

Guidelines on Cost Reflectivity between Payment Methods and the Prohibition of Undue Discrimination in Domestic Gas and Electricity Supply Contracts

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Target Audience: Gas and electricity suppliers, consumers groups and other interested parties

Overview:

The Gas and Electricity Markets Authority has decided to introduce two new domestic supply licence conditions, requiring cost reflectivity between payment methods and prohibiting undue discrimination in terms and conditions offered to customers. These licence conditions come into effect on 1 September 2009.

This document has been produced to provide relevant supply licensees with information on the way in which those conditions shall be interpreted and enforced. This document constitutes the guidance referred to in new Condition 25A.4 of the Standard Electricity and Gas Supply Conditions.

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Context

Ofgem's principal objective is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition. In keeping with this objective, we launched a study of the state of GB energy supply markets ('the Probe') in February 2008. Following the publication of our initial findings and subsequent consultations on proposed remedies, we gave notice of our intention to introduce two new domestic supply licence conditions requiring cost reflective payment methods and prohibiting undue discrimination on 26 June 2009. On 7 August 2009, following due process, the Authority directed that these new licence conditions come into force, with effect from 1 September 2009.

This document provides relevant supply licensees with information on the way in which we shall interpret and enforce the new conditions.

Associated Documents

- Addressing undue discrimination (72/09), 26 June 2009
- Addressing undue discrimination - final proposals (42/09), 15 April 2009
- Energy Supply Probe - proposed retail market remedies (41/09), 15 April 2009
- Addressing unfair price differentials (01/09), 8 January 2009
- Energy Supply Probe - Initial Findings Report (140/08), 6 October 2008

The above documents are available via the Ofgem website at the following location:

<http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx>

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1. Introduction

Background Purpose and Status of Guidelines

Background

1.1. Ofgem launched a study into the state of the GB energy supply markets ('the Probe') in February 2008.¹ The Probe focused on the functioning of competition in the electricity and gas retail markets for domestic and small and medium enterprise (SME) consumers.

1.2. On 8 January 2009, Ofgem published its consultation paper "Addressing unfair price differentials" as part of the Probe. Following consideration of the responses to that consultation document and subsequent due process, Ofgem, on 7 August 2009, modified the Standard Conditions of the Electricity and Gas Supply Licences. The following modifications were introduced, with effect from 1 September 2009:

- A new licence condition, 27.2A, requiring that any difference in the terms and conditions offered in respect of different payment methods is cost reflective, was added to Standard Condition 27 of both the Electricity and Gas Supply Licences. This modification is hereafter referred to as 'Licence Condition 27.2A'.
- A new licence condition, 25A, prohibiting undue discrimination between terms and conditions offered to different groups of customers, was inserted into the Standard Conditions of both the Electricity and Gas Supply Licences. This modification is hereafter referred to as 'Licence Condition 25A'.

Purpose

1.3. These Guidelines set out the principles Ofgem intends to take into account when interpreting and applying Licence Condition 27.2A and Licence Condition 25A; the Guidelines should be read in conjunction with those conditions. These Guidelines also set out the approach which Ofgem intends to take in deciding whether there is any "objective justification" when applying Licence Condition 25A.

1.4. Ofgem has introduced Licence Condition 27.2A to better reflect the contents of Annex A(d) of Directives 2003/54/EC and 2003/55/EC ('the EC Directives')² and address the detriment caused to consumers as a result of non-cost reflective differentials in payment methods applied by gas and electricity suppliers in the GB

¹ The terms 'Ofgem' and 'the Authority' are used interchangeably in this document. Ofgem is the office of the Gas and Electricity Markets Authority ('GEMA'), established under section 1 of the Utilities Act 2000.

² Directive 2003/54/EC concerning common rules for the internal market in electricity and Directive 2003/55/EC concerning common rules for the internal market in natural gas. Annex A(d) of the EC Directives provides: "Any difference in terms and conditions shall reflect the costs to the supplier of the different payment systems."

retail market ('Suppliers'). Licence Condition 27.2A is not intended to introduce any additional obligations beyond those imposed by the EC Directives. For consistency, Ofgem retains the term "payment methods", as referred to in the existing Standard Electricity Supply Conditions and the Standard Gas Supply Conditions, in Licence Condition 27.2A. For the purposes of interpreting and applying Licence Condition 27.2A only, Ofgem considers the term "payment methods" to be interchangeable with the term "payment systems" as referred to in Annex A(d) of the EC Directives.

