contract is for a single or multi site contract.

3.8 In addition to the quantitative information requested, Ofgem raised two qualitative issues on which it sought views, as to the importance of the issue for the development of competition and any action that could be taken to address the issue. The two issues raised by Ofgem were:

- ◆ the extent to which undue discrimination by PES distribution companies may be occurring in practice, despite Ofgem's amendment to PES licences which obliges the full operational and managerial separation of the distribution business from other PES businesses, and other licence conditions which state that the PES distribution businesses must operate in a way that confers no undue preference or undue discrimination on any supplier; and
- ◆ concerns about the size of the resources required to fulfil all the administrative requirements to enter the electricity supply market, and the extent to which this administrative burden may constitute a barrier to entry.

3.9 In addition, Ofgem asked respondents to raise any other issues that they believed were adversely affecting the development of competition in I & C electricity supply.

3.10 All PES distribution companies and first and second tier suppliers responded to the quantitative survey. The information provided in response to the survey was reasonably comprehensive, although some respondents had difficulty providing information split by volume bands and whether the contract was a single or multi site contract. We have explained in the relevant chapter any limitations on the quality of the results due to the quality of the information provided. Ofgem is grateful for the time and effort of the distributors and suppliers that responded to the survey.

4. Entry and exit of suppliers

- 4.1 A fundamental feature of a competitive market is the choice available to customers in the market. One way this may be measured is by reference to the number of industrial and commercial electricity suppliers operating in, entering, or exiting the market. This chapter explains the changes in the number of industrial and commercial electricity suppliers since October 1998. It also assesses which of those suppliers have been active since October 1998.

Electricity suppliers

- 4.2 The number of electricity suppliers licensed to operate in the industrial and commercial market has tended to increase over time. Between 1 October 1999 and 1 April 2000, for example, the number of electricity England and Wales supply licences increased from 26 to 33. Over the same period the number of Scottish supply licences increased from 13 to 19. This would, other things being equal, tend to indicate an increased interest in entering the electricity supply market.
- 4.3 Over the period of the survey there were a number of mergers and acquisitions, which affected the number of suppliers in the market. These included the merger of East Midlands Electricity and Powergen (July 1998), Scottish Hydro-Electric and Southern Electric (December 1998), London Electricity's purchase of SWEB's supply business (October 1999), Innogy's purchase of Midland Electricity's supply business (November 1999), and British Energy's purchase of Swalec's supply business (February 2000). These mergers and acquisitions have generally reduced the number of competing suppliers in I & C electricity supply. There have also recently been two further acquisitions which would affect the number of competitors. TXU Europe, which owns Eastern, has acquired Norweb's supply business, and Scottish and Southern Energy, which owns Southern Electric and Scottish Hydro-Electric, has acquired Swalec's supply business from British Energy. Furthermore, Independent Energy has gone into receivership and its continuing interests have been bought by Innogy, an existing supplier.

4.4 There is no requirement for licence holders actively to supply electricity to end users (subject to the terms of the licence revocation condition). Also some companies hold a number of supply licences. Hence the number of supply licences in existence may not be a good indicator of the number of suppliers actually supplying customers. A more useful indicator of competitive pressures might therefore be the number of suppliers currently supplying I & C electricity customers.

Table 1 - Ofgem's estimate of the number of active competitors in the industrial and commercial electricity supply market

PES Area	1 October 1998	1 October 1999	1 April 2000
Eastern	18	16	15
East Midlands	18	16	15
London	18	16	15
Manweb	17	15	15
Midlands	18	16	15
Northern	18	16	15
Norweb	18	16	15
Seeboard	17	15	15
Southern	18	16	15
Swalec	18	16	15
SWEB	18	16	15
Yorkshire	18	16	15
Scottish Hydro Electric	14	12	11
Scottish Power	15	13	12

- 4.5 Based on the results of Ofgem's survey, table 1 shows Ofgem's estimate of the present number of suppliers in I & C electricity supply in each PES area. As some of the returns to the survey did not distinguish between previously separate companies that have now merged, it was not possible in all cases to identify the number of suppliers in the early period covered by the survey. This may underestimate the figures for the number of active competitors at October 1998.
- 4.6 There were 15 active suppliers in England and Wales in April this year, a fall of 3 (2 in some areas) from October 1998. There were fewer suppliers in Scotland, although there was some churn, that is, not all of the 12 suppliers in April 2000 were supplying in October 1998.
- 4.7 It is worth noting that the number of suppliers in each area does not necessarily indicate the vigour with which they are competing with each other. This is a particularly relevant point in Scotland. Here, of around 11 suppliers, only about 5 are proactive in seeking and supplying I & C electricity customers, with other suppliers only supplying multiple sites when requested to do so by customers. This is less true in England and Wales, where most suppliers tend actively to seek custom.

