

Supplying low income and vulnerable customer groups

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Summary

This document is provided to help suppliers¹ who are considering developing tariffs aimed specifically at low income and vulnerable customer groups. The document outlines Ofgem's views on whether such tariffs could conflict with relevant regulatory obligations and competition law. This will be of particular interest to gas and electricity suppliers developing these sort of tariffs who are concerned that they may hold a dominant position in a relevant market for the purpose of the Chapter II prohibition contained within the Competition Act 1998 (Competition Act)². These companies may be concerned that offering tariffs aimed at low income and vulnerable customer groups could lead to an infringement of the Chapter II prohibition of the Competition Act.

In Ofgem's view neither the conditions in the supply licence, competition law nor other consumer protection law prevents suppliers from developing such tariffs for different groups of low income and vulnerable customers.

With regard to Chapter II of the Competition Act, Ofgem will take into account a range of factors with reference to relevant case law and the Office of Fair Trading's (OFT) Competition Act guidelines³. This document illustrates a number of factors that suppliers should bear in mind when considering offers to low income and vulnerable customer groups. It will be updated as necessary but in particular once the draft Competition Act guidelines are finalised and published by the OFT. Updates may also be needed to ensure that it is consistent with any new or revised guidance published by the European Commission with regard to Articles 81 or 82 of the EC Treaty.

The key points of guidance include the following:

The relevant market: groups of low income and vulnerable customers are in themselves unlikely to form a separate market for the purposes of competition law. More relevant considerations are the ease of supply and demand side substitution and whether the target group is large enough to affect competition in any possible wider market definition.

¹ For the purpose of this document suppliers are defined as companies from whom customers buy gas and/or electricity.

² The Chapter II prohibition is set out in section 18 of the Competition Act.

³ See www.oft.gov.uk for more details on the draft guidelines. At the time of publication the guidelines are in the process of being revised.

Difference between dominance and abuse: the possession of a dominant position in a market is not, of itself, prohibited by the Competition Act; it is rather any abuse of a dominant position that is prohibited. The OFT's Competition Act guidelines, European Commission guidance and relevant European Community and UK jurisprudence will be considered in deciding whether an abuse has occurred.

Price discrimination and predation: Some suppliers have expressed concerns that specific tariffs for the benefit of low income and vulnerable customer groups could be considered discriminatory. There is no licence restriction that prevents suppliers from offering different tariffs to different customers. A supplier may, for example, offer low income and vulnerable customer groups tariffs that are less profitable than other tariffs. Ofgem's concern is centred on behaviour that has had or is likely to have an anti-competitive effect on the market.

This document is intended to help suppliers who are considering developing tariffs aimed specifically at low income and vulnerable customer groups. However, Ofgem cannot, as a matter of law, fetter its discretion in its application of UK and European Community competition law, or to act as a Competition Authority in any proceedings. Compliance with the Competition Act is the responsibility of individual undertakings and Ofgem cannot give 'clearance' to a particular kind of offer or set of tariffs.

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1. Introduction

- 1.1. Ofgem is the Office of the Gas and Electricity Markets, which supports the Gas and Electricity Markets Authority (the Authority)⁴, the regulator of the gas and electricity industries in Great Britain. The Authority's principal objective is to protect the interests of consumers, wherever appropriate by promoting effective competition⁵. The Authority's powers are provided for under the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000 and other legislation.
- 1.2. The Authority shall carry out its functions in the manner best calculated to further its principal objective having regard to, amongst other things, the interests of people who are disabled or chronically sick, pensioners, those on low incomes and people living in rural areas⁶. In addition, one of Ofgem's priorities, as set out in its corporate strategy, is to help to tackle fuel poverty⁷.
- 1.3. Incumbent gas and electricity suppliers have expressed concern that Ofgem may consider tariffs aimed at low income and vulnerable customer groups to be anti-competitive.
- 1.4. Increases in energy prices tend to have a particularly adverse effect on low income and vulnerable customer groups. Given the current climate of rising energy prices, Ofgem is particularly keen to highlight that tariffs designed specifically for low income and vulnerable customer groups are not necessarily anti-competitive, even when offered by a company which may hold a dominant market position.