1.5. Ofgem is introducing Licence Condition 25A to address other situations, in which certain groups of consumers may be losing out by reason of their inability to access (or difficulty in accessing)³ the same supply terms and conditions as other comparable groups of consumers. Licence Condition 25A is intended to operate for a fixed interim period only, to ensure that consumers are protected whilst the rest of the Probe Remedies Package takes effect.

1.6. Licence Condition 25A is not intended to diminish in any way the ability of Suppliers to innovate, roll-out or test new products, improve their efficiency or competitive advantage over other Suppliers or introduce initial or 'incentive' offers in a legitimate attempt to penetrate certain markets or acquire new customers. Further guidance on the recognised importance of such market activity is set out below in Section 4 on Objective Justification.

1.7. Assuming any apparently discriminatory terms and conditions offered by a Supplier cannot be objectively justified, then insofar as it is practicable, efficient and reasonable to do so, the intended purpose of the prohibition of undue discrimination in Licence Condition 25A is to ensure equal access to the same terms and conditions of supply for all comparable groups of consumers.

1.8. For instance, if and insofar as certain considerations render universal access for all groups of consumers to all terms and conditions offered impossible or impractical,⁴ Suppliers must instead ensure that comparable terms and conditions (ensuring any price differential is cost reflective) are offered to any groups of consumers who cannot, by reason of relevant personal circumstances, avail of certain terms and conditions offered. For the avoidance of doubt, in this context, it shall lie within Ofgem's discretion to decide on whether any given groups of consumers and their personal circumstances are sufficiently "comparable".

Status

1.9. Unless any particular guidance below is expressly stated to apply to only one of Licence Condition 27.2A or Licence Condition 25A specifically, these Guidelines are intended to illustrate how Ofgem will investigate potential contraventions of both.

³ Ofgem includes the existence of significant switching costs, including search and transaction costs and consumer perception of the difficulties.

⁴ For example, consumers without a bank account are unable to pay by direct debit.

1.10. These Guidelines are without prejudice to Ofgem's powers and duties under the Competition Act 1998 and any guidance issued in respect of those powers and duties.

2. Consumer Detriment

2.1. For the avoidance of doubt, both Licence Condition 27.2A and Licence Condition 25A seek to prevent material detriment caused to consumers by Suppliers and, in particular, detriment to vulnerable groups.⁵ Unless there is evidence of consumer detriment having resulted from any alleged contravention of either Licence Condition 27.2A or Licence Condition 25A, then any such breach is likely to be trivial and in such circumstances, Ofgem is very unlikely to enforce either Licence Condition. In assessing whether any such detriment has resulted, Ofgem will be guided by the Guidelines on 'Materiality' set out below in Section 5.

⁵ For definition and discussion of 'Vulnerable Groups' see Section 6 below

3. Definition of Undue Discrimination in Supply Under Licence Condition 25A

3.1. In respect of Licence Condition 25A only, Ofgem intends to apply the following test in determining whether undue discrimination has arisen in a particular case:

(i) If a Supplier offers terms and conditions of supply to one group of customers which are materially⁶ different from the terms and conditions of supply offered to any other group of customers; and

(ii) Ofgem considers that any such difference or differences in the terms and conditions offered cannot be objectively justified;⁷

Ofgem will consider that Supplier to be engaging in undue discrimination for the purposes of Licence Condition 25A.

3.2. For the purposes of the above approach and the remainder of these Guidelines, the term 'customer' will be interpreted in accordance with the definition of that term as set out and applied under the existing Electricity Supply Licence Standard Conditions and the existing Gas Supply Licence Standard Conditions.

3.3. The terms and conditions of supply of an electricity or gas product which Ofgem will assess when applying Licence Condition 25A include all the elements of that product, including price, contracted for service features and the terms upon which a product or service may be offered in conjunction with another product or service (e.g. dual-fuel offerings).

