

Meghna Tewari
Senior Economist, Retail and Market Processes
Ofgem
9 Millbank
London
SW1P 3GE

15 October 2010

Dear Meghna,

**CONSULTATION ON PROPOSALS FOR AMENDING STANDARD LICENCE
CONDITION 23 – PERIOD FOR NOTIFYING UNILATERAL CONTRACT VARIATIONS
AND OTHER CONSEQUENTIAL ISSUES**

Thank you for the opportunity to comment on the proposals set out in the above consultation letter.

As we explained previously, concept of allowing retrospective individual notification of price increases was developed at the opening of the competitive retail gas market in 1996, in order to ensure that companies could respond with sufficient speed to changes in wholesale market pricing. In return for the possibility of retrospective notification, customers were given a highly unusual retrospective right to avoid the increase by changing supplier.

It is clear, however, that both Ofgem and the Government wish suppliers to provide advance notice at an individual level. As has been observed by City analysts¹, this is likely to require changes in company hedging and pricing policies to accommodate a much slower price change process and may make it harder for new entrants. We would therefore have liked to see a fuller process of analysis and consideration, including undertaking a regulatory impact assessment as required by section 5A of the Utilities Act 2003 before making firm proposals. We do not think that the policy review process followed so far on this occasion has enabled the optimum consumer interest to be weighed up and considered.

Recognising that there is a commitment to move to advance notification, we would like to suggest that the advance notice period should be reduced, to around 7 days. Given

¹ **Citigroup (1/10/10):** "UK regulator Ofgem has proposed a new rule that would require retail energy suppliers to provide 1 month's notice ahead of price rises. This follows criticism of the current system by the Secretary of State for Energy whereby the supply companies can impose a price rise before informing the customer. On the face of it this might seem to be a sensible piece of consumer protection. But in practice it may well work against the consumer. Gas / power prices are highly volatile particularly over the winter. Energy suppliers have typically waited for the winter to develop before making a decision on retail tariffs. Their ability to change prices quickly allows them the flexibility to wait and see. If they have to give 1 month's notice that flexibility would be materially reduced. We can therefore expect suppliers to become more cautious on their pricing strategies. Therefore, they will likely raise prices earlier and by higher amounts than would otherwise be the case, and wait longer to lower prices. Also, this requirement will likely work against new entrants, who rely even more on the ability to price flexibly."

that customers have “roll-back” rights, a brief period of advance notice is sufficient to give them notice that they might wish to change their consumption and to take a meter reading if desired; the existing roll-back provisions provide adequate time to switch supplier, should the customer wish to take this step. Such a compromise would reduce the impact on hedging strategies and the ability of the market to react to events, while achieving the consumer benefits identified by Ofgem largely in full.

Even a 7 day advance notice period would in practice lead to a lengthy cycle for price increases. To print and post a mailing to all offline customers would take about three to four weeks for a supplier selling about 5 million services to customers, so even a 7 day period amounts to a 4 week minimum process between announcement and implementation. A 30 day advance notice period roughly doubles this.

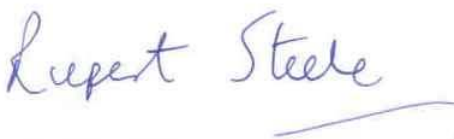
We also would suggest that in any final licence change, Ofgem continues to reserve the right to waive the right for advance notification in particular cases or circumstances. This may be necessary, for example, in order to promote the efficient takeover of a failing supplier or if a technical variation needs to be made to remedy a loophole that allows customers to avoid paying for energy they have used. It would be helpful if Ofgem would indicate that it is willing in principle to grant waivers of advance notification in these kinds of circumstances.

Our views on the remaining detailed proposals depend on whether Ofgem agrees that a shorter notice period is acceptable. In particular, a short notice period relies on the existing protections around roll-back remaining in force. But the logic for maintaining the existing elaborate roll-back rules if 30 days’ notice is provided – let alone extending them to run from the coming into force of the increase rather than the notice date – seems vanishingly thin.

Ofgem justifies the 30 day proposal by reference to common practice in a range of other sectors. However, these generally do not have the roll-back provisions that were created for electricity and gas precisely to allow for shorter or retrospective notification. It follows that were 30 days’ notice to be required, that these other requirements should be slimmed down or removed.

I attach our responses to your specific consultation questions in Annex 1. Please contact me using the contact details printed on the previous page, or Pamela Kelly on 0141 568 3231, if you have any questions or require further information.

Yours sincerely,



Rupert Steele
Director of Regulation

Questions for Stakeholders – ScottishPower Response

1. What are your views on our “minded to” position of requiring domestic suppliers to give customers Notice of a unilateral variation at least 30 calendar days in advance of the date on which the variation takes effect?

We draw Ofgem’s attention to the comment made by Peter Atherton of Citigroup, who said:

“UK regulator Ofgem has proposed a new rule that would require retail energy suppliers to provide 1 month’s notice ahead of price rises. This follows criticism of the current system by the Secretary of State for Energy whereby the supply companies can impose a price rise before informing the customer. On the face of it this might seem to be a sensible piece of consumer protection.

But in practice it may well work against the consumer. Gas / power prices are highly volatile particularly over the winter. Energy suppliers have typically waited for the winter to develop before making a decision on retail tariffs. Their ability to change prices quickly allows them the flexibility to wait and see. If they have to give 1 month’s notice that flexibility would be materially reduced. We can therefore expect suppliers to become more cautious on their pricing strategies. Therefore, they will likely raise prices earlier and by higher amounts than would otherwise be the case, and wait longer to lower prices. Also, this requirement will likely work against new entrants, who rely even more on the ability to price flexibly.”