⁴ The terms 'the Authority' and 'Ofgem' are used interchangeably throughout this document.

⁵ The Authority's powers are provided for under the Gas Act 1986 and the Electricity Act 1989, as amended by the Utilities Act 2000.

⁶ Electricity Act 1989 s3(A)(3), Gas Act 1986 s4AA(3).

⁷ Page 22, Ofgem Proposed Corporate Strategy 2004-2007. Households are considered to be fuel poor if, in order to maintain a satisfactory heating regime, they would need to spend more than 10 per cent of their income on all household fuel requirements.

- 1.5. The aim of this paper is therefore to highlight that competition and consumer law do not, in general, prevent particular offers being made to low income and vulnerable customer groups. The paper also discusses some circumstances in which suppliers will need to have particular regard to the Competition Act when developing such tariffs.
- 1.6. Ofgem remains happy to discuss with suppliers any other barriers to the development of tariffs for low income and vulnerable customer groups that they may identify⁸.

Structure of the paper

- 1.7. The paper is structured in two chapters. Chapter one contains a brief introduction. Chapter two sets out Ofgem's sectoral, competition and consumer protection law powers and discusses how suppliers might take these into consideration when developing tariffs for low income and vulnerable customer groups.

⁸ In doing so, Ofgem can not act to fetter its discretion in its application of UK and European Community competition law or its ability to act as the relevant competition authority in any proceedings.

2. Application of powers

- 2.1. This chapter begins by outlining briefly Ofgem's sectoral powers and discusses how supply licence conditions do not prevent suppliers from providing tariffs for vulnerable customers. This chapter also discusses Ofgem's powers under the Competition Act, and some of the issues that could arise under the Competition Act which may be of concern to suppliers if they want to offer this type of tariff. Finally, it highlights other relevant areas of consumer protection law.
- 2.2. Ofgem considers that there are no absolute legal barriers to preclude suppliers from constructing specific tariffs for low income and vulnerable customer groups. Ofgem recommends that when developing such tariffs suppliers take into account the issues outlined in this paper, the Energy Guidelines⁹, the guidance provided in the OFT Competition Act guidelines¹⁰, any European Commission guidance and obtain their own legal advice.
- 2.3. This document will be updated (if necessary) as soon as reasonably practicable after the draft Competition Act guidelines are finalised and published by the OFT. It may also be updated in order to ensure that it is consistent with any new or revised guidance published by the European Commission.

Sectoral legislation

- 2.4. Under the Gas Act 1986 and the Electricity Act 1989 it is an offence to carry out certain activities such as the supply of electricity or gas unless licensed or exempt from the requirement for a licence¹¹. Ofgem has a statutory obligation to have regard to a range of factors when carrying out its functions under the sectoral legislation referred to above. These functions include granting and amending licences, and also licence enforcement¹².

⁹ Draft – Ofgem and OFT *"The Competition Act 1998: Application in the Energy Sector"* August 2004.

¹⁰ See www.ofg.gov.uk for more details on the draft guidelines. At the time of publication the guidelines are in the process of being revised.

¹¹ Gas Act 1986 s5 (as amended by the Utilities Act 2000) and Electricity Act 1989 s4 (as amended by the Utilities Act 2000).

¹² See also: Ofgem *"Making markets work for consumers: Ofgem's approach to securing compliance with supply licence obligations and consumer protection legislation"*, July 2003, 70/03.

2.5. Where the Authority is satisfied that a licence holder is contravening or is likely to contravene any “relevant condition or requirement”, the Authority must make a provisional or final order to secure compliance with the condition or requirement, unless the Authority is satisfied that the licensee has agreed to take, or is taking, steps to comply with the condition or requirement, or that the contraventions were of a trivial nature¹³. If the Authority is satisfied that a licence holder has contravened any relevant condition or requirement or has failed or is failing to achieve any standard of performance, the Authority has the power to impose a financial penalty of such an amount as is reasonable in all the circumstances of the case¹⁴. The Authority cannot make an order or impose a penalty if it is satisfied that the Authority’s statutory duties preclude the making or the confirmation of the order or if the most appropriate way of proceeding is under the Competition Act.