3.4. In respect of dual-fuel offerings, Ofgem will assess whether the inclusion or exclusion of other products or services offered by a Supplier in conjunction with another product leads to one or other product (whether gas or electricity) being offered at below cost price.⁸ For the avoidance of doubt, provision by any Supplier of a product with another product (whether gas or electricity) at below cost is very likely to be treated as undue discriminatory conduct in respect of those customers not offered, or not able to access, the second product in addition to the first product (e.g. customers who are "off grid" and unable to access mains gas).

3.5. Ofgem is concerned that these Guidelines should not restrict Suppliers' ability to innovate in the retail market.⁹ For the avoidance of doubt, time limited or "initial"

⁶ For guidance on 'materiality' see Section 5 of the Guidelines.

⁷ Relevant circumstances would include the costs of supply to a group of customer. For guidance on 'objective justification' see Section 4 of the Guidelines.

⁸ The relevant costs to be assessed are Suppliers' forward looking avoidable costs which are not covered by the relevant below cost price charged for a sustained period. See further guidance on Materiality at Section 5 below and Section 8 on cost allocation.

⁹ See Guidelines on 'innovation' under Section 4 on Objective Justification.

offers, innovative offers or new customer acquisition targeted offers are likely to be objectively justified, as explained below.

3.6. Similarly, if Suppliers offer innovative tariff structures on a non-discriminatory basis, Ofgem would not expect to challenge the principles of such tariffs, examples of which are set out below.

(i) Fixed price tariffs

3.7 Fixed price tariffs are by their nature only offered on specific terms for a certain period of time. Provided any fixed price tariff (which is not a time-limited or customer acquisition targeted offer, as discussed separately below under objective justification) were to be made available on a non-discriminatory basis to all comparable groups of customers at the time of offering, any difference between fixed tariffs and other tariffs, shall not be subject to assessment for objective justification, as the conduct in question would not be discriminatory.

(ii) Green Tariffs

3.8 Similarly, provided any green tariffs offered by a Supplier are made available to all comparable groups of customers on a non-discriminatory basis at the time of offering, Licence Condition 25A will not be engaged. Any difference between green tariffs and other tariffs shall not be subject to assessment for objective justification, as the conduct in question would not be considered discriminatory under the above approach.

4. Objective Justification

4.1. In respect of Licence Condition 25A, Ofgem considers that any alleged objective justification relied upon by a Supplier for offering two or more groups of customers different terms and conditions can only be assessed on a case-by-case basis. The Guidelines set out below are intended to assist in such an assessment, although they are not intended to constitute the exclusive basis upon which any alleged objective justification will be assessed.

4.2. In assessing any potential contravention of Licence Condition 25A, Ofgem will first consider whether any differences in transaction terms and conditions offered to two or more groups of customers reflect differences in those customers' circumstances; or whether any relevant similarities in customers' circumstances are reflected in transaction terms and conditions offered. Differences between customers' circumstances may constitute an objective justification for offering different terms and conditions.

Cost Reflectivity

4.3. For the avoidance of doubt, the following Guidelines in respect of Cost Reflectivity are relevant to both Licence Condition 27.2A and Licence Condition 25A.

4.4. Ofgem is likely to consider discriminatory conduct to be objectively justified when the difference in the treatment of two or more groups of customers reflects the differences in the costs of supplying those customers.¹⁰ As such, an assessment of the objective justification of any price differential will usually involve an assessment of the relevant costs involved and the degree to which those costs are reflected in the respective prices charged by a Supplier.

4.5. Ofgem intends to assess the relevant terms and conditions offered by a Supplier on a forward looking basis, i.e. relative to costs at the date at which prices were first made available to a group or groups of customers, and will not generally assess any differences in terms and conditions offered to customers on an ex post basis.

4.6. Ofgem will take the following factors into account when assessing cost reflectivity under Licence Condition 27.2A and any alleged objective justification in respect of Licence Condition 25A:

(i) Geographical considerations:

- Ofgem recognises that there can be geographic cost differences, related, for example, to differences in network charges.

¹⁰ For further guidance on assessing Cost Allocation see Section 8 of the Guidelines.

- As transmission and distribution charges can vary by region, it would be objectively justified to reflect these variances in charges in prices charged to customers.

(ii) Payment Methods:

- Differences in prices which reflect the differences in costs associated with operating different payment methods would be objectively justified (e.g. any differences in Suppliers' costs associated with processing direct debit payments, as opposed to processing quarterly standard credit payments).

