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Dear Neil,

RWE npower's response to Ofgem's Energy Supply Probe – Initial Findings Report

Overview

1. We sympathize with the position of our customers when confronted with the heavy increase in costs which they have experienced recently. Pressures from primary fuel, environmental and network costs have never been greater. Against this background, it is unsurprising that a number of mis-perceptions have gained currency. We therefore welcome the Ofgem Energy Supply Probe as an opportunity to clear the air and establish the facts.
2. In particular, we note that Ofgem has found that the retail market is competitive and retail profits are far from excessive. In addition, contrary to some allegations, retail prices do not follow rises in wholesale prices more quickly than they follow reductions.
3. Of course, in any market there is always room to improve its operation. We set out below our own thoughts on the issues raised in the Report. We look forward to working constructively with Ofgem to identify workable and effective improvements. At npower we will be working hard to ensure that customers are well-informed about market developments and have the information to make choices best suited to their needs.

Introduction

4. RWE npower is a strong advocate of the competitive market and sees this as the best way to contain costs and to promote innovation and choice for customers. We support the remedies designed to make the market work even better by improving transparency, customer information & understanding and customer engagement. This leads us to be broadly supportive of all the proposals other than on debt blocking, market abuse and a prohibition on undue price discrimination or a relative price control licence condition.

5. We set out our response to specific remedies in terms of the sub-headings in bold, which we have numbered, in the Remedies section.

R1 Clearer information on customer bills, R2 annual statement, R3 annual prompt and R8 easy-to-understand price metric

6. We support Ofgem's R1 and R2 proposals; npower already provides the name of the tariff on all bills and details of average daily consumption for the current billing period compared to the equivalent period where available for Residential customers and provides information by telephone to small business customers.
7. For Residential, we propose:
- Provision of additional tariff details on joining or moving to tariff and then yearly or on changes to terms or charges (for R1). For example, at points throughout the customer journey, customers will be made aware of the SOL (Sign On-Line) tariff that they are on;
 - Additional historical annual consumption information will be possible once we have replaced our customer data and billing platform and in the interim we propose to meet this objective through an Annual Statement; and
 - The Annual Statement for Residential customers combines R1, R2, R3 and R8 along the lines of the draft information brochure we provided to Ofgem.
8. The Annual Statement for Residential customers would:
- Use Ofgem's updated low, medium and high approved consumption measures. We have suggested in the draft information brochure given to Ofgem a "look up" table to help the customer to identify his/her consumption levels which we would hope that Ofgem will be able to develop, based on typical household profiles and/or testimonials, into an industry standard (R1 & R2);
 - Set out the annual bill costs of such users by standard tariffs for different payment types and so indicate the potential savings by switching between them (R1 & R2);
 - Set out the pros and cons of each payment type as well as information on switching (R3);
 - Provide the information for an easy to understand price metric (R8) on key tariff types by Ofgem's approved measures of high, medium and low consumption for each region in an agreed format; and
 - Provide a means to offer customers information on saving energy through energy efficiency measures.
9. Additionally, we propose that suppliers are permitted to tailor the content and provide information on other tariff types, such as fixed price or green, as well in their Annual Statements. We would also suggest that it includes safety information as in our draft information brochure.

10. We are happy to discuss with Ofgem an equivalent document, *mutatis mutandis*, for the small business sector.
11. To help evaluate on-line offers, we propose an industry standard such that:
- The minimum period for any open ended introductory discount should be stated explicitly;
 - The period for any fixed duration introductory discount should be stated explicitly (in much the same way that savings accounts do) or any introductory discount should be expressed as an explicit cashback offer; and
 - Savings calculations used by companies and switching sites should separate introductory discounts and cashback offers to enable comparison on an enduring basis.
12. The ERA could be the vehicle for progressing these proposals.

R4 Promote confidence in price comparison and switching sites

13. In particular in relation to residential customers, we support these proposals to overhaul the accreditation procedures and create a code of practice to raise the standards of switching sites by providing:
- customers with advance information on sales commission;
 - comparisons between all suppliers and products irrespective of commission;
 - a facility for the user to select the basis of rankings;
 - an indication of where savings can be made by going to the supplier direct;
 - definitions and identified time-limited introductory offers; and
 - clear customer guarantees / indemnities.
14. In addition, we would suggest establishing a flagship comparison site, possibly under the auspices of Consumer Focus, which could include switching capability on a 'not-for-profit' basis or where the profit goes to an energy charity.