Credit Suisse also indicated that they thought that the principal effect of the proposal would be to change industry hedging and pricing strategies by restricting companies’ ability to react to market events.

We are concerned that the impact of slowing down the market in this way has not been considered in the drawing up of the proposals to date. We think that the preparation of a Regulatory Impact Assessment, in accordance with section 5A of the Utilities Act 2000, would have revealed these issues and enabled them to be built into Ofgem’s thinking.

In the case of smaller suppliers, we think that the increased hedging needs required by this proposal may act as a barrier to entry, especially because exchanges and some other counterparties require significant collateral for trading in longer dated products. It is unfortunate that, just as the industry is working to find ways to make it easier for small suppliers to enter the market, this proposal appears to be heading in the other direction.

We think that, if Ofgem wishes to require individual advance notification, the period should be no more than 7 days. This is sufficient to enable customers to adjust their consumption or take a meter reading, while minimising the effect on hedging policies and the ability of the market to respond to events. The arrangements for retrospectively rolling back an increase in the event of a change of supplier mean that the third option that a customer has – changing supplier – can be exercised after the price change.

Accordingly, the use of a 7 day notice period would achieve the consumer protection gains that have been identified as associated with the policy, while

mitigating the impact on the market from building in a very long delay to price changes.

Even a 7 day advance notice period would in practice lead to a lengthy cycle for price increases. To print and post a mailing to all offline customers would take about three to four weeks for a supplier selling about 5 million services to customers, so even a 7 day period amounts to a 4 week minimum process between announcement and implementation. A 30 day advance notice period roughly doubles this.

We think it will be important to assess these issues in a Regulatory Impact Assessment.

2. What are your specific views on the proposed consequential amendment to retain paragraph 23.6(a) of SLC 23 (20 working day right to cancel)?

The logic we have set out above for a 7 day advance notification period suggests that, with that period in force, the existing provisions for the 20 day right to cancel should be retained.

We would suggest that the 20 working days starts, as at present, from the date notification is received because there is no reason to elongate the process further. This formulation also deals automatically with the cases where the customer does not get notification in a timely way through no fault of the supplier (for example, as a result of change of tenancy or postal delay).

If there was a 30 day notification period, the logic for retaining the complex “roll-back” provisions is very weak as customers would have long enough to initiate a change of supplier well before the increase took effect.

We would be strongly opposed to the suggestion in the paper that the roll-back count-down would start from the expiry of 30 days’ notice. That would mean that the total time to complete a price change, including roll-back, would be 3 months – one for the mailing, one for the 30 days and one for the roll-back. This is a quite unnecessary drag on the competitive process. And if the customer were initially unable to switch because of debt, the period would extend to 5 months.

3. What are your views on the proposed consequential amendment to sub-paragraph 23.6(c) of SLC 23 (and sub-paragraph 14.9(c) of SLC 14) (30 working day period to repay debt)?

If Ofgem were minded to pursue a 7 day notification period, it could be appropriate to make an amendment of the type proposed.

We do not believe that it is necessary or appropriate to retain this right if moving to a 30 day advance notification period. The rationale for this recent change was to introduce extra assistance to indebted customers who were notified of a price increase shortly before it came into force or after it had already taken effect. However, this does not apply in the case where a customer is notified at least 30 days in advance of the price change date.

This right will only apply in the case where a customer has had a debt demanded in writing and been outstanding for at least 28 days before the price increase notification is received. Retaining this right will simply reward customers for staying in debt, by allowing them longer to delay the impact of the price increase, and giving them an advantage over customers who do not have a debt but wish to switch supplier following advance notification of a price change.

4. What are your specific views on the proposed clarificatory amendments to SLC 23 and SLC 24?

Subject to our comments above, we welcome these points of clarification and think that these are sensible and necessary changes.

5. What are your specific views on the proposed one-month time frame for implementing these proposals?

We think that the broad underlying change to notification in advance is relatively manageable with a month's notice, since suppliers have control over the timing of price announcements and have existing functionality to send out mailings. However, to achieve full compliance with the detailed procedures will inevitably take longer.

This is because suppliers will need to devise procedures to deal with exceptions (such as change of tenancy, product or supplier) which may interact with the notification process as well as dealing with any changes in the roll-back procedure that may finally be agreed.

It is unlikely to be feasible to fully address these complications within a one month implementation frame and we think a period of three to four months would be prudent. Ofgem's observation that this could have been anticipated from previous consultations and recommendations does not bear weight. It was not clear whether Ofgem would propose making advance notification mandatory and the detail of how the various exceptions and circumstances should be handled, which will be the time-consuming element to implement, is not yet clear.

While full compliance will inevitably take some time to implement, we would expect that suppliers would wish to comply with the spirit of any new rules, as far as is reasonably practicable, as soon as possible after they were put in place.

6. What are your specific views on the "minded to" decision not to propose any amendments to the 15 working day period for the supplier to receive notice under the Master Registration Agreement / Network Code?

We agree with Ofgem's proposal and reasoning on this point. It is appropriate to have a clear cut off so that the rules are clear and equitable for customers. And as Ofgem says, forthcoming requirements under the EU third package will increase the incentives on gaining suppliers to apply for the site as quickly as possible.

15 October 2010