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**Date** 13 January 2006

Dear Rachel

**CONSULTATION: NON-DOMESTIC SUPPLY MARKET REVIEW**

EDF Energy welcomes the opportunity to comment on Ofgem's consultation on the non-domestic supply market review. This response represents the views of EDF Energy, which includes the retail brands of London Energy, SWEB Energy, Seaboard Energy and EDF Energy.

Please find attached our response to the questions raised in the consultation. In summary, we do not believe that it is necessary for Ofgem to conduct a full-scale market review of the non-domestic supply market. On balance, we believe that competition in the market is working, although customers and suppliers could benefit from more transparent contractual terms.

In addition, Ofgem may wish to reconsider whether all I&C suppliers should become parties to the SPAA.

These suggestions are likely to enhance customer experience, increase confidence in the industry, and reduce supplier confusion during the supply change processes.

I hope you will find our comments helpful. If you have any queries on them, please do not hesitate to contact Ann Neate (on 01273 428464) or myself.

Yours sincerely

**Roger Barnard**

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EDF Energy's comments on the consultation questions are as follows:-

**1 Do you consider that there is sufficient justification for Ofgem to conduct a review of the non-domestic gas and electricity supply markets? Please provide specific evidence or data against the indicators above (or any additional indicators you consider relevant) to support your position.**

EDF Energy does not believe that a full scale review is required. We consider and provide evidence against some of the indicators described in the consultation document to support our views.

**1.1 *Parallel movements in prices offered by suppliers or other evidence of collusion***

In our view, there is no evidence to suggest that there are parallel movements in prices or other evidence of collusion.

Given that suppliers generally price against the wholesale market and movements in the wholesale market are subsequently reflected in retail prices, it may appear, on the surface, that there is a correlation between one supplier raising its prices which is subsequently followed by another. However, it would be incorrect to assume that this is evidence of collusion or any form of abuse. In practice, suppliers reflect changes in the wholesale market in different ways, depending on factors such as their risk policies, their view of the market trend and the speed at which their systems can be changed. This evidences itself in significantly different prices on any one day. As a result, Major Businesses have become more sophisticated in their purchasing behaviour, for example by signing deals that allow them to buy electricity in blocks and spread the timing risk.

According to Datamonitor<sup>1</sup> at least 60% of electricity and 50% of gas customers within the SME market are contract, as opposed to tariff. These customers use the contract renewal proactively to check prices with other suppliers and switch when they come across a better quote. If parallel movements in prices offered by suppliers existed, this would not be the case.

For Major Businesses, contract renewal usually goes out to competitive tendering. The process of tendering is extremely costly and time consuming, not only to the supplier but to the customer. Customers, take this opportunity very seriously to ensure that they get the best deal from suppliers.

For SME tariff customers, there were a number of price changes during 2005. These occurred independently of suppliers and the percentage increase varied from supplier to supplier.

**1.2 *Sustained increases in profit margins***

Energy prices have risen since the last market review in July 2003 but these increases have been primarily driven by wholesale costs which have increased by 194% in electricity and 201% in gas. The introduction of the EU Emissions Trading Scheme has also contributed to the increase in prices. They are not the result of profit taking by energy suppliers. This has been acknowledged and accepted by Ofgem and Government. In this regard, we support Ofgem's efforts to improve the liquidity and transparency of the upstream gas market.

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<sup>1</sup> UK SME Buyer Research 2005, Datamonitor, 20 October 2005.

### 1.3 *Predatory pricing in the supply market*

Despite rising wholesale costs, suppliers in general are trying to remain competitive by minimising price increases. We do not believe there is any evidence of predatory pricing in the supply market. Some smaller suppliers have exited the market. However, this is due to the volatility in the wholesale market rather than any attempt by a larger supplier to drive them out through predatory pricing.

### 1.4 *Barriers to entry or barriers to expansion, for supply companies*

The energy market is available to new entrants and a number of companies of varying sizes have indeed entered the energy supply market. These account for a small market share however and a number of them have subsequently exited the market. This is due in part to the available margins in the energy industry being lower than in other markets where these companies are more used to operating, e.g. retail and financial services. It is true that economies of scale will favour larger and established suppliers and that customers will generally respond more positively to a company that is established in a market, rather than a company that is making an offer outside their perceived specialism.

The volatility of the wholesale market, the need for high working capital for credit cover and quality of data, are examples of challenges that all suppliers are currently facing. These problems face all suppliers. Some have argued that vertically integrated suppliers have an unfair advantage owing to their generation business. However, we (and other suppliers) still purchase on the wholesale market. The recent unprecedented increase in wholesale prices cannot be classified as barriers as they affect all suppliers. The advantage an established company enjoys in addressing these risks is in terms of relative experience and ability in managing and mitigating market risks, rather than as a result of any structural difference.

There are, however, barriers to entry in certain areas. For example, we agree that it is extremely competitive in the Major Business market and that new entrants might find the initial capital investment required to set up an IT infrastructure to provide a robust billing system prohibitive and particularly so given the available returns on that investment. Smaller scale costs such as the tendering and bidding process for large contracts can also act as a barrier. Major Businesses, such as the Office of Government Commerce, have a team of consultants seeking the best deal for them and/or their clients and the costs and resource required in preparing a bid can be high. However, this is an experience shared by established suppliers as well.