Licence conditions

2.6. Gas and electricity suppliers must comply with standard licence conditions¹⁵ (SLCs). Many current domestic SLCs reflect Ofgem’s duty to have particular regard to certain customer groups such as those who are disabled or chronically sick, pensioners, those on low incomes and those living in rural areas. Ofgem does not consider that any of the SLCs present a barrier to suppliers offering tariffs to vulnerable customers, particularly since all suppliers can offer different contractual terms to different cases of customer or different classes of cases of customer, or for different areas¹⁶.

2.7. Prior to the introduction of the SLCs by the Utilities Act 2000, specific licence conditions prohibited suppliers from:

- ◆ showing undue preference
- ◆ exercising undue discrimination

¹³ Section 28 of the Gas Act 1986 and section 25 of the Electricity Act 1989.

¹⁴ Section 30A of the Gas Act 1986 and section 27A of the Electricity Act 1989. The policy and process which will be followed by the Authority has been published by Ofgem in two documents: “*Utilities Act Statement of policy with respect to financial penalties*” October 2003; “*Financial penalties, the process*” February 2003, 10/03.

¹⁵ In addition, licences may also have special conditions and/or amended standard conditions.

¹⁶ SLC 42 Domestic Supply Contracts.

- ◆ setting unduly onerous prices, and
- ◆ predatory pricing.

2.8. In October 2001, following a detailed consultation process¹⁷ as part of the implementation of the Utilities Act 2000, these conditions were removed. Since then only the general provisions of UK and European Community competition law have applied to prohibit anti-competitive behaviour. In particular, the Competition Act is of relevance to suppliers who are considering whether to offer tariffs to low income and vulnerable customer groups within the UK.

2.9. Licensees must not cross-subsidise, or receive any cross-subsidy from, any other business of the licensee or an affiliate or related undertaking of the licensee¹⁸. This would prevent a supplier subsidising a loss-making tariff for vulnerable customers from another part of its business outside the supply of gas or electricity, particularly if this might distort competition. However, this does not mean that suppliers are prevented from offering tariffs that may make less profit than those offered to non-vulnerable customers.

Common tariff obligation

2.10. In the past one of the features of the electricity market in the North of Scotland area has been the Common Tariff Obligation (CTO). On 4 August 2004 the DTI published a consultation on the draft legal text of an order relating to a CTO¹⁹. This consultation closed on 4 November 2004. The DTI has indicated that it will publish its decision as soon after the consultation closes as possible. If such an order is made after the DTI publishes its decision then suppliers will need to take this decision into consideration for tariffs that apply to the North of Scotland.

¹⁷ See Ofgem "A Review of the Gas and Electricity Supply Non-discrimination Licence Conditions: Initial Proposals" July 2000.

¹⁸ SLC 12B Prohibition of Cross Subsidies. A similar prohibition applies to some generation licensees (Generation licence SLC 17A).

¹⁹ DTI "Relaying the Common Tariff Obligation. Consultation on draft legal text." August 2004.

