Promoting choice and value for all gas and electricity customers

Retail markets: review and remedies

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Ofgem is proposing radical changes to make the energy market work effectively for consumers.

The review's remit

The review was announced in November 2010. Its brief was to assess the effectiveness of the retail energy market, investigate how well the measures we had put in place following the 2008 Energy Supply Probe were working and decide if further action was needed. At the same time we published analysis showing the margin on a standard dual fuel tariff rose to around £90 per customer a year in November, an increase of 38 per cent from September. This acted as another indicator that we should review the market.

Conclusions

The review found competition in the energy retail market was being stifled by a combination of tariff complexity, poor supplier behaviour, lack of transparency and the degree of influence of the big six energy suppliers - British Gas, EDF Energy, E.On, RWE npower, Scottish Power and Scottish and Southern Energy - have on the energy market.

Complex pricing

Concern

Gas and electricity is delivered to consumers' homes using the same pipes and wires, whoever the supplier, so price is one of the important ways in which companies can compete.

However, suppliers pricing structures make comparison difficult. Some offer a standing charge and then a flat rate for the energy used. Others do not have a standing charge but operate a two tier structure. This means they charge one price for a set level of consumption and then a different, typically lower rate, for any additional consumption.

The prices at which the two tiers are charged differs between companies as does the level at which the consumer is switched from the first to the second tier. This makes it hard for consumers to work out the unit price they are paying and compare it with the unit price offered by another supplier.

The number of tariffs on offer has grown in recent years from just under 200 in January 2008 to more than 300 at the beginning of 2011. Ofgem's research has shown that 70 per cent of those surveyed were confused by the number of tariffs available in the market.

Fewer customers are now switching, despite the significant savings available to many. In 2006 22 per cent of consumers changed their electricity supplier while 19 per cent switched gas provider. In 2010 the figures were 17 per cent for electricity and 15 per cent for gas.

(Complex pricing continued)

The savings from switching can be significant. Last year, a dual fuel customer who switched from a standard credit offer with their supplier to a similar product with the supplier offering the cheapest standard credit deal saved an average of £240 over the course of the year.

Yet even where consumers do switch, price complexity leaves some concerned that they may not have got a better deal.

Proposed reform

We recognise switching and the threat of switching are fundamental to competition. The higher the risk of customers switching, the harder companies will battle to keep the customers they have, or tempt consumers away from their rivals.

To address the complexity of tariff information provided by suppliers Ofgem proposes to make it simple for domestic consumers to compare prices and choose a better deal.

The proposal would restrict the number of tariffs for standard evergreen products from each supplier to only one per payment method (direct debit, standard credit and prepayment meters).

We also propose to standardise the format of these tariffs across suppliers, with suppliers allowed to compete on a single "per unit" price. Consumers would then be able to tell at a glance whether they can save money, either by switching supplier or by moving to a new deal. This would be a major reform impacting the 75 per cent of customers currently on standard evergreen products.

Suppliers would still be free to offer an unrestricted number of fixed-term products, so they could continue to innovate and give their customers genuine choice. However, we would seek to ensure that customers only buy into these products with full knowledge and assent to their terms and conditions. We propose to require suppliers to quote prices for all fixed-term products on a basis that is readily comparable to the unit price for their standard evergreen products.

Poor supplier conduct and response to Probe remedies

Concern

Ofgem found that the industry response to its 2008 Probe reforms has been patchy, and in some cases poor. We have been disappointed with the reaction of suppliers to many of the Probe reforms and formal investigations have been launched into whether suppliers are complying with their licence obligations. We are currently investigating the sales and marketing practices of four of the big six suppliers; EDF Energy, RWE npower, Scottish Power and Scottish and Southern Energy. We are also investigating British Gas, EDF Energy and RWE npower over how they handle customer complaints and have now launched an investigation into Scottish Power over the price differential between its standard credit and direct debit payment methods.[1]

Proposed reform

In addition to enforcement action Ofgem proposes to strengthen a number of its licence conditions, for example in relation to the amount and form of information to be included in bills and annual statements. The aim is to ensure suppliers abide by both the spirit and intention of the measures and to give suppliers less freedom in how they interpret their obligations.

In the business market we are concerned about the possible use of the objections procedure to frustrate business customer switching. Our evidence shows that some suppliers have a high level of objections and, or, a signifcant number of objections that are subsequently withdrawn.

