



Public Utilities Access Forum

Ofgem Consultation on : Addressing unfair price differentials

Response from the Public Utilities Access Forum

Public Utilities Access Forum (PUAF)

Founded in 1989, the Public Utilities Access Forum (PUAF) is an informal association of national consumer, charity and other organisations, which develops policy on the regulation of electricity, gas, communications and water services in England and Wales. PUAF facilitates the exchange of information and opinions between bodies concerned with the provision of those utilities to consumers with low incomes or special service needs, such as the elderly and people with mental and physical disabilities. It draws the particular problems of such consumers to the attention of the industries, the regulators and other relevant bodies, promoting the adoption of policies and practices which cater for their needs, exchanging information about service provision and promoting research.

Introduction

PUAF welcomes the opportunity to respond to this consultation. This response has been prepared by PUAF officers and a number of its member organisations will also be submitting their own responses. The responses from these different organisations will not be identical in terms of which options are favoured, but PUAF members are united in their view that there is the need for further action by Ofgem to tackle unfair price differentials.

PUAF has been raising its concerns about price differentials and the effectiveness of electricity and gas retail competition, particularly for many vulnerable households and those who use prepayment meters, since before price control was abolished in 2002. PUAF urged Ofgem to utilise a form of relative price control to protect prepayment meter customers at the time when Ofgem was consulting on ending price control in 2002. Since then PUAF has repeatedly raised its concerns about a number of the factors that were outlined in the Initial Findings report on the Energy Supply Probe published in October 2008.

Having been critical of Ofgem's unwillingness to take these concerns seriously in the past, PUAF welcomes the new rigour that Ofgem has applied to the Supply Probe and the proposals contained in the consultation. PUAF supports the remedies proposed in the Initial Findings Report that are oriented towards making competition work better through encouraging more consumers to participate actively in the market, improving the quality and accessibility of information available to consumers, and addressing inefficient barriers to new entry. However, the Report confirmed PUAF's perception that a significant proportion of customers (possibly more than 50%) are unlikely to become very active in the market, whatever further efforts are made and that low income and vulnerable customers are much less likely to do so than the better off. Remedies designed to boost competition could therefore take a considerable amount of time to have an impact. The prospects for new entry into the market also seem to be low for the foreseeable future. Therefore additional action to tackle unfair price differentials will be required.

The remainder of this response contains PUAF's views on the specific proposals on unfair price differentials contained in the consultation.

PUAF's preferred options

Although Option B has some attractions in terms of being able to deal with a number of different issues (e.g. in area versus out of area and payment methods), PUAF is somewhat more in favour of the introduction of Options A and C, as these will provide the combination of certainty for customers and companies, coupled with flexibility for Ofgem to deal with any changes in circumstances. With PUAF's additional proposal for Option A, this would also provide some protection for in area customers. If the provisions of Option A can be covered within Option C as a single licence condition then PUAF would support this simplification.

PUAF agrees that Option D may also be needed to deal with cross subsidy between gas and electricity, but recognises that a balance may need to be struck between achieving effective protection for all potential areas of consumer detriment and having too many licence amendments, with the risk of too much complexity and uncertainty for customers and suppliers.

Proposal A: Cost-reflective pricing between payment methods

PUAF supports this proposal and recommends that it should be extended to cover cost reflective pricing between different areas of the country. The purpose of this would be to ensure that "in area" customers could only be charged more than "out of area" customers if this was cost justified.

PUAF finds it difficult to see what the extra retail costs are of supplying a customer “in area” as opposed to one that is “out of area”. Indeed it seems likely that it would be cheaper to supply many in area customers for several reasons including :

- suppliers will not have incurred any acquisition and switching costs for in area customers who have never switched supplier (clearly there will be some such costs for those who have switched back)
- meter reading costs should be lower for in area customers as they will be more concentrated in certain areas than out of area customers thus producing some economies of scale

PUAF also notes that the Initial Findings report from Ofgem said that suppliers’ net margin earned on an in-area electricity customer during the period 2005 to 2007 was £36 a customer per year more than the equivalent out-of-area customer.(paragraph 7.40, p.83)

PUAF therefore takes the view that, unless differences in price are cost justified, customers should pay the same price for the same tariff (i.e. prepayment, standard credit, direct debit) irrespective of where they live.