### 1.5 *Impediments to customers switching supplier*

There is sufficient evidence to demonstrate that there is a healthy appetite of switchers within the non-domestic market and that they are continually rising.

Within the SME market, independent research as well as our own customer survey data shows that there is a high level of competition in the SME sector and there is a clear trend of the diminishing number of retained “dormant” customers. According to Datamonitor<sup>2</sup>, over 60% of electricity customers and

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<sup>2</sup> UK SME Buyer Research 2005, Datamonitor, 20 October 2005.

over 50% of gas customers have switched suppliers. Moreover, it expects the number of “dormant” customers to reduce to 15% for electricity and in gas to remain higher. The National Consumer Council also concludes in their ‘Switched on to Switching?’ survey that switching levels have risen in all markets except insurance. The report confirmed that the energy sector was the most active amongst switchers.

However, there are a number of issues around industry processes relating to change of supply which could be improved. In particular, the use of the right to object to customers leaving one supplier for another is inconsistent across suppliers and can create confusion between suppliers, as well as a poor customer experience. In the case of erroneous transfers, there are no formal industry processes for resolving these, and where they do occur, they can take some time to resolve. In the domestic market, these processes are established under the governance of the SPAA and the MRA, but there has been a reluctance to create mandatory processes for the non domestic market. The MRA requirements on I&C suppliers are therefore limited in order to prioritise flexible contractual arrangements with customers.

The issues are even more complicated in the gas market, as I&C suppliers are not required by Ofgem through their licence to be parties to SPAA, and efforts to get them to accede on a voluntary basis have repeatedly failed, with only those I&C suppliers with a domestic portfolio choosing to accede. The forthcoming introduction of the more detailed Review of Gas Metering Arrangements (RGMA) metering schedules to further ease the change of supply process is intended to be mandated on all suppliers. However, here again, the lack of governance through the SPAA is likely to undermine this initiative’s benefit for the I&C market.

The introduction of guidelines under the MRA such as that for non domestic erroneous transfers (guideline No 24) have highlighted how agreed industry processes can improve the change of supply process, and we feel that non domestic suppliers should be encouraged by Ofgem to review how far change of supply processes in their market could be improved whilst not prejudicing the flexibility of contractual arrangements. Whilst this work is already underway in the electricity market under the auspices of the MRA, there can be no meaningful dialogue in the gas market whilst I&C suppliers are not party to the SPAA governance arrangements. We believe, therefore, that Ofgem may wish to reconsider their position on requiring I&C suppliers to be parties to the SPAA.

1.6 *Poor information to customers on prices or services, or other evidence of restrictions on the ability of buyers, or their representatives, to engage fully with the commercial opportunities that the market should present*

In the SME market, we agree that there is not the same level of transparency of price information between suppliers as there is in the domestic market. However, as noted above, customers are using the contract renewal process proactively to check prices with other suppliers to switch to the most competitive supplier. Despite the lack of readily available pricing information, for example on websites, customers are able to, and are obtaining, price information individually from suppliers.

In the Major Business market, we have seen an increase in the use of intermediaries such as brokers and consultants. Our experience supports the

findings of Datamonitor<sup>3</sup>; 60% of corporate energy buyers use third party intermediaries to secure the most competitive contracts.

1.7 *Low rate of innovation and low degree of product differentiation*

We do not believe that there is a low rate of innovation or a low degree of product differentiation in the energy sector.

EDF Energy has developed a number of new products and services for both the SME and Major Business market.

1.8 *Poor quality of service*

As far as EDF Energy's quality of service is concerned, we are delighted to be the winner of Datamonitor's SME Customer Satisfaction survey in the UK. EDF Energy's No 1 position was achieved during 2005 and related to electricity. The award was based on a combined customer satisfaction rating of price, billing and service. We take pride in the quality of service we offer our customers and expect to continue to do so in the future.

**2 If you do consider a review is necessary, please answer the following questions:**

- **Which indicators of competitiveness should be the focus of this review (for example, market dominance of particular company/ies, quality of service, barriers of entry for suppliers), and why;**
- **Should the review cover all market segments (for example SMEs, medium and large gas and electricity supply markets) or focus upon a particular sub-set of these and why.**

EDF Energy does not consider that a review is necessary for reasons discussed above.

**3 If you do not consider a review is necessary, are there any measures Ofgem should be taking to improve the way the supply market is working? What are these measures and why are they required?**

EDF Energy agrees with Ofgem's view that the concerns raised by customers or suppliers reflect some of the inadequate systems and practices within the energy industry, and do not point to the supply market being non-competitive. Addressing these issues will allow for smoother switching processes as well as ensuring a good quality customer experience.

3.1 *Clear contractual terms.* We have experienced aggressive win-back practices by our competitors which have led to many SME customers changing their minds about switching. Our research also indicates that many potential customers are also dissuaded from changing suppliers owing to contractual technicalities i.e. not following the correct procedure set out in the contract or missing contract renewal windows.

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<sup>3</sup> The role of Third Parties Intermediaries in the UK Electricity and Gas Retail, Datamonitor, July 2005.

It is important that companies make their contractual terms clear, and that in particular the contract length and termination fees are fully transparent and cost-reflective.

- 3.2 *A review of industry processes regarding change of supply.* As noted above, there are a number of issues around industry processes relating to change of supply which ought to be improved. In this respect, Ofgem may wish to reconsider whether I&C gas suppliers ought to become parties of SPAA.

**EDF Energy**  
**January 2006**