Stefan Bojonowski
Retail Markets
Ofgem
9 Millbank
London
SW1P 3GE

1 June 2011

Dear Stefan,

The Retail Market Review- Findings and initial proposals

EDF Energy is one of the UK's largest energy companies, with activities throughout the energy chain. Our interests include nuclear, renewables, coal, gas-fired electricity generation, combined heat and power, and energy supply to end users. We have over five million electricity and gas customer accounts in Great Britain, including both residential and business users.

EDF Energy welcomes the opportunity to respond to Ofgem's consultation paper. Our detailed response is contained in the attachment to this letter, which includes an Executive Summary drawing together all of the key points we are making.

We share a number of Ofgem's concerns regarding the current operation of the retail market, particularly with regard to the complexity of suppliers' tariffs and the impact this has on consumer choice, and in respect of the development of trusted reference prices and product availability in the electricity wholesale market. Our response sets out positive, coherent and deliverable proposals for addressing these concerns. We believe they do not share the disadvantages of Ofgem's proposals, which will not in our view be effective in meeting the needs of customers.

We support Ofgem's desire that all consumers engage in the market, but we do not believe that Ofgem's approach to achieving this is the right one. Placing tight limits on the number of evergreen tariffs a supplier can offer would restrict consumer choice, and would force repeated contract renewal on consumers that are on time of use tariffs (the number of which is expected to markedly increase with the roll out of smart meters). Customers tell us that they want it to be easier to compare products, but at the same time they also tell us that they like choice.

EDF Energy's proposals seek to engage customers in a variety of ways, including:

- Requiring all tariffs to have the same simple standing charge/£MWh structure (consumers find £/MWh easier to understand, and they are used to this form of pricing structure – e.g. for mobile phones).
- Turning the annual statement into a strong call to action (displaying both supplier and Ofgem logos to promote trust), including an energy label setting out the key price and non-price features of the product (we believe that non-price features are important to consumers and to the ability of smaller players to compete).

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- Ofgem providing an independent switching service and seeking to improve the regulatory framework applicable to commercial switching sites.

Consumer confidence is key to participation. Dual-branding the annual statement, which we would rename the "Annual Review and Renewal Reminder", would help build consumer confidence.

It is also important that in future Ofgem helps, in its public statements, to build, rather than undermine, consumer confidence in the market, and in particular avoids making statements about supplier conduct that are unjustified (e.g. by referring to incomplete compliance investigations). We also urge Ofgem to abandon the term "Big 6", as this incorrectly suggests homogeneity of supplier behaviour and strategy, further encouraging consumers to disengage from the market.

We recognise that many stakeholders do not believe that the wholesale market meets their needs, but we also believe the liquidity is not a major barrier to entry (access to credit/collateral is far more important in this regard). We believe that the market will continue to develop, particularly through improvements being brought forward by the exchanges (such as small clip trading), market coupling, and increased levels of interconnection. We recognise that progress in some areas has not been as fast as hoped, which is why we are recommending that a new DECC/Ofgem led liquidity forum be established to provide focus and impetus.

We believe the Ofgem's focus should be on a liquid day-ahead auction that would set a trusted reference price and so underpin the development of risk management instruments, including forward trades and derivatives. This would enable small players to obtain the products they say they need at a transparent cost. It would also avoid the need for Ofgem to determine what products need to be sold, and the problem of how to regulate forward prices in the context of significant levels of uncertainly (e.g. around carbon prices). There is no need for Ofgem to mandate market making under our proposals, and in any case we favour a voluntary approach.

We would support the development of clear guidelines underpinning Ofgem's existing "Probe" remedies. However, we would not support extending them into the retail business market, where customer needs and capabilities are very different.

We would also support a requirement on all vertically integrated companies to produce segmental accounts in which any transfer and/or tolling prices are justified with reference to market prices. We believe that stakeholder trust in the information provided by the segmental accounts is key to the development of the regulatory framework and to consumers understanding that supplier profit margins are not excessive; Ofgem's statements regarding evidence that prices rise faster than they fall - in response to wholesale price movements - is not justified and undermines consumer confidence by creating the impression that returns are excessive.