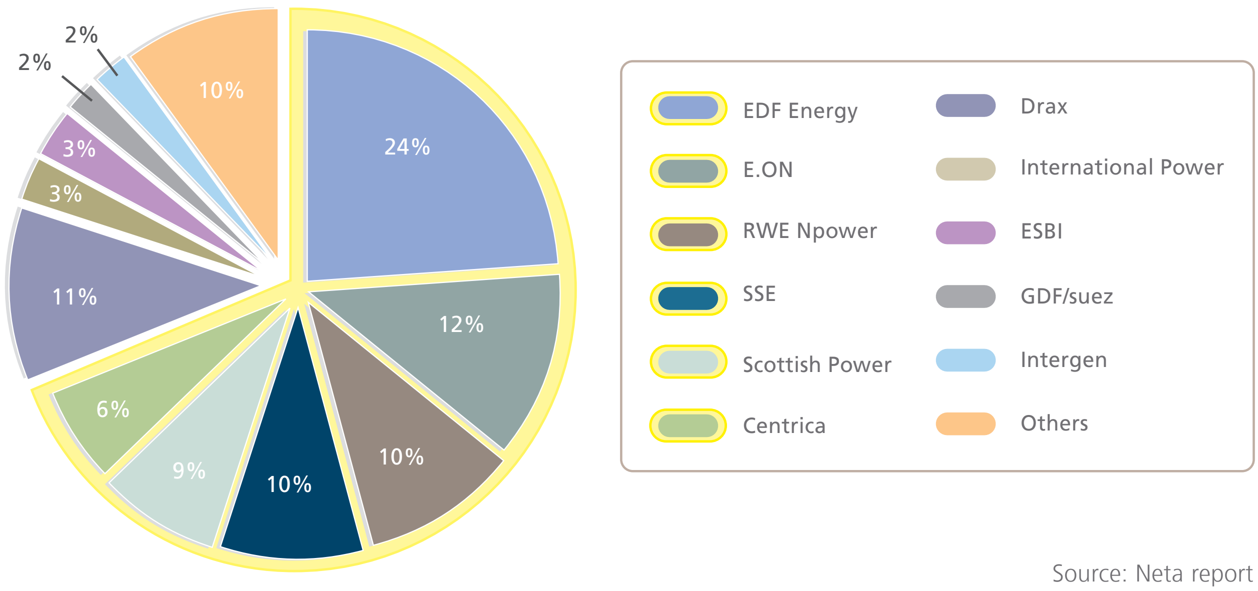
[1] For the avoidance of doubt, the fact that Ofgem has launched an investigation should not in any way be taken as implying that there has been a breach of a licence condition.

Liquidity and improving access to the wholesale electricity market

Concern

Ofgem continues to have concerns in relation to access to the wholesale market for new entrants and independent suppliers and generators. Intervention by Ofgem is needed to provide liquidity in the wholesale market to encourage new entry and so that market participants can compete against existing vertically integrated players.

GB Generation: Metered volumes 2010



Source: Neta report

Proposed reform

Subject to consultation and the outcome of our assessment of the wholesale power market, we propose to intervene with two initiatives. First, we propose a new licence condition that would require the big six to auction up to 20 per cent of their power generation into the market through a regular Mandatory Auction. It will be mandatory for the big six to offer power for sale. This should help potential supply market entrants to access the bulk of the wholesale products they need. It will also allow prices to be set by an open and competitive process. Second, we propose a new licence condition to require the establishment of Mandatory Market Making arrangements, to ensure that market participants are able to trade continuously and mitigate imbalance risks. We expect that these arrangements would particularly benefit participants who have difficulties accessing the market at present.

Our reforms would complement and support the Government's electricity market reform, by increasing liquidity in the electricity wholesale market.

Profits and Transparency

Concern

The price which energy suppliers pay for gas and power in the wholesale markets, and how this translates into the price they charge to retail consumers, is not transparent. This threatens to reduce public confidence in the market and its fairness. In this latest review of the market Ofgem has found for the first time that there is evidence that the big six suppliers have adjusted prices in response to rising costs more quickly than they reduced them when costs fell.

If all suppliers had held off their winter price increases like EDF Energy (that is until, but not including March 2011), we estimate that consumers would have been £250m better off. For customers on standard tariffs this would have been a saving of £10 per household customer.

This is why all our reforms are targeted at ensuring that competition acts as an effective brake on prices.

Proposed reform

After the Probe we demanded companies disclose more information about their retail businesses. The first segmental reports have now been published but they are still not transparent enough. Ofgem has now published its analysis of these accounts and we are appointing independent accountants to investigate further.

The next steps

We have given the companies until 1 June 2011 to engage constructively with our proposals or to put forward their own reforms to meet our concerns. If, following consultation, we consider that appropriate reforms do not have a realistic chance of addressing the consumer harm identified, either due to industry opposition or feedback as to the suitability of the initial proposals, we will consider alternative options. Such options would include a referral to the Competition Commission. We are also exploring whether or not additional powers should be sought from Government in a number of areas.

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