Conclusions

- 4.8 Since October 1998 there has been a decrease in the number of suppliers actively competing in the market as a result of some consolidation among the PESs and others. There remain fewer active suppliers in Scotland than in England and Wales.
- 4.9 It is important to consider this consolidation within the wider context of other indicators of competition in the market. The fact that there are fewer suppliers does not in itself necessarily imply reduced rivalry. However, this might be evidence of reduced competitive pressure if it were to be accompanied by other adverse indicators such as reduced pressure on prices.

5. Market shares

5.1 This chapter describes the present market shares, recent changes in these, and relates these to competition in I & C electricity supply.

Market shares

5.2 Market shares provide an indication of suppliers' performances at particular points in time. It is important to consider how market shares change over time and consider market shares in relation to market developments. This chapter summarises:

- ◆ the market shares of suppliers by the volumes supplied; and
- ◆ the market shares of suppliers by the sites supplied.

5.3 We have attempted to publish as much information as possible about suppliers' market shares, while bearing in mind the need to respect the commercial sensitivity of the information. Figures for Scotland are presently under review and so figures given here are provisional.

5.4 Tables 2 and 3 summarise market share data for I & C supply. 'First tier' refers to PES supply within their authorised areas. 'PES Second tier' supply is by PESs outside their authorised areas. 'Other' supply is by suppliers other than PESs.

5.5 For the purposes of these tables, Scottish PES market share is recorded under 'Other' in the England and Wales portion, and vice versa. Hence percentages for Great Britain for 'PES 2nd tier' and 'Other' are not weighted averages of the relevant rows above.

5.6 PESs' first tier market share in Great Britain has in general continued to fall both by volume and sites supplied. The over 1MW market appears to be more competitive, with a lower market share for first tier PESs.

- 5.7 The two Scottish PESs continue to maintain a much larger share of their first tier market compared with the first tier market in England and Wales. There is some evidence of penetration into the Scottish market in terms of the number of sites supplied, suggesting that suppliers other than the two Scottish PESs are supplying some of the smaller sites.
- 5.8 The apparent increase in PES and decrease in 'Other' market share over the period is largely a reflection of the acquisition of some PESs by players such as National Power and British Energy. Market share of the whole group is recorded under PES second tier.

The market shares of suppliers in Great Britain

Table 2 – The market shares of suppliers in Great Britain in the over 100 kW market by volume

%	(1998/99)			(1999/00)		
	Total > 100kW	100kW-1MW	> 1MW	Total > 100kW	100kW-1MW	> 1MW
England & Wales						
PES 1 st Tier	28	42	20	26	34	21
PES 2 nd Tier	35	39	32	57	55	58
Other	37	19	48	17	11	21
Scotland						
PES 1 st Tier	76	78	76	74	74	75
PES 2 nd Tier	13	12	13	14	15	13
Other	11	10	11	12	11	12
Great Britain						
PES 1 st Tier	33	45	25	31	37	26
PES 2 nd Tier	37	41	35	55	54	56
Other	30	14	40	14	9	18

Table 3 - The market shares of suppliers in Great Britain in the over 100 kW market by site

%	At 1 April 1999			At 1 April 2000		
	Total > 100kW	100kW-1MW	> 1MW	Total > 100kW	100kW-1MW	> 1MW
England & Wales						
PES 1 st Tier	54	56	34	39	42	19
PES 2 nd Tier	33	33	34	50	47	66
Other	13	11	32	11	10	15
Scotland						
PES 1 st Tier	81	81	72	67	67	66
PES 2 nd Tier	11	11	16	15	15	16
Other	8	8	12	18	18	18
Great Britain						
PES 1 st Tier	57	59	37	42	45	22
PES 2 nd Tier	34	34	39	49	46	65
Other	9	8	24	9	9	13

5.9 The 'Concentration Ratio' is another method for measuring market share. For example, the five firm concentration ratio gives the combined market share of the five firms with the greatest market share. The four, five and six firm concentration ratios by volume in the total over 100 kW sector in Great Britain for example all fell between 1999 and 2000.