We would support regulatory intervention in energy markets only where this is clearly justified. Ofgem's main proposals would in general create significant levels of detriment and would be justified only on the basis of significant benefits robustly identified (we have identified many weaknesses in Ofgem analysis and consumer surveys). EDF Energy's proposals do not suffer from this problem, while delivering the appropriate improvements in customer experience and market operation.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact my colleague Paul Delamare on 020 7752 2187 or myself.

Yours sincerely,

Denis Linford
Corporate Policy and Regulation Director

Attachment

Retail Market Review – Finding and initial proposals

EDF Energy's detailed response

Executive Summary

Overall assessment of the Retail Market

1. The RMR report indicates that Ofgem believes it has identified a number of features of the market and behaviours of large suppliers, which it asserts give rise to significant levels of consumer detriment.
2. EDF Energy recognises the dimensions of assessment used by Ofgem. However, in a number of cases EDF Energy does not agree with the evidence presented, or its interpretation.
3. Despite the issues we discuss in this response, the UK gas and electricity industry is highly competitive. It has one of the highest switching rates of any energy market across the world. EDF Energy has a domestic annual churn rate of around 17%. The intensity of competition and the effort and cost needed to win new customers or replace customers who switch should not be dismissed or underestimated by regulators.
4. It is also important that regulators recognise the differences between market participants. Ofgem's use of the term "Big Six" carries inappropriate suggestions of homogeneity.
5. EDF Energy is a relatively small player in the domestic market and does not benefit from the economies of scale (or margins) enjoyed by its larger competitors. The companies also differ in terms of their share of gas and electricity customers, in terms of regional/national focus, and with regard to the range of other services provided (e.g. boiler maintenance).
6. Our belief therefore is that there is much about the retail energy market that is working well. However, we do recognise that there are some areas in which additional steps may help build understanding and confidence.
7. EDF Energy believes that it is essential that the market participants and regulators work together to enhance the competitive market. Our approach in this response has therefore been to provide constructive enhancements or alternatives to the remedies suggested by Ofgem.
8. EDF Energy believes that a number of Ofgem's proposals would result in potentially significant detriment for consumers. These detriments include reduced choice, forcing changes in consumer's preferred patterns of market engagement, increased costs and distortions to the pricing of products in the wholesale market.
9. Our own proposals below are designed to both avoid these detriments and also deliver more effective solutions to the observed issues. As such, we believe that they will deliver superior results when assessed under the necessary Regulatory Impact Assessments (RIAs).

EDF Energy's proposed remedies

Proposal 1 – Improve tariff compatibility

10. EDF Energy wishes to operate in a market where each consumer is empowered to make the right choice for his or herself and suppliers are able to compete on a fair basis which results in robust competition. We agree that Ofgem is trying to tackle the problem in a constructive way and agree with many of Ofgem's proposals.

11. However, through analysis and customer research, we can see significant unintended consequences if the proposals are implemented as they stand. Therefore, we believe that some modifications are required in order to achieve the outcomes that are sought. We have grouped these under the following headings:

    - Encouraging all consumers to engage, especially the vulnerable:
        - Turn the annual statement into a "call to action" – renamed as the Annual Review and Renewal Reminder. Provide independent assurance with dual-supplier/Ofgem branding.
        - Ofgem to establish a switching service (on and off line) to help all consumers, but especially the vulnerable, make active and informed choices of product and supplier.
    - Empowering consumers to make well informed decisions
        - Making all products easily comparable by capturing all key elements of products, not just price, in a standardised "Energy Label" similar to the nutrition label used on food packaging.
        - Ofgem to undertake regular consumer surveys with results shown in the energy label.
    - Reducing complexity, preserving choice and increasing competition
        - All products to have a common structure, with a simple standing charge and unit rate (or unit rates for time of use tariffs).
        - All products described using simple common language.
        - Restricting time-limited to fixed and tracker prices to aid simplicity and fair comparison.
    - Improving trust in suppliers and confidence in the sector
        - Ofgem and suppliers working together to rebuild confidence.
        - We propose that Ofgem introduce a process whereby suppliers can challenge Ofgem's media statements and, if inaccurate, Ofgem would publish a correction, as per the Press Complaints Commission. This would help ensure that media statements are fair and accurate.

12. We strongly support the desire to engage all consumers in the market and unlock "sticky" consumers[1], especially the fuel poor and vulnerable. We agree that a clear offer, free of undue complexity and adverse conditions, with timely decision points and a simple means of comparing different offers, is fundamental to achieving this aim. We also support the proposal for Ofgem to offer switching advice but we feel this must go further to be really effective.

