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20 February 2009

Dear Sir

### **Addressing Unfair Price Differentials**

This consultation response on has been prepared on behalf of The Salvation Army in the United Kingdom with the Republic of Ireland (TSA).

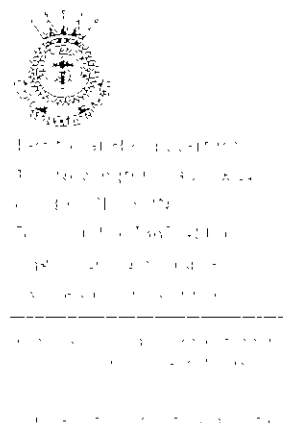
As a Christian church and charity, TSA's principal objectives are:

- the advancement of the Christian religion and pursuant thereto
- the advancement of education
- the relief of poverty, and
- other charitable objects beneficial to society or the community of mankind as a whole.

This means that whilst The Salvation Army is primarily a Christian church, it is also the most diverse provider of social care in the UK after the Government, striving constantly to put its beliefs into action in ways that engage with the needs of contemporary society.

We thank Ofgem for the opportunity to comment on proposed licence changes, building on responses to their Initial Findings Report.

We acknowledge that Ofgem's principal objective is to protect the interests of consumers, wherever appropriate by promoting effective competition.



In particular, we note that the Initial Findings Report referred to in the consultation document identified a range of instances of differential pricing that are of concern to Ofgem and offer our views with the aim of diminishing such differentials.

In summary, we recommend that:

Whilst the aims and objectives for addressing unfair price differentials appears to be comprehensive, there does not appear to be due regard to the delays associated with the processes proposed. Consumers, particularly the vulnerable, need to benefit from the observations made in the immediate to short term.

We would also advocate that expenses saved by the supplier on differing payment methods be redistributed to subsidise those payment methods which are most costly to the consumer. Being transparent by passing on the correct expense to the consumer is not enough and such terms are still discriminatory.

In terms of licence requirements, our preference is for a combination of the following:

- A. Cost-reflective pricing between payment methods
- B. Prohibition of undue discrimination
- D. Prohibition of “cross-subsidy” between gas and electricity supply

Our detailed response to the issues raised and accompanying rationale is set out over the following sections:

- approach to unfair price differentials; and
- proposals for licence requirements.

## **Approach to Unfair Price Differentials**

***2.2. We invite views on these aims and whether there are other issues we should focus on in taking a decision on the best way to proceed in this matter.***

Whilst the aims and objectives for addressing unfair price differentials appears to be comprehensive, there does not appear to be due regard to the delays associated with the processes proposed.

***2.6. Application of the proposed condition relating to cost reflective payment types would require us to set out clearly the approach that we would take to allocation of particular types of cost. We invite views on the appropriate approach to cost allocation including, in particular, allocation of costs of bad debt (which is relevant specifically in the context of a provision relating to cost reflective payment types).***

Cost allocation should include due regard for costs of bad debt, within agreed thresholds e.g. market testing.

***2.7. As well as considering cost differences, there may be a range of other potential justifications for price discrimination, such as social or environmental considerations. We invite views on whether these are appropriate issues to consider in relation to objective justification. We also***

***invite views as to how these exceptions might be captured in either licence conditions or guidelines.***

In our opinion, social and environmental considerations are both relevant and appropriate. There are published Government surveys of social and environmental status e.g. by postcode.

We suggest wording along the lines of “due account should be taken of customers’ social and environmental context as indicated by the most recent edition of definitive Government surveys. For example, the HM Treasury site in their Financial Inclusion Plan, (*Financial inclusion: an action plan for 2008- 2011*) that “It is not acceptable that anyone, least of all the most vulnerable members of our society, should face avoidable costs”

***2.9. We invite views on whether it would be beneficial to give a clear indication of materiality thresholds either on the face of any licence conditions or in guidance. While we see benefits in providing greater certainty, there is a risk that setting a lower limit to materiality might invite persistent low levels of undue price discrimination. On the basis that we would not seek to penalise a supplier unless there was a clear breach, we are currently minded not to specify materiality thresholds.***

In our opinion, these factors should feature in licence conditions, to be reviewed / updated regularly (in order to avoid persistent low levels of undue price discrimination)

***2.15. We invite views on whether it would be beneficial to introduce a new enforcement process for any of the proposed licence conditions set out in the document and, if so, whether that should be of the form set out here. We also invite views on whether there are any other considerations in relation to the detail of how such arrangements might work.***

We are in favour of the proposed enforcement process. However, consumers, particularly the vulnerable, need to benefit from the observations made in the immediate to short term.