(iii) Initial offers:

- Subject to the above guidance on competitive advantage operating as an objective justification, Ofgem is concerned to prevent discrimination in respect of enduring terms and conditions under which electricity and gas are supplied and not with initial offers made by Suppliers aimed at customer acquisition.
- As such if a Supplier were able to demonstrate that a particular price differential or any additional bonus or incentive was being offered on a time-limited basis only (for example, to assist that Supplier in the acquisition of new customers, to penetrate a market in a particular region or to meet a competitor's offer) Ofgem would likely consider any such 'initial' price differential to be objectively justified.
- However, in such circumstances, a Supplier must specify expressly in advance in their marketing materials that any such price differential or bonus incentive is time limited, and that the said time limited offer will revert, after a reasonable period of time, to the terms and conditions offered to all other consumers. Failure by a Supplier to adhere to these transparency requirements will lead Ofgem to assume that the price differential offered is intended to operate as an enduring offer for the purposes of Licence Condition 25A. For the avoidance of doubt, "time limited" refers to the actual duration of the tariff and not to a limited period during which the tariff may be made available.

(iv) Competitive advantage

- Licence Condition 27.2A and Licence Condition 25A are not intended to lessen in any way the incentives on Suppliers to improve the efficiency of their operations. The Guidelines on materiality, set out below, are intended to provide flexibility to allow any individual Supplier, who may be more innovative or efficient than the rest of the market, to benefit from any efficiency improvements they make for a reasonable period before passing that benefit on to consumers.
- In particular, Ofgem is likely to regard evidence of recent efficiency improvements, combined with competitive price differentials, as a potential objective justification for sustaining price differentials at above costs for a reasonable period of time. However as explained above, Ofgem intends to approach cost assessment on a forward looking basis.

- Following a reasonable period of time it would be expected that any such efficiency benefits would be passed on to customers, in a manner consistent with an effective competitive market.

(v) Innovation

- Licence Condition 27.2A and Licence Condition 25A are not intended to prevent Suppliers developing new products and charging a market price for such products, provided those products are made available to all comparable groups of customers on a non-discriminatory basis.
- However, if Ofgem were to require any roll-out of a new development/product to be made available to all customers simultaneously, Ofgem recognises that this could create a potential barrier to innovation.
- Ofgem considers that if a Supplier chooses to limit, for a reasonable period of time, a new product or offering to a particular group of customers, this conduct is likely to be objectively justified, if it can be shown to be a necessary part of development, testing or roll-out.
- Similarly, Ofgem is likely to consider barriers arising from technology or capability (e.g. smart meters) to be an objective justification for the limited availability of a product to a particular group of customers.
- It will be within Ofgem's discretion to decide whether any particular offering constitutes a "new" product and whether any such "new" product constitutes an objective justification for these purposes.

5. Materiality

5.1. Ofgem will not consider any terms and conditions offered by a Supplier to be an infringement of either Licence Condition 27.2A or Licence Condition 25A unless a materiality threshold is met.

5.2. In respect of both Licence Condition 27.2A and Licence Condition 25A, Ofgem recognises that it would be impossible for Suppliers to be precisely non-discriminatory and cost reflective at all times and to each individual customer. Costs can vary over time and are not always certain until after the fact. Also, Ofgem recognises that there are significant costs associated with changing prices and it would be inefficient to require frequent changes to ensure cost reflectivity at all times. However as set out above, Ofgem intends to assess costs on a forward looking basis.

5.3. The relevant considerations which Ofgem will take into account when determining the materiality of any alleged infringement of both Licence Condition 27.2A and Licence Condition 25A include, but are not limited to, the following:

(i) Timing

- Suppliers will be allowed a reasonable period of time to effect changes between pricing rounds. In general, unless Ofgem considered the time between price changes to be exceptionally long, it would not contemplate enforcement action under either Licence Condition 27.2A or Licence Condition 25A as a result of any cost differential movements between pricing rounds, but would expect these to be addressed by the Supplier at the next price change.

(ii) Scale and degree of impact on consumers

- The conduct of a Supplier will only be material if it impacts on a significant number of consumers. The financial impact per consumer will also be relevant. In considering the financial impact, Ofgem will judge materiality in the context of the typical margins earned by Suppliers.