5.10 First tier market shares over the same period fell by volume in 10 PES areas. One PES increased its share. Three PESs retained approximately their in-area market shares over the period.

- 5.11 Only two independent suppliers had any substantial market share in Scotland. One of these was Independent Energy, which went into receivership in September and whose continuing interests have been purchased by Innogy, parent company of npower.
- 5.12 In terms of overall (first and second tier) market shares by volume, 7 PESs lost and 4 gained market share over the period. For example, Eastern's share fell from 13.5% to 8.3%, Northern's increased from 5.5% to 8.8%.
- 5.13 No supplier presently has a share of the over 100 kW market over Great Britain as a whole of more than 14 per cent, either by volume or sites. The five suppliers with highest market share by volume have a fairly even split of market share. The suppliers with the highest market shares are :

Powergen	13.8%
TXU	11.5%
SSE (inc. SWALEC)	11.3%
Innogy	10.6%
London/SWEB	9.2%.

Conclusions

- 5.14 It is encouraging for the continued development of competition that first tier market shares are falling or not increasing significantly. The relatively even spread of market shares, and their relatively low level, would tend to be consistent with a competitive market, given positive competitive indicators elsewhere.
- 5.15 However, there remain concerns about the position in Scotland. Around three quarters of the Scottish market by volume is still supplied by first tier PESs. On all measures, Scottish PESs retain significantly more first tier market share than their counterparts in England and Wales.

6. Suppliers' price offers and switching behaviour

- 6.1 Suppliers were asked to provide an indication of the prices contained in contracts signed in each sub-sector of I & C electricity supply in October 1998, April 1999, October 1999 and April 2000. This pricing information was given by suppliers in the strictest confidence, and therefore Ofgem has not attributed specific pricing levels to particular suppliers. We have set out below average weighted prices and price ranges offered by suppliers over the period of the survey.
- 6.2 In general, the information provided by suppliers on indicative prices was clear and comprehensive. However there were a number of incomplete returns, which may distort the results, particularly for the calculation of weighted average prices. Also, to calculate weighted average prices very accurately would require detailed information about the profile of electricity consumption across the year, as well as other key terms and conditions of supply. Therefore the information presented below provides indicative estimates of pricing ranges and trends in the market.
- 6.3 Price illustrations are for single sites only. Multi site contracts would tend to apply to several or all PES regions, so making comparisons on a PES area by area basis difficult.
- 6.4 Prices exclude VAT. Prices are given in nominal terms. Over the period April 1999 to April 2000 the Retail Prices Index increased by 3 per cent.

Average prices and price ranges

- 6.5 Table 4 sets out ranges of price offers across all suppliers in each PES area. Prices differ between PES areas partly because, for example, distribution and transmission use of system charges vary by PES area. It should be noted however that some of the prices at either end of the ranges relate to relatively small volumes.

Table 4 - Indicative average prices offered by suppliers in each PES area by maximum demand size, single site, p / kWh