R5 Simplify the supplier switching process

15. We support the objective and propose:
- An obligation on the new supplier to resolve switching issues on behalf of the customer. For example, where the customer continues to receive bills from the old supplier, this would be resolved by all suppliers having dedicated teams;
 - Steps to promote customer confidence that they will not be exposed financially if they switch through protection measures including the DD guarantee and the Ombudsman scheme;
 - A focus on redesigning switching processes and settlement systems to future-proof smart metering rather than on short term piecemeal sticking plasters; and

- For small business, process improvements based on:
 - improved process information for the customer;
 - mandatory confirmation of customer and standing data; and
 - consideration whether to make the objection reason visible to the receiving supplier.

As already stated, the timing of these initiatives depends on our Atlas and smart metering programmes.

R6 Debt blocking

16. The current arrangements work well in as much as only about 5% of transfers are blocked due to debt. We will send Ofgem data to substantiate this view. Furthermore, the provision of social tariffs and the option of prepayment meters, where payment type differentials are set to fall, distinguish between the “can’t pays” and the “won’t pays”.
17. We are concerned about the potential malign effects of customers being allowed to leave their debts with the old supplier of:
 - Costs borne by those who manage their financial affairs responsibly
 - An increase in unpopular customer unfriendly procedures, such as: quicker debt chasing, more customer credit vetting and more security deposits.
18. We also propose consideration of options where customers falling into debt could be prioritized under the roll-out of a national smart metering programme.

R7 Customer awareness programme

19. We support these proposals. On the sustained customer awareness programme we would be happy for Ofgem to do more and we hope that our proposals on clearer information on bills and the Annual Statements will make an important contribution to this objective.

R9 Suppliers’ sales and marketing activities

20. We support strengthening the rules governing such activities and propose:
 - Implementing enhancements to processes along the lines already implemented by npower e.g. 100% point of sale verification, mystery shopping, and quality based bonuses; and
 - Introducing comparison with current supplier(s) prices.
21. We note the following practical issues:
 - Lack of complete information on all suppliers’ current and historic tariffs;
 - Cost and time to roll out enabled handheld devices with the required functionality;
 - The need for a range of approved confirmation options for POS and follow-up contact: electronic, voice record, written;

- Consumption data will be notional unless customer provides alternative; and
- Comparison will be based upon and contingent upon customer advice regarding current supplier and tariff.

R10 Roll-out of smart meters

22. We are delighted that Government is intending to mandate the rollout of smart meters to all residential customers and micro-businesses & sites (with the exception of group accounts). We would endorse the engagement of Ofgem in making this happen.
23. Key to the effective roll-out and to ensure significant benefits are achieved is the development of the most appropriate market model. npower has always supported the need for a managed and co-ordinated implementation programme, for example the Regional Franchise approach which provides full interoperability and facilitates a consistent dual fuel installation activity. This will deliver benefits through the simplification of industry processes, development in settlements, network charging and management as well as providing a stable and consistent infrastructure to deliver new products and services to support consumers in their management of energy usage.

R11 Review regulatory obligations

24. We also support a review of regulatory obligations to facilitate new entry provide that it did not discriminate in favour of specific suppliers and covered protecting existing suppliers from the costs arising from other suppliers' defaults.
25. Our proposals would be to:
- Fix network and BSUoS charges in advance to reduce supplier risks;
 - Remove GS/OS as this has been superseded by the statutory complaints arrangements; and
 - Address uncertainty from further unpredictable social and environmental obligations.

R12 Separate regulatory accounts

26. We agree that any published information should be on an aggregated annual basis as Ofgem has recently indicated. RWE npower would be prepared provide financial information, which we would regard as commercially confidential, on a similar basis to that provided for the Energy Supply Probe in order to assist Ofgem to monitor the market.

R13 Wholesale market liquidity

23. RWE npower is committed to enhancing liquidity in the wholesale markets and will be pleased to work with Ofgem on the issues relating

particularly to the electricity markets. As evidence of that commitment RWE has been leading, amongst other things through the involvement of Paul Benyon (Head of UK Power Trading, RWE Supply & Trading), as Chair of the Futures and Options Association Power and Trading Committee, the development of clearing and other infrastructure services for the trading of prompt power. The purpose is to enhance transparency through the forward price curve, reduce bilateral counterparty risk, facilitate financial trading to manage price volatility and deepen market liquidity and participation. We are pleased to advise you that a milestone was reached in the development of that project on 27 November when the Futures and Options Association announced the Nasdaq OMX Group and the Nordic power exchange Nord Pool Spot AS. as the recommended market infrastructure provider.