Competition Act

- 2.11. Ofgem has concurrent jurisdiction with the OFT to apply the Competition Act to the gas and electricity sectors in Great Britain. Ofgem's principal objective and general duties do not apply when Ofgem, after agreement with the OFT, decides to exercise its powers under the Competition Act. The Competition Act was amended with effect from 1 May 2004 to provide for the application and enforcement of Article 81 and 82 of the EC Treaty by the OFT and sectoral regulators.
- 2.12. Article 81 and Chapter I prohibit agreements between undertakings, decisions by associations of undertakings and concerted practices that have as their object or effect the restriction, distortion or prevention of competition. Article 81 relates to agreements within the common market, which may affect trade between Member States. Chapter I relates to agreements within the United Kingdom (or part thereof) which may affect trade within the United Kingdom.
- 2.13. Article 82 and Chapter II prohibit conduct by one or more undertakings which amounts to the abuse of a dominant position in the relevant market. Article 82 relates to conduct within the common market or a substantial part of it which may affect trade between Member States. Chapter II relates to markets within the United Kingdom (or a part thereof) which may affect trade within the United Kingdom.
- 2.14. The OFT, together with Ofgem and other sectoral regulators, has issued advice and information in accordance with section 52 of the Competition Act, explaining how that Act and Articles 81 and 82 will be applied and enforced²⁰. These guidelines are a useful source of guidance for companies seeking to understand the approach that Ofgem is likely to take in any potential Competition Act proceedings. Also of relevance are Ofgem's Energy Guidelines. Draft revised Energy Guidelines were published on 2 August 2004 by Ofgem²¹. The Energy Guidelines will be revised as necessary in order to ensure that they are consistent with updated guidelines published by the OFT. In addition, they

²⁰ See www.ofg.gov.uk for more details on the guidelines. At the time of publication the guidelines are in the process of being revised.

²¹ Draft – Ofgem and OFT “*The Competition Act 1998: Application in the Energy Sector*” August 2004.

may be updated as necessary in response to any further guidance issued by the European Commission. Ofgem has also published information on possible routes for receiving informal guidance on these issues²².

- 2.15. Whilst Ofgem welcomes tariffs aimed at vulnerable customers, it is important to note that the responsibility to comply with competition law ultimately rests upon suppliers. Suppliers should obtain independent legal advice in order to ensure compliance with competition law. Nothing in this document should be construed as acting to fetter Ofgem's discretion in its application of UK and European Community competition law or in its ability to act as the relevant competition authority in any proceedings. It will be necessary to consider the circumstances of each case on an individual basis, with particular reference to relevant case law.

Application of EC competition law

- 2.16. It is Ofgem's general view that tariffs to low income and vulnerable customer groups in Great Britain are unlikely to have an appreciable effect on trade between Member States. On this basis, it is unlikely that Ofgem will be required²³ to apply Article 81 and/or Article 82 of the EC Treaty. However, Ofgem will carry out a case-by-case assessment of whether conduct or an agreement has an appreciable effect on trade between Member States, and whether it is required to apply Article 81 and/or Article 82 of the EC Treaty. In carrying out its assessment Ofgem will have regard to the European Commission's Notice on the effect on trade concept²⁴.
- 2.17. Given Ofgem's views on the application of Article 81 and/or Article 82, the following part of this paper focuses on the application of the Chapter I and /or Chapter II prohibitions of the Competition Act.

²² Ofgem "Electricity supply competition: An Ofgem occasional paper" December 2002, 83/02, page 36.

²³ See Article 3 of EC Regulation 01/2003.

²⁴ Commission Notice "Guidelines on the effect on trade concept contained in Articles 81 and 82 of the Treaty" 27 April 2004.

Discussion

- 2.18. This section discusses some of the competition issues that suppliers have indicated they believe could prevent them from offering tariffs to particular customer groups. Providing suppliers consider the following points (and any other relevant issues) carefully, Ofgem sees no reason why they cannot offer specific tariffs²⁵ for the benefit of low income and vulnerable customer groups.
- 2.19. An agreement will infringe the Chapter I prohibition if it has as its object or effect the appreciable prevention, restriction or distortion of competition. On the evidence available, Ofgem does not consider that the Chapter I prohibition is likely to hinder a supplier's ability to offer tariffs to vulnerable customers. However, there are some circumstances in which the Chapter I prohibition would apply. For example, if two or more suppliers colluded tacitly or participated in a concerted practice with respect to the tariffs they provided and there was an appreciable effect on competition within the UK, this would be likely to be considered an infringement of Chapter I.
- 2.20. However it appears that some suppliers, particularly those with large market shares, may be concerned that offering tariffs to low income or vulnerable customer groups could lead to an infringement of the Chapter II prohibition. As stated above, Chapter II is concerned with the abuse of a dominant position by one or more undertakings. Section 18 of the Competition Act states that:
- “(2) Conduct may, in particular, constitute such an abuse if it consists in -
- (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
 - (b) limiting production, markets or technical development to the prejudice of consumers;
 - (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

²⁵ The comments in this section should not be construed as Ofgem's view on any offers that have been available, are currently available or may become available.