	<i>October 1998</i>	<i>April 1999</i>	<i>October 1999</i>	<i>April 2000</i>
PES Area				
Eastern				
100 kW – 250 kW	3.03 – 6.19	2.94 – 5.88	3.07 – 5.98	2.93 – 5.19
500 kW – 1 MW	3.11 – 4.64	2.80 – 4.59	2.78 – 5.03	2.71 – 4.73
Over 10 MW	3.18 – 3.58	3.49 – 3.98	1.66 – 3.54	2.72 – 3.50
East Midlands				
100 kW – 250 kW	3.28 – 5.22	3.12 – 5.96	3.27 – 6.16	3.03 – 5.16
500 kW – 1 MW	3.40 – 5.83	3.16 – 5.55	2.99 – 5.57	2.86 – 5.43
Over 10 MW	1.77 – 12.34	2.02 – 3.74	1.58 – 3.78	1.97 – 4.34
London				
100 kW – 250 kW	3.43 – 5.77	2.85 – 6.92	2.93 – 6.78	2.67 – 7.44
500 kW – 1 MW	2.96 – 4.75	3.20 – 5.13	2.76 – 5.42	2.10 – 4.93
Over 10 MW	3.64 – 3.64	3.49 – 3.49	2.96 – 3.15	3.24 – 3.24
Manweb				
100 kW – 250 kW	2.89 – 5.56	2.30 – 5.40	2.70 – 5.33	2.00 – 5.10
500 kW – 1 MW	2.74 – 5.24	2.03 – 5.63	2.52 – 5.38	2.29 – 4.54
Over 10 MW	3.20 – 3.60	1.60 – 3.49	2.30 – 3.43	1.19 – 3.91
Midlands				
100 kW – 250 kW	3.27 – 5.48	3.29 – 6.56	3.06 – 5.52	2.88 – 6.64
500 kW – 1 MW	3.12 – 5.52	2.94 – 4.39	2.92 – 5.19	2.06 – 4.35
Over 10 MW	2.83 – 5.20	2.58 – 5.35	2.56 – 5.21	3.16 – 3.48
Northern				
100 kW – 250 kW	3.60 – 6.00	1.90 – 5.51	2.30 – 5.46	2.00 – 5.29
500 kW – 1 MW	2.97 – 5.71	2.65 – 4.28	3.05 – 4.51	2.49 – 4.88
Over 10 MW	1.66 – 4.11	2.02 – 3.49	1.62 – 4.01	3.24 – 3.92
Norweb				
100 kW – 250 kW	3.43 – 5.82	2.92 – 5.61	3.05 – 5.94	2.18 – 5.97
500 kW – 1 MW	2.84 – 4.49	2.84 – 5.12	2.65 – 4.62	2.44 – 4.76
Over 10 MW	3.09 – 3.20	3.11 – 3.49	3.09 – 3.40	3.13 – 3.48

Table 4 continued - Indicative average prices offered by suppliers in each PES region by maximum demand size, single site, p / kWh

	<i>October 1998</i>	<i>April 1999</i>	<i>October 1999</i>	<i>April 2000</i>
PES Area				
Seeboard				
100 kW – 250 kW	3.34 – 5.55	2.89 – 5.85	3.09 – 5.85	2.71 – 5.15
500 kW – 1 MW	3.05 – 5.09	3.15 – 4.58	3.30 – 5.19	2.89 – 4.60
Over 10 MW	1.61 – 4.06	3.48 – 3.87	3.25 – 3.87	1.54 – 3.87
Southern				
100 kW – 250 kW	3.77 – 5.58	3.01 – 5.26	2.81 – 5.10	2.80 – 4.96
500 kW – 1 MW	2.64 – 5.07	2.82 – 5.30	2.87 – 5.00	2.50 – 5.29
Over 10 MW	2.46 – 4.20	2.67 – 4.19	1.83 – 4.02	2.13 – 3.46
SWALEC				
100 kW – 250 kW	3.06 – 6.05	3.01 – 6.01	2.89 – 6.41	2.38 – 5.82
500 kW – 1 MW	2.62 – 5.12	2.59 – 5.88	2.71 – 5.50	3.28 – 5.13
Over 10 MW	3.63 – 3.77	2.61 – 3.87	3.53 – 4.08	2.54 – 3.60
SWEB				
100 kW – 250 kW	3.15 – 5.78	3.24 – 6.23	3.03 – 6.44	2.76 – 5.92
500 kW – 1 MW	3.30 – 4.65	3.60 – 5.19	2.73 – 5.17	2.64 – 4.68
Over 10 MW	3.80 – 3.80	2.50 – 3.85	2.44 – 4.60	2.05 – 4.19
Yorkshire				
100 kW – 250 kW	3.46 – 5.54	3.00 – 5.52	2.97 – 5.30	2.81 – 5.16
500 kW – 1 MW	2.67 – 4.57	2.81 – 4.43	2.75 – 5.09	2.39 – 4.68
Over 10 MW	2.10 – 2.70	1.63 – 3.49	1.80 – 3.32	3.10 – 3.10
Scottish Power				
100 kW – 250 kW	2.90 – 6.39	2.53 – 5.53	3.35 – 5.72	2.63 – 5.30
500 kW – 1 MW	2.14 – 5.01	2.51 – 4.78	2.68 – 5.36	2.96 – 4.39
Over 10 MW	2.83 – 2.83	3.44 – 3.44	2.82 – 2.82	2.86 – 2.86
Scottish Hydro				
100 kW – 250 kW	3.85 – 5.57	2.00 – 6.10	3.69 – 8.82	3.70 – 5.34
500 kW – 1 MW	2.35 – 4.74	4.62 – 4.62	2.38 – 5.36	4.30 – 4.66
Over 10 MW	2.90 – 2.90	4.43 – 4.43	2.99 – 2.99	1.57 – 3.88

