No Hot Air is webblog that concentrates on energy and carbon reduction for SME and all business users in the UK market.
We found it unfortunate that Ofgem only released it's own research from the Energy Probe on the last business day before the end of the consultation period. The research appears to be at odds with the Ofgem finding that of a market operating to the benefit of both domestic and businessend users. Having made this observation, we can understand better and fully supportall of Ofgem's action points, and welcome them all as positive steps to promote true competition and true value for consumers.

We especially welcome Action 2

An easy-to-understand price metric is vital, but fear that that easy-to-understand and easy-to-implement are mutually exclusive given the existing industry of confusion marketing from suppliers, TPIs and web switching sites with a vested interest in making energy more complex than it already is.

Chief among the issues is that consumers have been lead to expect easy answers in the form of longer-term prices that cover all times of use. TOU is vital to full and efficient price discovery and any metrics have to take that into account. This will necessitate an education program for end users to help them to abandon previously held concepts that are now outdated.

There are of course already daily balancing indices available for both gas and electricity from a variety of sources: National Grid, Heren, ICAP, Spectron etc, etc. These matrices are already used for price discovery in larger commercial sites; extending them to smaller sites is far less problematic than suppliers may make out, especially for gas supply. Many TPIs will no doubt object, as it disrupts their business model.

Ofgem may also need to consider that wholesale indices do not accurately reflect long-term gas purchase arrangements from domestic suppliers, and there may possibly need to have separate domestic and commercial matrices.

A major change for consumers is that price metrics will have to change monthly to reflect true energy costs.

Many SME and domestic users are divorced from understanding energy basics such as seasonality and prices. End-users simply have to get away from an emphasis on fixed long-term prices (which more properly belong in the realm of insurance than energy) and be provided with monthly prices that fluctuate in line with market basics such as supply and demand balance and energy commodity prices.

It must be considered in this respect that worldwide, floating prices are the norm in both domestic and commercial markets. Millions of consumers throughout North America see gas and electric rates change monthly as a matter of course. A new choice architecture based on default options will assist UK consumers in joining the rest of the world in paying for energy when used.

When consumers are armed with both accurate metering and the incentives of wholesale dynamic price options, they can be expected to be more aware of energy costs and act accordingly. The impact on UK carbon targets could be quite considerable as a result.

UK consumers prior to competition also had dynamic tariff prices, but these did not fluctuate as much as today for a variety of reasons connected to the monospony suppliers operating in a completely different pre-globalisation arena. Another key reason why prices did not fluctuate was the UK peculiarity of quarterly billing, another unique characteristic of the UK market not unconnected to the lack of reliable metering. Quarterly payment, and dumb metering comes from, and belongs to, the nineteenth century.

SME customers from 1992 onwards were suspicious of the benefits of competition and a fixed annual, or longer, price addressed fears that initial savings would evaporate. A more preferable method may have been for suppliers guaranteeing percentage savings against tariff prices, as used in North America and Europe today. Once British Gas price controls were removed this was no longer an option. In a world of collapsing oil prices long-term options were big money makers for suppliers, but their worst impact was in causing end-users to equate competition with falling prices, whereas the reality was that it was mostly coincidence. It became part of the mental furniture among consumers that competition caused low prices, and neithersuppliers, TPIs or it must be admitted Ofgem, wanted to disabuse anyone of their misconceptions. Suppliers bought market share, TPI's made, and make still, a fortune for little or no effort and Ofgem had a rationale for existence. End users thought it was Christmas for several years, with the majority not knowing that fixed prices hid even lower monthly floating prices.

By concentrating on fixed prices as opposed to the floating prices that underpinned them, end users decoupled energy price from energy use, and for most domestic and SME customers this is still the case.On the other side, larger sites have been able to access wholesale market prices for some years. The savings from fixed to floating can be substantial, as spot prices are based on reality. Longer term prices depend on fear: of supply shock, extreme weather, political risk and any number of potential drivers of high prices. We find end-users rely on the mainstream press for a view of energy, a view unrelentingly pessimistic and sensationalist. TPIs in common with many suppliers were particularly pessimistic in summer 2008 and locked in many customers for two to three years at historical highs. We have no idea of the outcomes of such decisions will be in the future, but the immediate outturn in Q3 2008 has been disastrous: Compared to fixed prices, October and November 2008 power and gas indices were 45% lower than fixed term rates. Many smaller SMEs may be forced into redundancies or bankruptcy as a result of both high costs and being unable to compete with more nimble competitors. The nimble competitors are often larger competitors simply because suppliers will not give index prices to smaller volume sites.