[1] Our research shows that a significant proportion of consumers require greater savings than are available, or perceive that they will have to invest significant time and effort in order to switch

13. We agree that suppliers should be restricted in making adverse unilateral variations and those customers on time limited deals should be provided with a clear next offer, with switching prompts, in plenty of time to enable them to fully engage in choosing the next product for themselves.

14. Consumers require more information than just price in order to make a well informed decision and we wish to see this shown in a simple, standardised manner to facilitate easy comparison of offers. More choice is required in evergreen products to satisfy specific consumer segments.

15. We urge a note of caution with respect to Ofgem's proposals. These are wide reaching and radical and it is clear that there may be significant unintended consequences, particularly with respect to the removal of choice in evergreen products and the setting of a regional standardised charge.

16. Our proposals go further in encouraging consumers to engage, empowering well informed decisions and reducing complexity, whilst preserving choice and increasing competition. However, importantly, they are consistent with the steps already taken by Ofgem since the 2008 Probe. These amendments provide bold changes but also limit the effect of damaging, potentially difficult to reverse, unintended consequences, whilst retaining the flexibility of making further change in the future.

17. Our suggested amendments build on previous changes, where the full effects are yet to be seen and understood.

Proposal 2 – Enhance liquidity

18. EDF Energy has developed proposals focused on delivering two key outcomes:

    - The creation of a robust reference price in order to encourage financial trading (e.g. to manage shape risk).
    - The reduction of barriers to entry for small suppliers and other participants.

19. We propose remedies based on maximising the use of existing market initiatives. The basis of our proposal is a renewal of the initial commitment agreed by the major participants of the Power Trading Forum (PTF). The commitment was that all day-ahead volumes should be traded through the N2EX exchange. We set out in our response the reasons why a day-ahead auction is more likely to create a robust reference price than a monthly auction.

20. Secondly, we propose the establishment of an Ofgem/DECC led Liquidity Forum. Drawing on the recent example of the Smart Grid Forum, we believe that this would help create common focus and provide drive and direction on the development of thinking - and action - about liquidity. We set out in more detail how a Liquidity Forum would offer a number of clear advantages to the benefit of all market participants.

21. In addition, in March 2011 we published a set of EDF Energy commitments[2] to small suppliers. We believe these commitments will give small suppliers access to the market whilst other market developments initiated by the N2EX continue to gather momentum. Eventually, small suppliers will have a choice in how they access the market.

22. We agree that Ofgem should continue to monitor the impact on liquidity levels of any market initiatives. Should the existing measures still not establish a robust reference price, and as an industry we still believe this is an important development, then EDF Energy would be prepared to make a formal commitment to submit a proportion of

[2] http://www.edfenergy.com/about-us/energy-generation/PDF-Documents/liquiditycommitMarch11.pdf

our available capacity at the day-ahead stage to the auction, along with all the major generators, not just vertically integrated companies.

23. While we agree that a recognised reference price is an important tool for all market participants, including potential new entrants, we do not agree that Ofgem's proposed mandatory monthly auction will deliver this. Similarly, while we agree on the importance of facilitating market access for small suppliers, we do not believe that the mandatory market maker is the best solution. Our response details the technical reasons as to why we believe this to be the case

24. EDF Energy does not believe that market liquidity is one of the most important barriers to entry in GB supply markets. There are many other barriers to entry, particularly in the retail market, such as credit and collateral requirements, the cost of trading and billing systems, historic low margins in retail supply, and regulatory uncertainty.

25. In determining potential measures to improve either bulk liquidity or contestability if necessary, EDF Energy believes that Ofgem should adhere to certain key principles:

    - Solutions must be market based with minimum intervention to achieve the desired outcomes. Only when market based solutions are not working, do we see intervention as a potential solution, especially as this is a sign that the market has failed.
    - Risks that exist in the market, such as credit and collateral, must be acknowledged and accounted for appropriately, rather than ignored.
    - Any intervention must be consistent with wider policy goals.

26. EDF Energy strongly supports voluntary commitments rather than licence conditions and believes that the commitments should be met by all of the relevant participants, not just vertically integrated players.

