

OFGEM'S PROPOSED CORPORATE STRATEGY AND PLAN 2008-13

FPAG welcomes Ofgem's probe into energy supply markets. This will obviously have a major impact on Ofgem's strategy in a number of its activities.

The references, in the Ofgem Press Release about the probe, to customers who do not pay by direct debit and online are very helpful. On the other hand Ofgem in the press release and in some of its comments yesterday gave the impression that it is simply carrying out the probe because of public pressure and that it is not convinced of its value. We hope very much that the probe will be rigorously objective and will face up to any difficult issues, if the market is not working well in some respects. We wish Ofgem well with the challenges of the probe!

On one specific point, we would urge Ofgem to look at the whole supply chain [or most of it]. The supply companies are all to a significant degree vertically integrated and it is not adequate to focus just on the supply company parts of the business, and just on the retail-wholesale price relationship.

Our recommendations below in the sections on tariff differentials and on the level of prices can be taken as areas for examination in the probe. But there are also a number of points in the note below on other issues.

Tariff Differentials

This is the key Ofgem issue for us. The current position is shocking, certainly not improving, both for prepayment – direct debit/online; and for standard credit – direct debit/online. The gap between prepayment (both fuels) and online is now on average over £200 pa, between standard credit and online it is £180 pa, and between prepayment and direct debit offline it is £125pa. Either some companies are making very large profits from their prepayment and standard credit customers, or they are making losses on their online customers. Whatever the technical description, prepayment and standard credit customers are in practice subsidising direct debit and online customers.

Ofgem should make these differentials a special project and should devote far more resources to this issue. It is understood that many of Ofgem's other activities are relevant to fuel poverty, but the budget for fuel poverty of £0.4m pa (just over 1% of Ofgem's total budget and 2% of its operating activities) seems extraordinarily low. Specific actions, which in our view Ofgem should pursue, include:

- Ofgem should assess the relationship between relative prices and relative costs and for companies where prices and costs are far out of line it should consider whether further action – legal, regulatory, guidance, persuasion – should be taken.
- The companies have obligations in their Licences to provide specific payment methods. Ofgem will want to consider whether those companies who charge exceptionally high prices for some payment methods are in breach at least of the spirit of the Licence conditions and are virtually making a mockery of them. Ofgem will want to consider what action it could and should take.
- Similarly, Ofgem should investigate the indications that some prepayment customers are switching to a markedly worse deal, and should proactively consider possible actions, e.g changes to sale practices, and obligations on companies by self-regulation or Licence changes to explain the position to customers.
- More support needs to be given, on the benefits of switching and on the best prices available, to organisations providing advice to low income customers. The

Proposed Strategy refers to (1.8) the June 2007 switching campaign. It would be helpful to have information on the impact and success of this campaign.

- The price comparison switching site should provide the same facilities for prepayment as for other customers.
- The debt blocking situation should be reconsidered especially, but not only, where the receiving company is willing to take on the debt. The problem of customers trapped by debt with a high cost prepayment supplier should be looked at seriously.
- We appreciate that Ofgem is supportive of smart metering (1.31), but there should be more emphasis as well on the important potential benefits for prepayment meters. There should be a determined drive by Ofgem (and Government) to secure the installation of modern “pay as you go” meters at the earliest possible opportunity.
- If progress is not made by other means, the size of the differentials should be re-regulated.
- On social tariffs and programmes strong minimum standards are in our view needed and Ofgem should re-examine this issue. It will also be important for Ofgem to build on its good work and to monitor the companies’ performance on a regular basis, taking account both of their social programmes and the prices charged to vulnerable customers.
- Ofgem in (6.11) says that the best means of protecting customers in terms of price and service quality is by ensuring that the energy markets remain fully competitive. No evidence is presented for this statement and competitive markets are not serving many prepayment and standard credit customers well. Ofgem should either be much more vigorous in ensuring that the market does work well for these customers or, if it cannot be made to function properly Ofgem should consider the alternatives in an objective way.

In response to the questions on Chapter 1 Page 2 and Chapter 4 Page 32, the Fuel Poverty Advisory Group does not believe that the strategy has identified all the relevant issues and that Ofgem’s approach is the right one. It is our view that Ofgem’s starting point should be that the current tariff differentials are unacceptable and that Ofgem will do absolutely everything in its power to reduce them. The performance indicators on this (and other relevant) points are exceptionally weak.