(iii) Detriment to Vulnerable Groups

- As noted above, Licence Condition 27.2A and Licence Condition 25A are concerned with the minimisation of detriment to consumers caused by Suppliers, and in particular, detriment to vulnerable groups.¹¹ If the evidence demonstrates that the detriment caused to consumers by any alleged infringement of Licence Condition 27.2A or 25A is minimal or non-existent, Ofgem will not generally seek to enforce Licence Condition 27.2A or 25A. Similarly, Ofgem is more likely to

¹¹ For definition of vulnerable groups see Section 6 on Social Tariffs.

enforce Licence Condition 27.2A or 25A if the evidence demonstrates that vulnerable consumers are particularly affected by the alleged conduct in question.

6. Exception for Social Tariffs

6.1. Under the Gas and Electricity Acts, Ofgem is obliged to have regard to the interests of: (a) individuals who are disabled or chronically sick; (b) individuals of pensionable age; (c) individuals with low incomes and (d) individuals residing in rural areas.¹² These four groups are referred to in these Guidelines as 'Vulnerable Groups'.¹³

6.2. In December 2004, Ofgem published guidance in which it was made clear that there were no regulatory or legal barriers to Suppliers offering social tariffs.¹⁴ On 19 December 2008, Ofgem published a report "Monitoring suppliers' social programmes 2007-08" in which a social tariff was described as being at least as good as the lowest tariff offered by that Supplier to a customer in that region on an enduring basis ('Social Tariffs'). This is regardless of that customer's payment method and includes online tariffs.¹⁵

6.3. As a result of Ofgem's statutory obligations, in respect of both Licence Condition 27.2A and Licence Condition 25A, if a Supplier chooses to offer more favourable terms and conditions to a relevant Vulnerable Group, any such Social Tariff is very likely to be treated by Ofgem as an exception to the obligations imposed on a Supplier under Licence Condition 27.2A and Licence Condition 25A. In this context, the below Guidelines on the scope of Licence Condition 27.2A in respect of any below cost payment methods offered are also relevant.

¹² See Section 3A of the Electricity Act 1989 and Section 4AA of the Gas Act 1986 which places the statutory obligation to do so on Ofgem's Authority.

¹³ The relevant sections of the Electricity Act and the Gas Act go on to provide: "*although that is not to be taken as implying that regard may not be had to the interests of other descriptions of consumer.*"

¹⁴ *Supplying low income and vulnerable customer groups* (272/04), December 2004

¹⁵ Para 2.14 of "Monitoring suppliers' social programmes" 2007-2008

7. Scope of Licence Condition 27.2A

7.1. Directive 2003/54/EC concerning common rules for the internal market in electricity and Directive 2003/55/EC concerning common rules for the internal market in natural gas (together 'the EC Directives'), place obligations on national regulatory authorities such as Ofgem to ensure, amongst other things, that all final consumers and in particular vulnerable consumers are protected.¹⁶ These obligations are also reflected in the Electricity Act 1989 and the Gas Act 1986.

7.2. Licence Condition 27.2A is designed to reflect Annex A (d) of Directive 2003/54/EC and Directive 2003/55/EC which provide that; "Any difference in terms and conditions shall reflect the costs to the supplier of the different payment systems." For the purposes of interpreting Licence Condition 27.2A only, Ofgem regards the terms "payment methods" and "payment systems" as interchangeable.

7.3. Ofgem interprets the EC Directives as intending, amongst other things, to protect consumers who pay by the typically more expensive payment methods such as prepayment meters ('PPMs'), in particular because those consumers may not have the choice of other payment methods. As such, and given its statutory obligations under the Gas and Electricity Acts, Ofgem does not intend to pursue discrepancies in pricing of payment types which result in lower PPM charges. Given Ofgem's administrative priorities, it would not be an appropriate use of Ofgem's resources, nor is it likely to accord with Ofgem's statutory duties, for Ofgem to target such action under either Licence Condition 27.2A or Licence Condition 25A.¹⁷

¹⁶ Article 3(5) of *Directive 2003/54/EC concerning common rules for the internal market in electricity* and Article 3(3) of *Directive 2003/55/EC concerning common rules for the internal market in natural gas* provide:

"Member States shall take appropriate measures to protect final consumers, and shall in particular ensure that there are adequate safeguards to protect vulnerable consumers, including measures to help them avoid disconnection. In this context, Member States may take measures to protect final consumers in remote areas. They shall ensure high levels of consumer protection, particularly with respect to transparency regarding contractual terms and conditions, general information and dispute settlement mechanisms."

