Response to Supply Market Probe Initial Findings Report

Neil Barnes,

Firstly we would like to congratulate the Ofgem team on a very thorough analysis of the electricity and gas markets in Great Britain. However, we would also like to express concern over the time taken to carry out the probe and the likely time for any further action that may result from this consultation. The time issue is perhaps particularly poignant given that two companies that contributed to the initial probe are no longer in the market. It is very important to us that Ofgem now takes significant action within a timeframe that is meaningful to small suppliers.

I would hope that any further analysis could be more focused. Given that over 99% of the residential market is still supplied by companies that essentially inherited their customers it would be reasonable to start with the hypothesis that there IS a problem with regards to the proper functioning of this market. This is supported by the fact that these companies have apparently not made any money in their supply activity, which should also be a concern since at the group level they have been very profitable, and that they maintain higher prices in their historic territories than elsewhere.

The analysis presented in section 7 on the growing gap between competitive direct debit (DD) tariffs and other products demonstrates that the Big Six are able to price discriminate. The consequence of this is that the existence of an active minority section of the market is NOT protecting the majority of customers. Price differentials are not being competed away and big inefficient incumbent suppliers are not delivering as much value to consumers as they should.

In addition to not benefiting consumers in all market sectors, the pricing policies of the Big 6 (together with their ability to price discriminate) have had the specific effect of preventing new entrants from gaining customers. We presented information to Ofgem that clearly showed that at least two major suppliers changed prices in order to keep Utilita out of the market and without regard to cost (they cut retail prices when wholesale prices were rising). We also presented information that suggests that the cost to serve for new customers is significantly higher than for mature customers. When taken together with other customer acquisition costs (e.g. commission payments), these differentials are at least as high as the differences in cost to serve between DD customers and Pre-pay customers, and almost certainly mean they are loss making. Ofgem's own information relating to customer churn would suggest that those customers that have engaged in the market are price sensitive and probably switch regularly thus removing the potential for a supplier to make them profitable in the longer term.

In its written evidence to the Berr select committee (paragraph 7.17), British Gas dismissed the acquisition of on-line DD customers through its low priced tariff, which were estimated at 120,000 at that time (June 2008), as a niche product. It is important to recognise that 120,000 customers is more than the number supplied by the entire new entrant community. Preventing access to these active switching customers is therefore very significant in terms of the effect that it has had on limiting competition.

We believe this is evidence of predatory pricing.

We therefore ask that, as an interim measure, Ofgem introduces some form of relative price control on the Big 6 suppliers that restricts their ability to offer non-cost reflective differentials to different consumer groups. This would inhibit their ability to price discriminate, and at the same time ensure that the benefits of competition are passed on to all customers, not just the active minority. This is suggested in Action 5 of the Energy Supply Probe – Initial Findings.

We also believe that Ofgem should immediately enforce Action 3, the requirement for separate accounts for generation and supply businesses. This will provide further clarity on the allocation of profit between various activities of the major suppliers.

Regards

Bill Bullen

Director, Utilita

PRI House, Moorside Road
Winchester SO23 7RX

Response to Supply Market Probe Initial Findings Report #2

Nigel,

I have had some conversations with some people at Ofgem (Selvi Jegatheswara?) regarding our contractual arrangements around our smart meter product. A key issue for us is the potential for a stranded asset problem or customers that switch away just after we install our new meters. We have tried to cover this with a termination payment. The feedback we got is that Ofgem were happy with this, i.e. they understood the need for the termination payment and thought it was fair. However, in practice what this means is that customers switch away and because we cannot object they sleep walk into a termination payment that they can't afford (these are pre-pay customers and typically lower income households). In addition, in line with Ofgem's Probe, they have probably just switched to a more expensive tariff (in fact we know they have because we monitor prices and ensure that our pre-pay prices are the lowest in the region).

This isn't a great situation. A fuel poor customer has switched to higher prices and incurred a termination payment because of some mis-selling and a rule that says we cannot object to a CoS. Whatever the reasons for the "no objections" rule, I am sure that they were not intended to hit fuel poor customers in this way.

I would like a better way to manage the problem. What I would propose is that, for example, if I committ to ensure that our pre-pay prices are the lowest in a region then I am allowed to object to a CoS. Obviously if the customer has had the consequences of their decision explained to them and still want to switch away we would release them (otherwise it would end up with the Ombudsman and I don't want to go there). If you think this idea has legs could you get it raised in the context of the Probe consultation (unless it's not too late for me to do it – we did submit one response already but I didn't include this issue).

Regards

Bill Bullen

Director, Utilita

PRI House, Moorside Road

Winchester SO23 7RX