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Dear Neil

Addressing unfair price differentials

Thank you for providing Scottish and Southern Energy with the opportunity to comment on Ofgem's proposals regarding the concerns it has identified following the energy market probe.

Our detailed response to the questions posed in the consultation is set out in the attached appendix.

We are disappointed that Ofgem believes that competitive pressures alone and the other remedies it has proposed, such as enhanced information and encouraging customer participation in the competitive market, will not address its concerns about unfair price differentials. Fundamentally, we believe that the established competitive market will determine whether a supplier has got its pricing strategy "right" and customers will switch if they feel that they are not getting a fair deal. In setting our prices we seek to strike a balance between cost-reflectivity and competitiveness in order to retain and gain customers.

We firmly believe that our tariffs are cost-reflective across the different payment methods and would vigorously dispute any allegation that customers have been adversely disadvantaged by our pricing policy. Having said that, following publication of Ofgem's initial findings report, we have reflected carefully on our pricing policy. We believe that the amendments that will be made once our recently announced price decrease has been implemented on 30 March 2009 will fully address any outstanding areas of concern that Ofgem might have identified with SSE's tariffs.

Notwithstanding the actions which have been taken by SSE, we have some sympathy with Ofgem's view that regulatory action is still necessary to improve customers' perception of the functioning of the competitive market and to restore confidence in suppliers' pricing structures. In this regard we are supportive of the overall objectives outlined by Ofgem in the consultation and, if Ofgem continues to believe that action is required, we consider that Ofgem must ensure that its proposed approach is appropriate and proportionate.

In particular, we agree with a broad-based non-discrimination condition with enforcement based on large, persistent discrimination "offences". Our preference is for a licence condition framed in this way as we believe that it will avoid placing Ofgem in the uncomfortable and inappropriate position of being *de facto* price setter. We also believe that it is important to ensure that any new regulatory framework does not conflict with the competitive market and would therefore continue to encourage supplier innovation and the development of new products to the benefit of customers. We therefore consider that this approach would be the most appropriate way of addressing the issues within the context of the competitive market.

We welcome Ofgem's suggestion that the proposed new licence condition could be time-limited and propose that following implementation Ofgem should undertake a review in, say 12 months' time, which would allow some of the wider medium-term remedies that are currently under discussion to play out.

In addition, we are supportive of the multi-stage enforcement process outlined in the consultation document and look forward to commenting on Ofgem's proposed guidance as to how it would interpret any new licence conditions. We consider that this approach would mitigate our concerns about the regulatory risk associated with the introduction of a non-discrimination obligation in the context of a highly competitive supply market.

I hope that you find our comments useful and constructive. Please contact me if you would like to discuss any of the points raised above or in the attached annex in further detail.

Yours sincerely

A handwritten signature in black ink, reading "Katherine Marshall". The script is cursive and fluid, with the first name and last name clearly distinguishable.

Katherine Marshall

Regulation Manager

Annex: Unfair Price Differentials: Detailed comments from Scottish and Southern Energy plc

Scope

The obligation should apply to all suppliers to the domestic sector, not just the "big 6".

We are supportive of the overall objectives outlined by Ofgem in the consultation and consider that it is important to ensure that any new regulatory framework does not conflict with the competitive market and would therefore continue to encourage supplier innovation and the development of new products to the benefit of customers.

Cost allocation

We agree with the overall principles that Ofgem intends to apply in order to assess cost-reflectivity. With specific regard to bad debt cost allocation, we believe that a reasonable approach is to allocate costs between different payment methods on the basis of the extent of the bad debt write-off by customer payment type. However, we recognise that a proportion of prepayment bad debt cost arises from uncollected standard credit debt and therefore our cost allocation model splits bad debt equally between standard credit and prepayment meter customers. Further details of our cost allocation models were set out in our submissions to Ofgem's information requests last year.