¹⁷ Given that vulnerable groups are over-represented in the consumer group who pay by prepayment meter method.

8. Cost Allocation

8.1. Compliance with and enforcement of both Licence Condition 27.2A and Licence Condition 25A will often require consideration of the costs associated with servicing particular customer groups. In this respect, Ofgem intends to take the following approach.

8.2. In broad terms, there are three types of cost:

Those that can be attributed to particular products and services

- Such costs can be used in justification of price differentials. In practical terms, these are more likely to be direct costs, but they could also include some costs with more indirect characteristics, such as charges for customer service. Transmission charges between different areas are one example of a cost that can be attributed to particular products and services, as they may vary according to area of supply.

Those that cannot be attributed to a particular product, but are clearly attributable to the energy supply business

- If these costs have identifiable drivers (e.g. overall revenues or unit sales), then these costs can be allocated on that basis and used to justify any cost allocation; otherwise, they should not be used in justification of price differentials. For instance, billboard advertising focused on direct debit customers may nonetheless contain multiple corporate measures, and hence not be attributable only to direct debit customers, but to Standard Credit customers as well.

Overheads not attributable to the supply business

- These should not be used in justification of price differentials. For instance, a group charge for intellectual property such as branding or risk should not be used as justification.

8.3. With regard to the following elements of cost:

Working capital and revenue collection costs

- Ofgem would likely view differences in working capital costs as being an appropriate justification for price differentials between different groups of customers (for instance, between advance payment plans and standard credit accounts). Ofgem would not view any such charges as discriminatory, but would nonetheless monitor Suppliers' approaches to the use of such charges as part of its debt and disconnection work.

Bad debt and credit risks

- Where Suppliers offer credit terms as a part of their gas and electricity services, they are likely to incur some bad debt costs. Ofgem would view a reasonable level of premium for this credit risk as a potential objective justification for price differentials between payment methods.

9. Sunset Clause in Respect of Licence Condition 25A

9.1. Licence Condition 25A includes a “sunset clause” so that the proposed new licence condition prohibiting undue discrimination lapses after three years.

9.2. Licence Condition 27.2A does not include any such provision, given that it reflects existing obligations under Directives 2003/54/EC and 2003/55/EC, and no more than those obligations.

9.3. The inclusion of a sunset clause in Licence Condition 25A is intended to reflect Ofgem’s expectation that the full package of measures proposed in the “Energy Supply Probe - Proposed Retail Market Remedies” document, published in April 2009, will accelerate the transition of energy supply markets to fully effective competition and that, over time, those measures alone will be sufficient to guard against undue discrimination.

9.4. Ofgem is of the view that a period of less than three years would not allow sufficient time for the reforms identified in the Energy Supply Probe to fully take effect. However, Ofgem intends to keep this situation under review and proposes to carry out regular reviews in accordance with the procedure set out in the text of the licence condition itself.

9.5. Once Licence Condition 25A has lapsed, Ofgem will continue to interpret cost reflectivity, for the purposes of applying Licence Condition 27.2A, in line with relevant European Commission and European Court of Justice jurisprudence.

10. Licence Condition 25A Enforcement Procedure

10.1. Ofgem will, as a matter of policy, prioritise its resources to focus on systemic issues in its monitoring of the application of both Licence Condition 27.2A and Licence Condition 25A.

10.2. Ofgem will enforce Licence Condition 27.2A and Licence Condition 25A in accordance with its existing 'Enforcement guidelines on complaints and investigations' ('the Enforcement Guidelines') published on 28 September 2007 as amended from time to time. Consistent with the Enforcement Guidelines, in deciding on priorities for investigation, Ofgem will give weight to the level of consumer detriment arising.

10.3. In addition, in respect of Licence Condition 25A only, Ofgem will normally employ a three stage process of escalation in dealing with possible breaches, giving weight to the level of consumer detriment arising:

Stage 1

- If, on its own initiative or following a complaint, Ofgem identifies a concern with a pricing differential which satisfies its prioritisation criteria, it will write to the Supplier concerned, giving it an opportunity to respond and provide objective justification for the pricing differential. At this stage, Ofgem may expect the Supplier to provide cost data supporting the existing structure and justifying any subsequent change.