- 6.6 In general, prices at higher consumption volumes are lower. Broadly speaking, prices have fallen across most consumption volumes from April 1999 to April 2000. In many areas, and consumption volumes, there has been an increase in the range of prices on offer. However, the range of prices on offer has tended to remain narrower for the higher consumption bands.
- 6.7 The ranges of prices offered in the two Scottish PES areas are in general narrower than the ranges offered in England and Wales, particularly for the lower consumption volumes. Price reductions from April to April have in general been smaller than in England and Wales. Prices in Scottish Hydro's area are substantially higher than elsewhere. These indicators might suggest weaker competitive forces in Scotland compared with England and Wales, perhaps deriving from fewer active players in the Scottish supply market.

Switching behaviour

- 6.8 Chapter 5 described market share trends since October 1998. Market shares provide an indication of a supplier's performance at particular points in time and market share trends provide an indication of changes in suppliers' market positions and customers' behaviour over time. However, market share trends do not explain why the changes in supplier performance have occurred.
- 6.9 One indication of a well functioning competitive market is the extent to which customers switch supplier following a change in the value of suppliers' relative offers. The following paragraphs consider how customers' choices have reacted to changes in suppliers' offers since October 1998. To analyse customers' behaviour, we have considered changes in a number of suppliers' relative prices in sub-sectors of I & C electricity supply and the consequent changes to suppliers' market shares.
- 6.10 One company which retained most of its first tier market share over the period (Electricité de France) also reduced its in-area prices by the most. However, the pattern of prices inversely relating to market share is not a consistent trend across all suppliers. For example, another PES that maintained an almost constant market share in area (Scottish and Southern) also increased its in-area prices more than any other PES. The supplier that lost the greatest in-area market

share, Norweb, increased its prices slightly for some volume bands, but there were a number of suppliers who made more significant price increases in their respective areas.

- 6.11 Not all respondents provided separate figures for single and multi-site prices, but by way of example, Northern Electric appear to have increased their market share by reducing prices to multi-site customers (in many cases quite substantially), but raising single-site prices. Looking at volume figures, they have increased volumes to single- and multi-site contracts in similar proportions.
- 6.12 It should be noted that comparisons of pricing and switching behaviour will tend to be distorted by the marketing efforts and terms of contracts of suppliers. Such factors may also help to explain movements in market share.

Conclusions

- 6.13 The price ranges offered by suppliers, and the reductions in prices over the period April to April, suggests that customers that shop around for an alternative supplier can obtain relatively competitive prices. There remain concerns that customers in Scotland are less able to shop around for competitive offers.
- 6.14 The evidence suggests that price is not the only factor which influences choice of supplier in this market. Other factors such as brand and service level are likely to be significant.

7. Barriers to entry

- 7.1 Potential entrants to the electricity supply market and suppliers within the market will consider the return they expect to make there as compared with deploying their resources in other markets. The extent of any real or perceived barriers to entry and their associated costs will be a factor that potential entrants and existing suppliers bear in mind when making their decision as to how to deploy their resources in order to maximise returns.
- 7.2 The 2000 I & C electricity market survey asked respondents to comment on the extent to which two specific issues constituted effective barriers to entry, and therefore, barriers to suppliers making, and customers receiving, potentially competitive offers, and what, if any, action should be taken to address the issue. The issues raised in the survey were:
- ◆ the extent to which the separation of PES supply and distribution businesses had occurred in practice, in accordance with the requirements of the PES electricity licence; and
 - ◆ the extent to which the administrative burdens to enter the electricity supply market constituted effective barriers to entry.
- 7.3 In addition to these specific issues, Ofgem asked respondents to explain any other commercial practices which may in the future act as barriers to entry to supplying I & C electricity customers. In each area, this chapter sets out the concerns raised, respondents' views, and Ofgem's conclusions.