Proposal 3 – Strengthen Probe remedies – domestic

27. EDF Energy shares Ofgem's desire to improve domestic consumers' experience of the retail energy market and will support targeted and proportionate reforms necessary to achieve this.

28. We would welcome Ofgem giving clearer guidance on how suppliers should interpret and implement the Probe obligations.

29. In developing proposals for amendments or additions to the probe remedies as part of its Retail Market Review, Ofgem must take a holistic view of the many obligations being placed on suppliers (including Green Deal and best tariff on bills).

30. Ofgem also has a key role in building trust in the energy market which has not been evidenced through its recent media activity. We are disappointed that Ofgem has, on a number of occasions, referred to its various compliance investigations as if these amount to evidence that suppliers have not implemented the existing probe remedies fully.

31. Ofgem should have given time for the full suite of probe remedies to be in operation and for consumers to adjust their behaviour in response.

32. We believe that consumer trust is best achieved by an open and transparent regulatory regime that works in the best interests of its consumers, rather than one that rushes to take enforcement action. The Office of Fair Trading (OFT), including Trading Standards and the Information Commissioner's Office (ICO) has publicly adopted such an approach.

33. We believe that any guidance issued by Ofgem should include a two stage investigatory process. Where potential regulatory concerns exist, Ofgem should

undertake informal bespoke discussions with licensees (using the model provided by SLC25A) with a view to resolving any potential compliance issues or concerns, without the need to move to a second stage process involving formal enforcement proceedings.

34. We believe that Ofgem's overarching standards of conduct should be enforceable, but we do not believe they would work well in their current form as licence conditions. This is because they are high level statements and inevitably would be open to interpretation and legal challenge.
35. We believe that this could be achieved either through self regulation, which would involve the development of and Energy Supply Code, similar to the Banking Code.

Proposal 4 – Strengthen Probe remedies – non-domestic

36. The extension of the scope of SLC7A would constrain commercial innovation for larger businesses.
37. If businesses not currently covered by the micro-business definition need additional protections, we would first support a clear identification and definition of these needs as well as to which type of customers these protections should apply. We would support a review of the micro-business definition.
38. Extending elements of the standard of conducts to licence conditions would not be appropriate for large parts of the non-domestic market. What can be seen as complex would be very subjective regardless of the size of the business and some elements of the contracts that could be seen as complex or inappropriate for some customers might come at the request of customers.
39. We support Ofgem's recommendation to not extend the tariff simplification on to the non-domestic market where this would not be relevant.
40. We have concerns over Third Party Intermediaries activities and would support the development of a suitable regulatory framework.

Proposal 5 – Improve reporting transparency

41. The segmental accounts should be the primary method by which Ofgem understands the profitability of energy supply and generation licensees.
42. Ofgem's quarterly retail and wholesale market reports provide an unsatisfactory approach to assessing margins. They only focus on averages, and ignore the different cost levels faced by each individual company. They are also based on simplified and hypothetical hedging assumptions.
43. Ofgem's quarterly reports are unrepresentative of the low margins being earned by EDF Energy's retail business, and as a result mislead consumers as to the profits we are earning.
44. EDF Energy's segmental accounts are based on market based transfer prices. We will be happy to discuss our approach with Ofgem's appointed experts.
45. Licensees should be free to choose an approach to segmental accounting which fits their business model provided that transactions between businesses can be verified against market prices independently set.

Ofgem's assessment of the retail market

Question 1: Do stakeholders agree with our findings of the Review in relation to causes of persistent consumer harm and barriers to entry in the energy retail markets.

46. Answer: No, as is explained below, EDF Energy believes that the picture portrayed by Ofgem is incomplete for a number of reasons.

47. The RMR portrays an extremely complicated picture which EDF Energy have analysed closely. The overall picture presented is one where a number of observed characteristics are linked to market distortions and adverse outcomes. All of these are then attributed to underlying causes of poor supplier conduct and targeted by the proposed remedies.

48. EDF Energy does recognise the dimensions of assessment used by Ofgem and agrees that they are relevant to the development of a retail market. However, EDF Energy believes that the picture portrayed by Ofgem is incomplete for a number of reasons:

    a) EDF Energy's own customer research;

    b) Areas in which the evidence presented by Ofgem is flawed;

    c) Factors not considered by Ofgem;

    d) Areas in which EDF Energy does not agree with the evidence presented, or its interpretation.