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of the contracts.”²⁶.

- 2.21. It is important to note that it is not the position of dominance that is unlawful, but the abuse of that dominance. A dominant undertaking is, nevertheless, under a special responsibility not to allow its conduct to impair undistorted competition²⁷.
- 2.22. Since there can only be an abuse if an undertaking holds a dominant position in a relevant market, the first step in considering whether there is an abuse is to consider whether a supplier is dominant. This involves defining the relevant market. Ofgem and the OFT have published guidelines detailing how to define a relevant market and ascertain market power²⁸. In defining markets within the gas and electricity sectors, Ofgem has previously published an analysis which indicates that competitive pressures seen in price movements are consistent with, although not proof of, a regional definition of markets for electricity and a national market definition for gas²⁹. However, it will be necessary to consider the circumstances of each case on an individual basis.
- 2.23. From Ofgem’s analysis to date it appears unlikely that a tariff aimed at a particular low income or vulnerable customer group would indicate that the particular customer group constituted a separate market. In considering whether a customer group constitutes a separate market, Ofgem would consider the ease of supply and demand side substitution. The supplier also needs to consider whether the size of any target group is large enough to affect competition in any possible wider market. If the customer group represents a separate relevant market, it would be necessary to consider whether the supplier was dominant in that market and, if it was, whether it had abused that dominance.

²⁶ This is not an exhaustive list of possible anti-competitive conduct.

²⁷ Michelin v Commission (Case 322/81 [1983] ECR 3461, [1985] 1 CMLR 282, para 57.

²⁸ See www.ofg.gov.uk.

²⁹ Ofgem, “Domestic Competitive Market Review”, April 2004, 78/04, Chapter 6

- 2.24. Different types of conduct may be considered an abuse of a dominant position. There are a number of factors to consider in assessing whether a particular activity constitutes an abuse. Ofgem would normally only be concerned about any behaviour that had or is likely to have an anti-competitive effect on the market.
- 2.25. In considering whether conduct amounts to an abuse of dominance, Ofgem will have particular regard to any objective justification an undertaking may have for engaging in such conduct. Neither Article 82 nor the Competition Act contains a provision under which an abuse can be exempted because it produces benefits. But conduct may not be regarded as an abuse where there is an objective justification for the conduct. For example, a refusal to supply might be justified by the poor creditworthiness of the customer. It will be necessary for a dominant undertaking to show that its conduct is proportionate.
- 2.26. Some suppliers have indicated that they do not consider that they could offer specific tariffs to vulnerable customers because this could be considered discriminatory. Paragraphs 2.7 and 2.8 explain that there is no longer a SLC prohibiting such discrimination. Paragraph 2.6 explains that suppliers' licences allow them to offer different prices to different classes of customers.
- 2.27. Price discrimination occurs frequently and in a wide range of industries, including industries where competition is effective. It is a term that denotes many specific types of pricing behaviour that can be either beneficial for consumers or anti-competitive. Therefore, it is not necessarily the case that price discrimination by a dominant undertaking is an abuse.
- 2.28. An energy tariff that enables vulnerable customer groups to consume more energy than they would have otherwise is unlikely to have a detrimental effect on competition. Such a tariff may simply reflect the different willingness to pay of different types of customers. In Ofgem's opinion if a tariff, offered by a dominant undertaking for the benefit of vulnerable customers, was not exclusionary, predatory or excessive, it is unlikely to be considered anti-competitive. A supplier may, for example, offer low income and vulnerable customer groups tariffs that do not make as much profit as those offered to other customer groups.