Separation of PES supply and distribution businesses

Concerns raised

- 7.4 The separation of PES distribution and supply businesses is required by the PES licences. Some suppliers expressed the view that some PESs were introducing this separation too slowly. Views were sought on the extent to which the lack of full separation of PES supply and distribution businesses was affecting the development of competition in the I & C electricity supply market.

Respondents' views

- 7.5 All the PESs that responded to the survey believed that all the evidence in practice showed that competition in I & C electricity supply was developing well, and that there were no obvious barriers to entry. The PESs were not aware of any cases of distribution businesses favouring particular suppliers or PESs cross-subsidising their supply businesses. Some PESs believed that the licence conditions enforcing separation were sufficient to prevent discrimination and that these would be strengthened by the introduction of separate supply and distribution licences as required by the Utilities Act 2000.
- 7.6 One non-PES supplier was concerned that the PESs were not progressing quickly enough with the implementation of their separation plans. It suggested that PESs should be required to publish more information about their separation plans and timetables. Another respondent wanted to ensure that PESs' supply and distribution businesses were separately branded to minimise customer confusion.

Ofgem's conclusions

- 7.7 PESs have made many changes to the way they run their distribution businesses to ensure managerial and operational separation from their supply businesses. Some companies have made substantial progress on separation, such as London Power Networks, Northern Electric Distribution Limited, TXU, and Western Power Distribution. Other companies still have relatively integrated distribution and supply businesses, such as Infracore, Scottish and Southern Energy, and Scottish Power (including Manweb).
- 7.8 All companies have plans to introduce separate brands by March 2002 at the latest. The new arrangements are designed to increase the independence of the distribution business and help prevent cross subsidy or discrimination in the provision of services. The Utilities Act 2000 requires legal separation of the PES distribution businesses to be achieved by a date set by the Secretary of State, presently anticipated to be April 2001.

The administrative burden of market entry

Concerns raised

- 7.9 Some recent entrants and potential entrants to the electricity supply market, including the I & C electricity market, have complained to Ofgem that the process to enter the market is very complex and costly. Some of these concerns will be addressed by the New Electricity Trading Arrangements (NETA), which replace 'the Pool' with bilateral trading of electricity and a balancing market operated by the National Grid Company (NGC). However there remain concerns about the need to sign a large number of different agreements to cover transmission, distribution and metering, and the need to undertake extensive system testing to enter the electricity supply market in all PES areas.

Respondents' views

- 7.10 The PESs all agreed that the current arrangements to enter the electricity supply market are complex, but all except one PES believed that the arrangements were necessarily complex. Most of the PESs believed that the testing required to enter the market was necessary to ensure that the systems of new entrants are able to inter-operate with the market. One PES also believed that the testing helped new entrants understand the operation of the market. One non-PES said that a number of industry processes had already been reviewed and others were currently under review, hence nothing should be changed without consulting the MRASCos.
- 7.11 All respondents that commented generally welcomed the introduction of NETA and agreed that it was likely to simplify the administration process. One PES believed that NETA provided a good opportunity to remove other genuine barriers to entry. Another PES believed that it was inappropriate to change the market arrangements at the same time as NETA was being introduced.

Ofgem's conclusions

- 7.12 All respondents to the survey have already entered the electricity supply market, and therefore, do not have an incentive to simplify the process for future

potential entrants. There are also relatively few non-PES suppliers competing in I & C electricity supply.

- 7.13 Ofgem is presently considering a number of initiatives that should help to reduce the administrative burden of market entry. Ofgem has recently published the consultation document 'Improving Customer Transfers'. This sets out a number of perceived shortcomings in the present process for transferring customers between suppliers, and suggests a number of ways in which the process might be improved. Such improvements would tend to benefit potential suppliers by simplifying some of the transfer processes and reducing operational costs.
- 7.14 Ofgem's review of and proposals for reform of Scottish trading arrangements should in the longer term facilitate entry into the Scottish market by aligning trading arrangements throughout Great Britain. Ofgem is also shortly to publish a consultation paper on the structure of Distribution Use of System (DUoS) charges which will, among other things, consult on the ability of the distribution companies to facilitate competition by publishing appropriate statements of charges.