***2.16. We invite views on whether the possible licence conditions set out in this document should apply to all suppliers active in the market for domestic consumers - or only to a subset of these suppliers, such as the Big 6.***

In our opinion, it would avoid unnecessary bureaucracy if the conditions applied only to the Big 6, representing say 80% of the market. However, it is important that the (unlikely) possibility a more fragmented market should not be overlooked.

***2.19. We invite views on our proposal to review any licence conditions and on what a suitable time period would be before such a review.***

Given our comments above, an annual review appears reasonable.

## **Proposals for Licence Requirements**

***3.4. We invite views on the relative merits of each of the proposals.***

Our preference is for a combination of the following:

- A. Cost-reflective pricing between payment methods
- B. Prohibition of undue discrimination
- D. Prohibition of “cross-subsidy” between gas and electricity supply

**3.12. We invite views on this proposed licence condition and, in particular, on the following issue:**

- *How would we best apply such a condition in order to minimise concerns over regulatory uncertainty and risks to competition and innovation?*

We are in favour of this condition (A). We suggest benchmarking e.g. relative cost comparison within the Big 6, with relevant reference to other utilities' costs e.g. water, communications.

**3.22. We invite views on this proposed licence condition and, in particular, on the following issues:**

- *How would we best apply such a condition in order to minimise concerns over regulatory uncertainty, and risks to competition and innovation?*
- *Are there other non-price issues we should specifically seek to take account of?*
- *Could this sort of prohibition be used to address instances of cross subsidy between gas and electricity supply – or would an additional condition, such as an explicit prohibition on cross subsidy, be needed to address this issue?*

We are in favour of this licence condition (B). Comparison and benchmarking is a key approach. It should take due account of social and economic contexts. Our preference is for an explicit prohibition on cross subsidy (D).

**3.34. We invite views on this proposed licence condition and, in particular, on the following issues:**

- *How would we best apply such a condition in order to minimise concerns over risks to competition and innovation?*
- *Which price differentials should be covered by relative price controls?*
- *How would we define the relevant benchmark tariffs by payment method and by geographical area?*
- *Would 3 years be a reasonable length for each price control period to last, after which time we would look to reset the differential limits (or should there be a firm sunset clause)?*
- *Under what circumstances should we allow the price controls to be re-opened?*
- *How would we take into account different consumption levels? Should the limit in relation to payment methods be expressed in a way that avoided the amount charged varying with consumption?*
- *Would a revenue cap be preferable to a relative price cap? This could involve a cap on the differential in terms of the extra revenue generated across customers as a whole for the tariff in question, rather than in*

*terms of the extra charge made to an individual customer on that tariff. While this could allow suppliers more charging flexibility within tariff, we have concerns that it could be less effective than a price cap in protecting specific consumers, and could have further unintended consequences.*

We are not in favour of this approach (C) – intuitively it would be unduly complex to implement. No further comment.

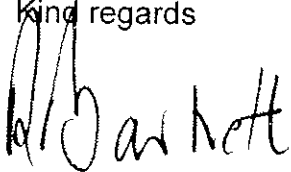
**3.43. We invite views on this proposed licence condition and, in particular, on the following issues:**

- *Are there alternative ways to address the sustained high margins earned on single fuel electricity customers?*
- *Should we specify what represents a significant implicit cross subsidy or, as we have proposed, rely on the principle of materiality in order to decide?*
- *Would it be appropriate, as we have proposed, to introduce a reciprocal condition to deal with potential cross subsidy of electricity supply from gas supply?*

We are in favour of this approach (D) and support Ofgem's proposed approach.

Please do not hesitate to contact me should there be any comment or queries at all on this response.

Kind regards



Royston Bartlett  
Lieut-Colonel  
The Salvation Army