Social or environmental considerations

There are some forms of non cost-reflectivity which have been not only tolerated but positively encouraged by Ofgem and others which need to be considered in the round. For instance, SSE has a social tariff, energyplus Care, which meets Ofgem's July 2008 criteria in that it is the lowest price offered to a customer in a region irrespective of payment method. The social tariff, which offers a substantial discount against our standard prices, is clearly **not** cost-reflective and discriminates in favour of a certain group of customers. In addition, we are also under pressure to maintain prepayment equalisation with standard credit, develop tariffs which meet climate change objectives, as well as offering high export prices to microgeneration and low prices to dynamically teleswitched customers.

We therefore believe that Ofgem needs to consider how a proposed "no undue discrimination" licence condition might be framed to create exceptions to enable such "beneficial" price discrimination to continue. This will be necessary if the social and other tariffs described above are to remain available for suppliers to offer in response to competitive and other market drivers.

Materiality

We agree with Ofgem that there could be perverse consequences of specifying materiality thresholds to determine whether or not there has been a licence breach.

Enforcement

We agree that the "two-stage" enforcement process outlined in the consultation document is helpful and proportionate. We look forward to commenting on Ofgem's proposed guidance as to how it would interpret any new licence conditions. We consider that this approach would mitigate our concerns about the regulatory and compliance risk associated with the introduction of a new licence condition against the backdrop of a highly competitive supply market.

Duration

We welcome Ofgem's suggestion that the proposed new licence condition could be time-limited and propose that following implementation Ofgem should undertake a review in, say

12 months' time, which would allow some of the wider medium-term remedies that are currently under discussion to play out.

Proposal A: Cost-reflective pricing between payment methods

We do not support this proposal. We believe that this approach would require detailed guidance to be provided by Ofgem on "cost-reflectivity" and that there would be a significant compliance burden on suppliers. Ofgem must recognise that there cannot be absolutely rigid regulatory rules with regard to cost-reflectivity. When suppliers are setting tariffs they are looking forward and are attempting to predict and forecast a range of costs, such as wholesale energy costs, use of system charges and meter service costs. As a result, because these multiple factors need to be taken into account when setting prices, as soon as a supplier has set prices, they will inevitably become less cost-reflective as other factors change.

In addition, as Ofgem has acknowledged, there would need to be clarity on how suppliers should allocate costs between different payment methods. We consider that adopting this approach would be a significant retrograde step which would undermine the competitive supply market. We are concerned that it would deter the development of new and innovative products as a supplier would want to ensure that a new product satisfied the criteria before launching it in the market place. This would place the onus on Ofgem to effectively pre-approve new products with the inevitable delays which would be detrimental to the continued success of the competitive supply market and the interests of customers. We would also require Ofgem to produce clear unambiguous guidance on what would be acceptable.

B: Prohibition of undue discrimination

We agree with a broad-based non-discrimination condition with enforcement based on large, persistent discrimination "offences". We believe that adopting this approach will avoid placing Ofgem in the uncomfortable and inappropriate position of being *de facto* price setter. It would also ensure that any new regulatory framework does not conflict with the competitive market and would therefore continue to encourage supplier innovation and the development of new products to the benefit of customers.

C: Relative price controls

We do not agree with this proposal. We believe that if implemented it would not have the effect of addressing the concerns raised, nor would it meet the objectives Ofgem has highlighted. Instead, it would have the opposite effect to that intended and would lead to excessive involvement by Ofgem in tariff setting. In addition, there is a risk that competition could be distorted for particular customer groups if such an interventionist approach is adopted. This would, in our view, be completely undesirable and would inevitably have a significant adverse impact on competition and innovation. Ofgem should bear in mind that where it believes that a supplier's prices distort competition, it has recourse under its existing powers.

D: Prohibition of "cross subsidy" between gas and electricity supply

We do not believe that a prohibition of "cross subsidy" obligation is necessary or appropriate in the competitive market. However, if Ofgem is insistent on implementing such an obligation, we consider that similar measures in relation to "two-stage" enforcement and time-limiting of the condition should apply, for the same reasons as for the non-discrimination condition.