Scottish wholesale trading arrangements

Concerns raised

- 7.15 Wholesale trading arrangements in Scotland have developed little since Vesting and have been criticised as hindering the development of efficient trading and also new entry in Scotland. The vertically integrated nature of the Scottish companies, their market power in generation, and control over interconnector access, are also regarded as obstacles to the development of competition.

Ofgem's conclusions

- 7.16 The above factors have served to reduce the development of competition and entry to supply in Scotland and, by extension, in the whole of Great Britain. For these reasons Ofgem reviewed the Scottish electricity trading arrangements⁸ and,

⁸ Scottish Trading Arrangements Consultation Paper December 1998, Review of Scottish Trading Arrangements, A Consultation Document October 1999 and Ofgem Press Notice 27 Notice March 2000, Initial Proposals and Issues for Consideration on the Reform of Scottish Trading Arrangements

in August 2000, announced the vision of GB electricity trading and transmission arrangements (BETTA)⁹. This project has the objective of promoting competition and thereby facilitating entry to electricity supply in Scotland and Great Britain.

Other issues

Concerns raised and respondents' views

- 7.17 One respondent was concerned that there was insufficient consultation by transmission and distribution companies about proposed changes to use of system charges because sudden changes adversely affect the development of competition.
- 7.18 Suppliers are presently in the process of introducing a new database system for registering customer sites called the PES Registration System (PRS). The previous system used was called the Electronic Registration System (ERS). One supplier was concerned about the effect on customers of the delay in migrating sites from the ERS to the PRS. Customers registered on the PRS benefit, for example, from lower settlement charges.

Ofgem's conclusions

- 7.19 Following the passing of the Utilities Act 2000, Ofgem published in October 2000, on behalf of the Secretary of State, proposals for new standard licence conditions in both the electricity and gas industries. These address, among other things, points raised above.
- 7.20 Ofgem has proposed to the Secretary of State for Trade and Industry that transmission licence standard conditions include conditions requiring the licensee to give 150 days notice of changes in use of system charges, and to consult relevant parties where the licensee intends to change the charging methodology.
- 7.21 Ofgem remains concerned about the slow migration of customers / sites from the ERS to the PRS. As well as denying customers registered with the ERS certain benefits, the failure to migrate customers to the PRS might impede new suppliers

⁹ Interim Proposals for the Reform of Scottish Trading Arrangements : British Electricity Trading and Transmission Arrangements (BETTA) August 2000

entering the market from signing customers registered with the ERS. This is because new suppliers are unlikely to have made provision for interface with the ERS given that it was to have been superseded by the PRS in the summer of 2000. Ofgem has encouraged suppliers to expedite the completion of the ERS / PRS migration. Ofgem has also emphasised that suppliers with sites registered in ERS should prioritise the migration of such sites belonging to customers that request transfer to suppliers whose systems support only PRS. Ofgem presently anticipates that the ERS should be closed by the spring of 2001.

Conclusions

- 7.22 Ofgem is concerned about the extent to which the present degree of separation of PES supply and distribution businesses inhibits entry. Ofgem notes that companies may face a number of difficulties in becoming, or wanting to become, active electricity suppliers.
- 7.23 However, the provisions of the Utilities Act 2000 to enforce the legal separation of PES supply and distribution businesses are designed to reduce these problems. The introduction of NETA, initiatives concerning the Customer Transfer Process and Great Britain wide trading arrangements will also help to address concerns over barriers to entry.