24. We have attached to this response the full Press Release. Peter Kreuzberg, Managing Director, RWE Supply & Trading, also commented specifically:
“RWE hold a long and deep commitment to improving transparency and liquidity in energy wholesale markets. Establishing a solid foundation for growth in liquidity is a requirement for the UK as it seeks to expand wholesale volumes, which have lagged behind the growth rates of its European neighbours over the last 3 years. The FOA process which has now reached a recommendation for a global provider of exchange services has been a necessary part of the wholesale market's evolution, combining a market structure (designed by all parts of the value chain) able to provide services to the UK over the long term with a high degree of consensus among the participants. We are delighted to have reached the end of the selection phase, and we will continue to support the process and look forward to a successful delivery.”
25. We note APX's day ahead market exchange that opens on 2 December, which may help to improve liquidity in the short term and further interconnection with France and the Netherlands in the long term.
26. The difficulties potential entrants face are low retail margins and difficulty demonstrating sufficient credit-worthiness – RWE Supply and Trading has discussed and offered trading services with small suppliers on the same basis as it provides them to npower.

R14 Additional powers to guard against potential market abuses

27. The purported reason for Ofgem's proposal is the increase in BSUoS charges and to anticipate future changes to the system such as a greater share of intermittent generation and more system constraints.

28. However, Ofgem has not demonstrated that there is a problem which needs to be solved. As such, any attempt by Ofgem to introduce a new licence condition to address some hypothetical and unspecified future problem would breach Ofgem's statutory duty (Electricity Act 1989 section 3A, subsection (5A)) to have regard to the principles of better regulation and, in particular, the principle that regulation should be proportionate to the problem it seeks to address and targeted only at cases in which action is needed.
29. Ofgem's current proposal mirrors closely the market abuse licence condition (MALC) which Ofgem implemented in 2000. This condition was referred to the Competition Commission (CC). The CC rejected the condition, inter alia, on the grounds that:
- The condition was insufficiently rigorous in respect of its assessment of the impact on competition. In particular:
 - It did not address itself to the impact of potential competition;
 - It made no attempt to define the relevant market; and
 - It made no attempt to establish that prices had been raised above the competitive level, but simply inferred abuse from raised prices;
 - To the extent that Ofgem's concern related to the exploitation of market rules, Ofgem could change the market rules;
 - The MALC would increase regulatory uncertainty for generators and deter normal competitive behaviour; and
 - The imminent introduction of NETA should address many of Ofgem's concerns.
30. Nothing in the intervening years has undermined the force of the CC's reasoning. Rather it has been confirmed and reinforced.
31. The CC's concerns are particularly relevant in the current context: a more general power than those provided under existing competition law raises particular risks in the present political and media climate of being used to suppress competitive market prices. Many stakeholders have made an equation between primary fuel costs and retail electricity prices. In fact, there is a widespread expectation that the market will tighten significantly in the coming months and years. In our energy only market, one would therefore expect increases in the capacity element of prices which could offset any impact from falling primary fuel costs. Although Ofgem has not fallen prey to the simplistic thinking which ignores the value of capacity, there is a risk that Ofgem may be pressured into an inappropriate use of a MALC if it existed. Even if Ofgem were able to resist this pressure, as noted by the CC, there can be no guarantee that companies will not distort their pricing decisions for fear of the application of the MALC. Such decisions would ultimately prove contrary to the public interest as they will fail to remunerate plant and deter much needed new investment.
32. NETA/BETTA has now been in force for some six years. Under these market arrangements, there is no evidence justifying stronger powers.

We note that Ofgem is investigating the bidding of the two Scottish generators under its Competition Act powers. If it can be demonstrated that the Competition Act takes too long to bring effective relief then this is an economy-wide issue requiring revision of competition law generally and not specific provisions targeted solely at energy regulation.