- 2.29. Ofgem's approach in assessing whether conduct is or is likely to be anti-competitive will be determined on a case-by-case basis. Two examples of conduct by a dominant undertaking that may result in anti-competitive price discrimination are discussed below: excessive prices and predatory prices³⁰.
- 2.30. Excessive pricing concerns prices which are above the competitive market level. This may constitute an abuse if the price had "no reasonable relation to the economic value of the product supplied"³¹. An excessive price may indicate that the undertaking was abusing its market power if, for example, excessive prices were combined with exclusionary practices. A careful assessment of whether prices reflected cost would be necessary in determining whether prices were excessive.
- 2.31. Predatory pricing is a low pricing strategy where an undertaking incurs losses in order to eliminate a competitor so as to be able to charge excessive prices in the future. Ofgem, in carrying out its assessment as to whether conduct constitutes predatory pricing, will have regard to factors such as: the effect or likely effect on competition, whether prices reflect cost, the appropriate cost basis and the undertaking's intent.
- 2.32. Other types of tariff that may raise competition concerns are those which 'lock in' a large number of customers to contracts for long periods of time without the option to terminate the contract under reasonable terms. Also of concern would be the automatic renewal of contracts without the need for positive action by the customer. In assessing the anti-competitive effect of such a contract, Ofgem would have regard to the number of customers affected.

Consumer protection law

- 2.33. In addition to the protection provided to customers by competition law and licence conditions, there are a number of areas of general consumer protection law where Ofgem has enforcement powers. The Authority has concurrent powers with the OFT for the enforcement of a range of Regulations including:

³⁰ This is not an exhaustive list.

³¹ Case 27/76 United Brands v Commission [1978] ECR 207, [1978] 1 CMLR 429 at paragraph 250 (United Brands).

- ◆ the Unfair Terms in Consumer Contracts Regulations 1999 (the Unfair Terms in Consumer Contracts Regulations)
- ◆ the Consumer Protection (Cancellation of Contracts Concluded Away From Business Premises) Regulations 1987, and
- ◆ the Consumer Protection (Distance Selling) Regulations 2000 (the Consumer Protection (Distance Selling) Regulations).

2.34. Under the Enterprise Act 2002 (the Enterprise Act), the Authority has been designated as an ‘enforcer’ and has the powers to obtain an enforcement order in relation to breaches of consumer protection legislation. Legislation covered by the Enterprise Act includes:

- ◆ the Control of Misleading Advertisements Regulations 1998 (as amended)
- ◆ the Consumer Protection (Cancellation of Contracts Concluded Away From Business Premises) Regulations 1987
- ◆ the Unfair Terms in Consumer Contracts Regulations, and
- ◆ the Consumer Protection (Distance Selling) Regulations.

2.35. In practice, the Unfair Terms in Consumer Contracts Regulation³² requires that contracts must be in plain, intelligible language and set out the relevant information clearly, including price information. It would also follow that contracts should clearly make consumers aware of particularly important implications, such as the duration of the contracts and termination fees.

2.36. Consumer protection law also requires suppliers to ensure that customers are aware that they are signing a contract³³ and that any information given orally or in writing on pricing is not misleading³⁴.

³² In addition to Part 8 of the Enterprise Act, Ofgem also has direct enforcement powers under the Unfair Terms in Consumer Contracts Regulations. Unlike Part 8, the latter enforcement actions are not limited to cases where there is harm to the collective interests of consumers.

³³ The Trade Descriptions Act 1968 – see prosecution of Northern Electric by Cheshire Trading Standards

³⁴ Part 3 of the Consumer Protection Act 1987 – misleading price indications

Conclusion

- 2.37. It does not appear to Ofgem that anything in the supply licence SLCs, the Competition Act or any other consumer protection law prevents suppliers from developing tariffs for low income and vulnerable customer groups.
- 2.38. Clearly there are issues which suppliers would need to consider in developing tariffs for low income and vulnerable customer groups, but Ofgem believes there is scope for innovative proposals to be developed which would not cause any regulatory or competition concerns.
- 2.39. Ofgem remains happy to discuss with suppliers any other barriers to the development of tariffs for low income and vulnerable customer groups that they may identify³⁵.

³⁵ In doing so, Ofgem will not act to fetter its discretion in its application of UK and European Community competition law or in its ability to act as the relevant competition authority in any proceedings.