49. We comment on each of these areas in turn.

a) EDF Energy's own customer research

50. EDF Energy has undertaken substantial quantitative and qualitative research to support our response to the RMR.

51. A number of key findings are evident:

    - Substantial savings are required before consumers will switch supplier;
    - Tie-ins with boiler insurance are a barrier to switching;
    - Consumers' value choice;
    - Entrants face a reputational barrier.

52. We believe that these findings point to a number of challenges in respect of the RMR's proposed remedies:

    - A key barrier to switching is that consumers desired savings have risen markedly and hence are not achievable in the market place;
    - This also implies that simplification of tariffs is likely to have only a very limited impact;
    - Consumers are unlikely to react well to Ofgem remedies which reduce their available choices;
    - The research points to a number of important elements such as bundled products which the RMR does not recognise.

53. Detail of EDF Energy's consumer research is included in Appendix 1.

b) Areas in which Ofgem's evidence is flawed

54. Ofgem states that it has evidence which suggests that suppliers' retail prices have tended to rise more quickly in response to increases in wholesale costs than they have

fallen, when wholesale costs decline. Ofgem notes in its consultation paper that its econometric model (the evidence referred to) is sensitive to the technique used and assumptions made. Ofgem says that it is keen to receive feedback on its findings.

55. We do not believe that Ofgem's evidence is robust, and that even if asymmetric pricing behaviour existed, we do not believe that it necessarily provides evidence of problems with the retail market.

56. Energy UK has submitted to Ofgem a paper by NERA which explains our concerns in more detail. In summary, NERA:

- notes the caution expressed by Ofgem's authors in respect of drawing robust conclusions from its econometric model;
- explains why rational and efficient asymmetry of price movements can occur between cost-minimising competing suppliers;
- notes that the presence of such explanations mean that Ofgem would need to do further work to show that price asymmetry reflected problems with competition in retail energy markets; and
- finds a number of problems which undermine the econometric analysis:
    - use of implausible coefficients on key cost items; and
    - selection of variables which show asymmetry and rejection of others that does not.

57. We note that Ofgem made a great deal of its findings in this area, portraying its evidence that prices rise more quickly than they fall as one of the major findings of concern in the RMR. We therefore believe that it is important that Ofgem recognises the flaws in its evidence in future RMR documents in order to avoid further damage to consumers' confidence in the retail market.

c) Factors not considered by Ofgem

58. EDF Energy believe that there are four particular factors that Ofgem have not considered sufficiently:

- Challenges with the use of Behavioural Economics
- Lessons from Competition Economics
- Possibilities of new entry
- Impact of world energy markets

59. Detailed EDF Energy's arguments on each of these points, including a paper on the use of Behavioural Economics (BE), is included in Appendices 2 and 3.

d) Areas in which EDF Energy does not agree with the evidence presented, or its interpretation.

60. Ofgem brings together a number of elements to paint a picture of a stagnant GB retail market that allows margins to rise, and at a faster rate than cost increases. We summarise what we believe to be the key features of Ofgem's diagnosis below:

- Complex tariff information and a poor response to the Probe remedies/poor supplier conduct have contributed to low customer engagement ("sticky customers"), which adversely impacts the levels of switching, and poor switching decisions.
- Market segmentation results in higher margins from "sticky customers" (and lower margins from active customers) which are not accessible by entrants, thus deterring entry/expansion.

- Co-ordinated effects between suppliers result in similar pricing and hedging strategies, restricting competition between the existing players.   This leads to poor levels of customer service, low levels of innovation and permits inefficiency.
- Vertical integration results in high levels of self supply restricting the availability of wholesale markets and the development of transparent wholesale prices. A lack of liquidity inhibits entry.
- Cross subsidisation between supply and generation, aided by a lack of transparency, hides profit levels and also inhibits entry.