R15 Helping small business customers – terms and conditions

33. As you will be aware from our previous correspondence (6 June, 10 July 2008) and response to your recent request for information on terms and conditions (25 November 2008), we already fulfil these requirements by:

- Writing to customers in advance of their contract renewal date with details of our offer for the next contract period which also will act as a reminder for the customer to test the market should they wish to;
- Having SME (including small business) Terms and Conditions on the website;
- Having FAQs about Terms and Conditions, suggested by the Ofgem non-domestic working group, with answers on the website;
- Providing copies of the FAQs with sales confirmation literature and with renewal letters; and
- Providing full information access via customers' preferred engagement channel – telephone.

R16 Helping small business customers – objections

34. We would support the proposal for a code of practice given an explanation of the motivation and its specification as we consider the current arrangements are adequate for the following reasons:

- The contractual right to object to transfer “in contract” can be an efficient way to resolve risks between customers and suppliers;
- To the extent that problems have been caused by lack of clarity over contract termination arrangements, these should be addressed by remedies under terms and conditions;
- There are clear rules governing the objections process set out in the licences and MRA. For example, in 2007, Ofgem implemented new arrangements which outlawed the practice of contracting during the objections window with customers on deemed or tariff contracts.

R17 & R18 Helping small business customers - accreditation scheme for switching sites and a code of practice for Third Party Intermediaries (TPIs)

35. We would support enhanced regulation of TPIs who deal with small businesses. This might include the implementation of an accreditation scheme and/or industry code of practice. We have concerns that the status quo is not conducive to fully effective competition.

R19 Payment types must be cost reflective

36. We support the proposal that differences in tariffs for payment types should be cost reflective. We are reviewing our pricing structure and, in particular, looking at two matters recently raised by Ofgem:
- The possibility of a standard price differential between PPM and DD irrespective of consumption level; and
 - Ways of better allocating bad debt costs amongst Standard Credit customers.
37. In implementing cost reflective pricing, the following factors should be recognized and allowed for:
- Cost differences are dynamic and for pricing purposes should wherever possible be based on forward looking costs and risks, not historic costs e.g. our forward looking assessment of bad debt costs;
 - Pricing differentials are also dynamic reflecting changing views of customer value, competitive pressures and market strategies;
 - Some cost differences vary with the level of consumption (e.g. debt) whereas others do not;
 - Implementing npower's proposals on greater clarity of online discounts will support the general aims of Ofgem's remedy, by avoiding an initial discounted rate being misconstrued as an enduring pricing differential for online servicing;
 - Such a licence condition could stymie the competitive market if rigidly applied. For example, where one supplier achieves competitive advantage over its rivals e.g. by developing a low cost technology for one payment method, in a competitive market it would expect to keep some of the innovation value in the form of improved competitive position until its rivals caught up. The Ofgem proposal potentially undermines this normal competitive process which creates the incentive to innovate and to build on supplier strengths; and
 - A rigid straight jacket of price differences would erode the scope for differentiated competitive strategies, making companies and products increasingly homogeneous, which reduces the incentive for customers to participate in the market.

R20 A prohibition on undue price discrimination

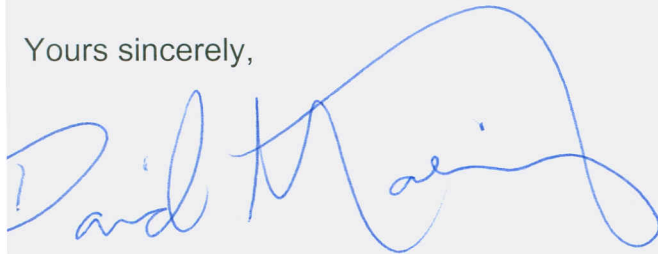
38. We are not convinced that such a licence condition is the best way to address the issues raised by Ofgem as:
- Competition is working:
 - npower's in-area market shares are eroding and price differentials declining; and
 - our business plan projects that gas and electricity margins will converge;
 - The remedy would have malign and unintended consequences:

- As it will bear unevenly on different market players with the effect of restricting and distorting competition both in terms of pricing flexibility and profitability;
- A condition of this form could act as a significant barrier to new entry; and
- Fixed margins over all propositions would destroy the competitive market.

39. In our view, an approach which is more consistent with Ofgem's Better Regulation duty is to allow the market improving remedies to take effect and to focus additional measures where is a clear, immediate imperative. We propose to introduce measures for those customers who may currently have more difficulty participating in the market. For example, we intend to:

- Enable PPM customers to switch to npower via our website;
- Ensure that our social tariff satisfies Ofgem's definition of a qualifying social tariff; and
- Review our arrangements for our off gas grid customers

Yours sincerely,



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RWE npower