Level of Prices

In 6.1 it is stated that it remains Ofgem’s priority to help ensure that prices are no higher than necessary. It does not seem to us that Ofgem has been as tenacious on this as it should have been. In the light of the recent report by Cornwall Energy for the National Right to Fuel Campaign/Unison, Ofgem should in our view:

- Provide comments on the data in this report and set out the facts as Ofgem sees them. This seems to be an essential part of Ofgem’s job, shining a light on these important areas of concern.
- Assess, as far as is possible, the profitability of the supply chain and the different parts of it.
- Discuss the implications - are the increases in margins and resulting levels of profitability reasonable, or reasonable apart from the affects of EUTS, or not reasonable.
- Supply comments on profitability each year, perhaps along with the Ofgem review of the working of the market.

In this context Ofgem's focus on the windfall gains made by some of the companies from the EUETS and the desirability of using some of these for fuel poverty programmes is most helpful. We would encourage Ofgem to make an assessment more generally of profitability in the supply chain and the different parts of it. It is acknowledged that there are difficult issues here, but at a time when many customers are suffering real hardship as a result of the higher prices, it does not seem reasonable that 1/3 of the price increases should be taken in increased margins. The balance is not right and it is important that Ofgem should make the data transparent and give its views on these issues.

Network Regulation

- There is a clear problem with the regulatory system and opportunities for securing benefits for customers are being missed. Companies and assets, especially electricity and gas distribution companies/assets, are being sold at prices well above their Regulatory Asset Values. The most recent example is United Utility's sale of its electricity distribution business at a price 45% above its Regulatory Asset Value.
- There can sometimes be reasonable explanations for high prices in such situations when companies are sold, but this has been repeated several times both in energy and water. It does not seem that the high prices are solely the result of the incoming companies over-paying or being able to reduce costs significantly.
- FPAG's comments on this issue were at first ignored and then brushed aside by Ofgem in the Gas Distribution Price Control Review.
- The balance between gains for shareholders and customers in these situations seems to FPAG to be wrong. This is particularly important at a time when customers are facing very large price increases. Some of the gains in these situations should therefore be returned to customers in the form of lower prices after the sale or via fuel poverty programmes.

If it is true, as Ofgem claims, that they do not have the power to secure some of the gains for customers, then Ofgem should strongly support FPAG's proposed small change in Ofgem's duties to fill the gap in Ofgem's ability to act in customers' interests in these situations, exposed by the United Utility and National Grid sales.

Vigilance

Ofgem should be extremely vigilant in protecting the interests of low income customers. Ofgem only took action over (predominantly) low income customers with token meters being back-billed for debts about which they often knew nothing – after a concerted campaign by Energywatch, Citizen's Advice and MPs. It is understood that Ofgem will, in many cases, rely on others for information about developments on the ground, but it should be more proactive in picking up and working on the issues.

Building on Good Areas of Work

In a number of activities Ofgem's work has been most useful and it will be helpful if Ofgem continues and builds on these:

- Social Tariffs (referred to above)
- Promotion of energy efficiency (6.1 and 6.15)
- Role in the development of EEC/CERT/Supplier Obligation policies especially social obligations (6.15)
- Contribution to policy developments more generally, especially carbon reduction policies

- Monitoring of debt and disconnection policies and promotion of best practice (6.16)
- Gas Network Extensions (6.19) – to ensure as far as possible that the maximum use is made of the provisions and monitoring of their implementation.

Conclusions

In conclusion, we think that Ofgem should:

- Work tenaciously to keep prices as low as possible
- Secure major reductions in the very large tariff differentials
- Drive for low cost pre-payment meters
- Ensure that customers' interests are adequately protected in the network price controls
- Continue to contribute proactively to the consideration of social tariffs and programmes and to monitor the companies' programmes
- Help to ensure that maximum use is made of the provisions for gas network extensions in the Gas Distribution Price Control
- Continue to play an active role in the development of CERT and in the Supplier Obligation, especially the provision for low income groups
- Support the small change in Ofgem's duties to fill the gap in its ability to protect customers exposed by the sales of network subsidiaries
- Continue proactively to contribute to the development of policy – especially the development of carbon reduction policies, to help to ensure that they are as cost effective as possible and that any gains from the policies are shared reasonably between customers and companies
- Ensure that companies' debt and disconnection policies are the best possible.