The table below presents our interpretation of this thesis. We also summarise the likely detriments we see arising from Ofgem's proposed remedies.:

Conduct	Recognised by EDF Energy?	Commentary on evidence and diagnoses	Likely detriments from Ofgem proposals
Complex tariffs	**Partially**	Complexity overstated and it reflects competitive innovations, not objective to “bamboozle”. Other barriers to switching key	Forces some customers into repeated market engagement, reduces non-price innovation, and impacts on smart-metering benefits
Poor response to probe remedies	**No** - EDF Energy has fully implemented	May apply to other Suppliers but arguably premature conclusion given limited time and open investigations	Clear guidance on interpretation and implementation may help customers – but Ofgem media approach likely to damage confidence
Market segmentation	**Partially**	Inevitable feature of efficient supplier behaviour in **all** competitive markets	Ofgem formalises segmentation into evergreen and fixed term
Co-ordinated effects	**No**	No evidence of collusion. EDF Energy has independent strategy for growth – winter price freeze	Ofgem inadvertently encouraging co-ordinated effects by limiting choice and validating cost base
High self-supply	**No**	Adequate liquidity in prompt; liquidity concerns reflect shortage of shape further out; EDF Energy puts significant volumes through markets; issues of collateral is critical	Mandatory month-ahead auction risks significant market distortion/regulatory risk, and risks inconsistencies with EMR outcomes
Failure to engage with small suppliers	**No**	EDF Energy always prepared to offer terms, and has made specific proposals in terms of commitment to small suppliers in 16 March letter	Mandatory market making may result in MiFID status as investment firm, with significant cost impacts and would not reducer barrier to entry for small suppliers
Excessive retail margins hidden	**No**	EDF Energy uses market based transfer prices and is losing money in residential retail	Over-transparency could undermine competition, e.g. by revealing hedging strategies
Inadequate transparency	**Partially**	Root issue is lack of confidence in reports provided, not absence of reports	Review welcomed if it builds confidence – should confirm that trades based on verifiable market prices

61. Detailed discussion on each of these issues is included in Appendix 4.

EDF Energy's proposed remedies

Proposal 1 – Improve tariff comparability

Summary

62. EDF Energy wishes to operate in a market where each consumer is empowered to make the right choice for his or herself and suppliers are able to compete on a fair basis which results in robust competition. We agree that Ofgem is trying to tackle the problem in a constructive way and agree with many of Ofgem's proposals.

63. However, through analysis and customer research, we can see significant unintended consequences if the proposals are implemented as they stand. Therefore, we believe that some modifications are required in order to achieve the outcomes that are sought. We have grouped these under the following headings:

   a) Encouraging all consumers to engage, especially the vulnerable
   b) Empowering consumers to make well informed decisions
   c) Reducing complexity, preserving choice and increasing competition
   d) Improving trust in suppliers and confidence in the sector

64. We strongly support the desire to engage all consumers in the market and unlock "sticky" consumers[3], especially the fuel poor and vulnerable. We agree that a clear offer, free of undue complexity and adverse conditions with timely decision points and a simple means of comparing different offers is fundamental to achieving this aim. We also support the proposal for Ofgem to offer switching advice but we feel this must go further to be really effective.

65. We agree that suppliers should be limited in making adverse unilateral variations and those customers on time limited deals should be provided with a clear next offer, with switching prompts in plenty of time to enable them to fully engage in choosing the next product for themselves.

66. Consumers require more information than just price in order to make a well informed decision and we wish to see this shown in a simple, standardised manner to facilitate easy comparisons of offer. More choice is required in evergreen products to satisfy specific consumer segments.

67. Our modifications to Ofgem's proposals are as follows:

Encouraging all consumers to engage, especially the vulnerable

- The annual statement should become the primary engagement vehicle for consumers. We would propose the structure and content of the statement is defined by Ofgem, following consumer research and potentially be co-branded to provide independent assurance. The messaging should change to be forward looking and strongly encourage consumers to engage, becoming, for example, "Annual Review and Renewal Reminder" (ARRR).

- Ofgem to establish a full on and off-line switching service to help consumers, especially the vulnerable, make trusted, active and informed choices of product and supplier. To be recharged to suppliers at cost.

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[3] Our research shows that a significant proportion of consumers require greater savings than are available, or perceive that they will have to invest significant time and effort in order to switch

- In addition we would expect the ARRR to make clear how easy and safe switching is and to dispel common myths and misconceptions that consumers fear (paying twice, getting disconnected, losing boiler insurance etc.).
- Any solution implemented today must retain the flexibility to work with "mydata", as this will empower all, but most importantly, vulnerable consumers to engage with increasing data-intensive smart offers with minimal personal difficulty.