Stage 2

- If Ofgem is not satisfied with the response, it will write to the Supplier and explain why it is not satisfied. It will allow the Supplier a reasonable period within which to respond. If, at this stage, the Supplier revises its pricing structure, Ofgem is unlikely to take further action, unless there is evidence of a persistent failure to comply with the relevant condition.

Stage 3

- If the Supplier does not revise its pricing differential, Ofgem will make the case for a licence breach. It will send the Supplier a statement of the case for a breach and will give it the opportunity to make written and oral representations to the decision maker(s) established to decide on the case, in line with the existing Enforcement Guidelines.
- If the Supplier is subsequently found to be in breach, it may face a financial penalty and/ or an enforcement order requiring it to remedy the breach. The

amount of any penalty imposed will be determined by the Authority in accordance with its published policy.¹⁸

¹⁸ See GEMA's "*Statement of Policy with respect of financial penalties pursuant to section 27B of the Electricity Act and Section 30B of the Gas Act*" published in October 2003.

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Appendix 1 – The Authority’s Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This Appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute, principally the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Act 2004, as well as arising from directly effective European Community legislation. References to the Gas Act and the Electricity Act in this Appendix are to Part 1 of each of those Acts.¹⁹

1.3. Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This Appendix must be read accordingly²⁰.

1.4. The Authority’s principal objective when carrying out certain of its functions under each of the Gas Act and the Electricity Act is to protect the interests of existing and future consumers, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the shipping, transportation or supply of gas conveyed through pipes, and the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors.

1.5. The Authority must when carrying out those functions have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
- the need to secure that all reasonable demands for electricity are met;
- the need to secure that licence holders are able to finance the activities which are the subject of obligations on them²¹;
- the need to contribute to the achievement of sustainable development; and
- the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.²²

¹⁹ Entitled “Gas Supply” and “Electricity Supply” respectively.

²⁰ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

²¹ Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Act in the case of Electricity Act functions.

²² The Authority may have regard to other descriptions of consumers.

1.6. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed²³ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems;
- protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and
- secure a diverse and viable long-term energy supply.

1.7. In carrying out the functions referred to, the Authority must also have regard to:

- the effect on the environment of activities connected with the conveyance of gas through pipes or with the generation, transmission, distribution or supply of electricity;
- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.8. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation²⁴ and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

²³ Or persons authorised by exemptions to carry on any activity.

²⁴ Council Regulation (EC) 1/2003

Appendix 2 – Glossary

A

Authority

The Gas and Electricity Markets Authority ('GEMA') established under section 1 of the Utilities Act 2000

D

Direct debit

A method of payment where a fixed or variable amount is taken from a bank account each month, quarter or year

Dual-fuel offering

A type of energy contract where a customer takes gas and electricity from the same Supplier

F

Fixed price tariff

A tariff that guarantees that the price paid per unit of gas or electricity used will not change for a given period of time

G

Green tariff

An energy tariff which is marketed as having environmental benefits and is consistent with Ofgem's published Guidelines on Green tariffs

P

Price differential

The difference between two sets of prices. For example, the difference in the price charged by one electricity Supplier to consumers using different payment methods.

Prepayment meter (PPM)

These are meters that require payment for energy to be made in advance of use or they will prevent the supply of gas or electricity. A PPM customer pays for energy by inserting electronic tokens, keys or cards into the meter.

Probe

Ofgem's study of the state of GB energy supply markets, launched in February 2008

Probe remedies package

The package of proposals put forward by Ofgem for consultation following publication of the 'Energy Supply Probe – proposed retail market remedies' dated 15 April 2009.

S

Smart meter

A generic term for innovative forms of metering that provide increased levels of functionality above that of a basic meter. It usually includes at a minimum the ability to read the meter remotely via a communication channel.

Standard credit

A payment method where consumers pay on receipt of the bill. This typically covers a wide range of payment mechanisms including cash, cheque, credit card and standing order.

Standard Gas Supply Conditions

Gas Supply Licence Standard Conditions issued by GEMA as at 1 April 2009

Standard Electricity Supply Conditions

Electricity Supply Licence Standard Conditions issued by GEMA as at 1 April 2009