8. Conclusions

- 8.1 Ofgem's review of the development of competition in industrial and commercial electricity supply suggests that significant competitive forces are continuing to develop.
- 8.2 There has been a modest reduction in the number of companies actively supplying I & C electricity customers. In England and Wales there were at 1 April 2000 an average of 15 suppliers in each PES region, compared with 18 as at October 1998. In Scotland the maximum number of suppliers in either PES region fell from 15 to 12, of whom only around 5 are actively seeking custom. The number has now fallen further in all regions following the exit of Independent Energy in September 2000. There are presently around 14 active independent suppliers in England and Wales, with around 11 in Scotland.
- 8.3 Taken together, the PESs' first tier market share by sites of the total over 100 kW market in Great Britain has fallen from 57 per cent to 42 per cent. By volume, the figures are 33 per cent in 1998/99 and 31 per cent in 1999/00. The decline in their market share has been faster in the 100 kW to 1 MW market, where by volume it fell from 45 to 37 per cent and by site from 59 to 45 per cent. Taking Scotland alone, the two Scottish PESs' retained about three quarters of the over 100 kW sector by volume between 1998/99 and 1999/00.
- 8.4 Prices have in general fallen in nominal terms between April 1999 and April 2000, although there are a number of exceptions to this rule. The range of prices on offer, however, suggests that customers are able to shop around for competitive deals. This is less true in Scotland. Other evidence suggests that the market is operating in a competitive manner since price reductions by some suppliers have been accompanied by an increase in market share.
- 8.5 Taking all indicators together, competition appears to be relatively well established in both the 100 kW to 1MW and over 1 MW sectors in England and Wales.
- 8.6 However, the picture at a Scottish level is more mixed. There are relatively few active suppliers in the Scottish PES areas compared with each of the England and Wales PES areas. As in England and Wales, the number of active suppliers in

Scotland has fallen recently. Market share figures indicate that Scottish PES first tier market share remains high compared to England and Wales PES areas, and on a volume measure has remained steady. Some pricing data also indicate higher prices, smaller price reductions and a narrower range of price offers available to customers in Scotland compared with England and Wales, particularly at lower levels of consumption. Taking all indicators together would suggest evidence of weaker competitive forces in Scotland compared with England and Wales.

8.7 Ofgem and a number of respondents also remain concerned about potential barriers to entry. Ofgem and respondents have identified the following as the principal potential barriers :

- the extent to which the continued integration of PES distribution and supply businesses impedes entry; and
- the extent to which administrative burdens such as securing industry agreements and systems testing increases entry costs and discourages entry.

8.8 Other potential barriers to entry include concerns over notice periods for distribution and transmission use of system charges, concerns over the slow introduction by suppliers of new customer databases, and the lack of a consistent set of trading arrangements that cover the whole of Great Britain.

8.9 Ofgem is continuing with a number of initiatives designed to facilitate the potential entry of suppliers to I & C electricity supply and the development of competition. Ofgem has for example undertaken a considerable volume of work to ensure that PESs fully separate their distribution and supply businesses. Ofgem has recently consulted on the issue of improving customer transfers, which suggests a number of improvements that may benefit potential suppliers. These proposals are geared to improvements in the processes for transferring domestic customers, but are, in principle, applicable to I & C supply. Ofgem is shortly to consult on Distribution Use of System issues. Proposed new standard licence conditions for transmission licences address concerns over the notice period for transmission use of system charges. Ofgem has taken steps to encourage suppliers to complete the introduction of new customer databases. Ofgem is

also presently reviewing trading arrangements in Scotland with a view to introducing consistent trading arrangements across the whole of Great Britain.

- 8.10 The Electricity Act 1989, as amended by the Utilities Act 2000, gives Ofgem a principal objective to protect the interests of consumers, wherever appropriate by promoting effective competition. This review of Industrial and Commercial electricity supply has concluded that customers are benefiting from the operation of an increasingly competitive market. However, there remain concerns over barriers to entry.
- 8.11 Bearing in mind Ofgem's concerns about the development of competition, it will remain appropriate, and will be consistent with Ofgem's principal objective, to continue to review the operation and development of competition in Industrial and Commercial electricity supply. This will continue to take the form of monitoring market data provided to Ofgem, other data sources, and considering any complaints or issues that may arise from customers or suppliers. In doing this, Ofgem will pay particular regard to the potential entry by new suppliers, and the status of perceived barriers to entry.

Appendix 1 – Respondents to the qualitative survey

1.1 The companies that responded to the qualitative survey are listed below:

British Gas Trading

London Electricity

Northern Electric

Norweb

Scottish and Southern Energy

Scottish Power

Seeboard

TXU Europe

Unit energy Ltd

Yorkshire Electricity