Empowering consumers to make well informed decisions

- Consumers must be offered a simple means of comparing all key elements of products, not just short term price. We propose that these are captured in a standardised "Energy Label" similar to the nutrition label used on food packaging. This Energy Label, such as illustrated in Appendix 5, would be a key part of "Your Annual Review and Renewal Reminder" (ARRR) and any switching comparisons.
- Ofgem undertakes a regular consumer survey to inform the energy label.

Reducing complexity, preserving choice and increasing competition

- All products should be mandated to have a common structure, using simple common language to describe products and with a simple standing charge and unit rate[4]. Suppliers should have the ability to reflect their own costs in these charges as appropriate, as they are best placed to measure these. Ofgem would use their existing powers to ensure a tight range of cost-reflectivity.
- In addition to above (and going further than Ofgem currently propose) we recommend restricting products with more complex, potentially adverse, terms. In addition to roll-over contracts we would prohibit, or cap, termination fees and restrict time-limited products to either a fixed price over their term, or a tracker price, but with clear pre-defined reference prices.
- All prices expressed in terms of £/MWh rather than p/KWh, providing simpler and more impactful savings messages.
- Allowing suppliers to continue to offer a number of simple evergreen products preserves choice, especially in green products and in time of use, as smart metering is rolled-out.
- Empowering consumers to make well informed decisions, reducing complexity and preserving choice enables new entrants to innovate and compete for growth in enduring products rather than primarily via discounted time-limited products.

Improving trust in suppliers and confidence in consumers

- In addition to the engagement and independent assurance that Ofgem's switching service and ARRR will provide, we believe more can be done by both the industry and Ofgem to inform consumers and create greater levels of trust. Whilst it is incumbent upon the industry to deliver the actions we have outlined, Ofgem needs to lead the communication of knowledge essential to the foundation of trust.
  - Providing consistent, simple guidance on the potential for price rises longer term
  - Demonstrating that healthy (but realistic) short term savings can made by switching product or supplier

[4] Consumer friendly terms for these needs to be agreed

- o Recognising that there is more to choosing energy products than short term price - those worried about price rises should consider fixed price products, for example
- o Reassuring consumers that it is easy and safe to switch and this can be achieved with minimal personal effort (it would be helpful for Ofgem to indicate the time cost in ARRR)
- o Acknowledging that suppliers need to make a fair profit given the risks that they take and this encourages greater competition from new entrants
- o Providing an independent assessment of service performance

- ➢ We think these would help consumers to make confident decisions through informed choices, with accurate information and realistic expectations.

Bold and consistent change

68. We urge a note of caution with respect to Ofgem's proposals. These are wide reaching and radical and it is clear that there may be significant unintended consequences, particularly with respect to the removal of choice in evergreen products and the setting of a regional standardised charge.
69. Our proposals go further in encouraging consumers to engage, empowering well informed decisions and reducing complexity, whilst preserving choice and increasing competition. However, importantly, they are consistent with the steps already taken by Ofgem since the 2008 Probe. These amendments provide bold changes but also limit the effect of damaging, potentially difficult to reverse, unintended consequences, whilst retaining the flexibility of making further change in the future
70. Our suggested amendments build on previous changes, where the full effects are yet to be seen and understood.

Detailed Response

Ofgem Objectives:

Make it far easier for domestic consumers to compare prices and choose a better deal

Make sure the Probe remedies are strengthened and where necessary enforced, so that they achieve their original objectives

Our View of the Market and Consumer Engagement

71. EDF Energy wishes to operate in a market where each consumer is empowered to make the right choice for his or herself and suppliers are able to compete on a fair basis that creates robust competition:
    - ➢ Since privatisation, suppliers have increasingly offered more complexity in their offers in an attempt to offer consumers greater choice and differentiate themselves.
    - ➢ This, combined with the increase in suppliers operating in the market, has led to a situation whereby a significant number of consumers are daunted by the options available to them and find it difficult to make a choice and, therefore, engage actively with the market.
    - ➢ We do not believe that this is an ideal outcome for consumers.