The wording of the licence condition might be along the following lines :

“Any difference in terms and conditions shall reflect the costs to the supplier of providing supply in different geographical areas.”

Proposal C: Relative price controls

For all the reasons that Ofgem sets out in the consultation document, PUAF believes that relative price controls would be a transparent and relatively simple form of regulation that would provide certainty for suppliers regarding compliance and greater clarity for customers. Such an *ex ante* condition would also be easier for Ofgem to monitor and enforce than *ex post* measures. Relative price controls would provide suppliers with an incentive to become more efficient, and would provide them with the flexibility to price below the limit set out in the control.

PUAF recognises and accepts that a relative price control will take some time to implement and that there will need to be consultation on actual proposals, but believes this extra time will be worth it to have an effective and efficient control. However, PUAF is not sure why Ofgem thinks there would be a need for another round of consultation before proposals could be brought forward, which would add unnecessary delay. The next consultation should be on actual proposals.

Any price controls have the potential to impact negatively on competition and innovation. Ofgem suggests that this risk could be mitigated by providing headroom in the price limits. This means that customers on the price controlled tariffs would pay more than is justified by cost reflectivity so that potential new entrants would be able to enter and offer lower prices and/or the incumbents would be able to innovate. PUAF does not consider that such “headroom” would be justified in the initial 3 year period of the price control. However, if there is evidence of new entry and/or innovation being inhibited then it could be considered at the review stage for inclusion in the future, if continued price control is justified. PUAF takes this view because it does not think entry is very likely anyway in the next few years given the lack of entry in the last few years and the current economic climate. Scope for innovation will still exist despite the price control – e.g. through the internet, dual fuel, smart meters, green tariffs and ESCO packages.

Ofgem raises the concern that price controls could lead to an incentive on suppliers to reduce customer service to, for example, PPM and standard credit customers, if the premium they are allowed to charge these customers is limited. PUAF believes that this can be adequately tackled through licence conditions governing customer service.

Although Ofgem envisages that relative price controls might be applied to the “in area” differentials as well as the payment method differentials, PUAF is not convinced that there are any good (i.e. cost reflective) reasons why in area customers should pay more than out of area customers and therefore is not convinced of the merits of relative price controls in this case. Accordingly therefore PUAF recommends the extension of Option A to deal with the in area and out of area differentials, as noted above. This should provide an incentive to suppliers to provide fairer prices to in area customers. PUAF notes that some suppliers have already reduced these differentials during the Ofgem probe.

PUAF therefore recommends that Ofgem apply the relative price controls to standard credit and prepayment (linked to monthly direct debit).

PUAF makes the following responses to some of the specific questions raised about this proposal

- Length for each price control period – 3 years seems reasonable. There should be no sunset clause – Ofgem should retain the flexibility to review whether and in what form to continue with the price control depending upon developments.
- Under what circumstances should we allow the price controls to be re-opened? There should be no reopening unless there are some major problems that need to be addressed.
- Different consumption levels. PUAF assumes that retail costs probably do not vary much with consumption so it would be sensible to limit the difference to £x, regardless of consumption.

- PUAf favours a price rather than a revenue cap for the reasons that Ofgem itself has identified – i.e. a revenue cap could be less effective than a price cap in protecting specific consumers, and could have further unintended consequences.

Conclusion

PUAF would encourage Ofgem to proceed with licence amendments to address unfair price differentials, until competition becomes more effective. PUAf would expect these measures to provide particularly useful help to many low income and vulnerable customers. PUAf is happy to discuss the content of this response further with Ofgem if that would be helpful.

20 February 2008