Fixed monthly DDs make it difficult to concentrate on actual use, while at the same time causing outrage among customers when they see, as happened this year, the monthly DD double or triple. On a monthly DD, the amount is roughly equivalent to energy used four month of the year. For the remainder, four months are spent taking what is effectively a loan at an exorbitant interest rate and the final four paying that interest with an additional interest free loan to the supplier.

Consumers internationally know that when the heating is on, or it gets dark in the evening one has to pay for it. UK consumers don’t pay for what they use until many months or yearslater when the DD is adjusted. Apart from anything else, this provides very weak incentives for conservation and/or efficiency. When the impact of efficiency savings only reveals itself months afterward, the case for the investment is weakened.

NHO propose two very simple ways for SME and all commercial users to cut energy costs:

Pay As You Go based on monthly floating prices: commodity + transportation+ margin.
Pay on use, as used, on either smart or automatic meter reading.

With a redefinition of the choice architecture, and some solution being found to the overhang of energy debt domestic users find themselves under, this simple process can be applied to domestic users as it is for example to millions of National Grid customers in the USA. This is different. It is not rocket science and it works for the majority of utility models internationally. In fact it is the UK that is out of step and both domestic and SME customers do not operate on a level global playing field as a result.

A floating price, default option will agree with the further Action 2 points by simplifying supplier’s sales and marketing activities and further promoting smart meter roll outs.

This approach will certainly encounter resistance from the TPI sector and switching sites as they thrive in the current “confusopoly” environment.

NHO fully supports Action 4. The switching process appears to us as a pre-digital anachronism and should be as fast as switching supplier or porting numbers in the telephony sector.

TPIs need to be as regulated and transparent as other financial services. We predict that if TPIs had to operate with regulation similar to those of mortgage brokers in regard to how they get paid, and highlighting the number of suppliers and products offered, many would cease to exist. Certainly any consumer of mortgage or pension products would look askance at any one who refused to offer tracker products for example. In an international context the obvious connections between prevalence of default options and absence of a TPI presence of any size must be highlighted.

In short, we believe that TPIs have a vested interest in maintaining many of the current energy market inefficiencies that Ofgem has noted.

Finally on Action 5, we point out the issue of price discrimination in the SME market.

SME customers find themselves the victims of double discrimination in respect of the generally lower domestic rates available without long term contracts and the type of products larger users can access.

SME users are often refused access to tracker products by almost all suppliers. Tracker products are common-place among larger customers or for sites part of a larger portfolio. This is an additional barrier to entry for SMEs in that they are denied any choice except to take fixed long term prices. The lack of tracker products for smaller commercial energy users is directly related to TPI penetration in the market place – no one will pay a TPI for a default option, or at least not for very long. Some suppliers have a don't ask, don't tell attitude towards trackers. The usual response to end users who ask is to deny they exist for customers who aren't daily metered or use at least £50K per year and up.

This explains why, according to British Gas quoted by Channel 4 in June 2008, they have 2,500 tracker product domestic customers out of several million! It appears to us that either the product is simply not sold, or is among the most unsuccessful product launches of all time. The only logical conclusion we can come up with is that it is promoted only to Centrica employees. They are more likely to understand the implications of the scheme, but BG derives some value by being able to use the tariff’s existence to convince Ofgem of innovative pricing strategies. Certainly the probe mentioned trackers as existing but, we were recently unable to see any domestic or SME tracker products on offer on websites of British Gas, EdF, npower, Eon or Scottish and Southern Energy and Atlantic Energy. Similarly we have been unable to find any domestic switching site which provides any tracker product.

A commonality among our experience, Ofgem's own studies and that of organisations such as the late, lamented energywatch, is that consumers do not participate in the market primarily due a lack of information.

Ofgem has squandered many years denying what it's own recent research confirms: market forces in isolation do not provide efficient outcomes.However, the proposed actions would be as welcome as they are late and we hope that a minimal delay in their implementation will occur.

Regards

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