Agreement with the Key Elements of Ofgem's Proposals

72. EDF Energy agrees that Ofgem is trying to tackle the problem in a constructive way and agrees with many of Ofgem's proposals:

- We strongly support the desire to engage all consumers in the market and unlock "sticky" customers by making it easier to compare prices and, therefore, reduce the investment consumers need to make in terms of time and effort to be empowered to make a well informed choice.
- We also support the desire to introduce a timely decision, or trigger, point for consumers in order to induce them to engage.
- We believe that consumers should receive clear and transparent information, both in terms of an annual review of their consumption and when considering alternative tariff options.
- We agree that in order to achieve clarity and minimise consumers' investment in time when engaging with the market, information that they are confronted with should be in a standardised format.
- In line with the possible actions outlined under Proposal 3, we would want fully support Ofgem directly providing consumers with information/advice regarding the switching process and take steps to improve consumer trust in switching sites.
- We support the proposals to ensure that all penalties and contract terms are clear and that there are no terms that allow adverse unilateral variations.
- We agree that customers on time limited products should receive a statement ahead of the end of their term with a clear rollover offer including switching prompts and an adequate window of opportunity to switch should be provided.

Points of Difference between EDF Energy and Ofgem

73. EDF Energy does not agree that the best way to get consumers to engage is simply to compare offers on the basis of a single price metric and limit choice in evergreen products to only one per supplier:

- Our belief, supported by research findings, is that consumers want to choose their supplier and tariff based on more than just price. We also believe, again supported by research, the majority of consumers' desire similar or greater levels of choice to that currently available. We do not feel that it is necessary to limit choice in order to provide consumers with a simple, meaningful, comparison between products.
- Furthermore, if price is the only metric compared, we are extremely concerned that this will drive companies to follow a strategy of becoming (or remaining) the lowest cost producer, which would inevitably favour the supplier with the lowest unit costs (i.e. the company with the largest economies of scale).
- There is a real danger that suppliers will purely focus on getting the headline price down and will either cut out costs e.g. service related, or attempt to make supplementary charges for them, either explicitly or implicitly.
- Cutting down on the standard of service has particular implications for vulnerable consumers, whose need is greatest in term of interaction with their supplier.
- The low-cost airlines model is a clear example in what could happen if price alone is pushed as the only comparable metric. It is likely that suppliers will attempt to charge for supplementary services, creating complex comparisons for consumers.

- Lastly, the pursuit of ever greater economies of scale to either obtain, or retain, a cost advantage, is likely to drive suppliers towards consolidation, thereby reducing the current levels of consumer choice in suppliers.
- The immediate result of Ofgem's proposals would be to encourage the dominance of British Gas and could result in the exit of some of the smaller players in the domestic retail market. It is, therefore, hard to see how a focus on price alone would be helpful to small players/entrants.

74. We do not see the value in Ofgem's proposal to compare the consumer's product price with a weighted average of the supplier's fixed term products. Our position is that consumers want to and need to compare more than price, in order to get the right product for themselves.
    - We are also unclear what is meant by weighted average:
        - If all products, then this is misleading as the consumer cannot purchase closed products
        - If those available to purchase, then weighted average on what basis?
75. Some consumers will desire a variable rate (evergreen) time of day, or green, tariff. For these groups, taking away the ability of suppliers to offer choice in evergreen products denies them the ability to obtain the product that they want

Building on Ofgem's Proposals

76. EDF Energy believes that only relatively minor modifications to Ofgem's proposals are required in order to obtain the outcomes that we are both seeking in terms of clarity of offer and increased consumer engagement.

Encouraging Consumers to Engage

77. We believe that it is right to prompt consumers to engage, but more needs to be done to ensure that they can do so with a high level of confidence in the information that they use.
78. We see the annual statement becoming the vehicle to communicate and engage consumers in the switching process, similar to that induced in the insurance industry with the annual renewal notice:
    - We recommend that annual statements are retitled "Your Annual Review and Renewal Reminder" and includes a standardised set of words that strongly encourage consumers to engage with the market and check whether they are on the best deal.
79. We believe that there is a specific issue with British Gas' dominance in boiler maintenance which is materially holding back consumers (with this product) from engaging. Our research shows that consumers with a boiler maintenance contract with their energy supplier are 40% less likely to look to engage with the market and switch supplier.

Empowering Consumers to Make a Well Informed Choice

80. We believe that consumers must be offered a simple means of comparing all key elements of products used for decision making purposes, not just price
    - Our history of research shows us that consumers balance price, with financial risk, environmental impact and expectations of service when making an energy purchase
    - We propose that these are captured in a standardised "energy label" similar to the nutrition label used on food packaging. We enclose a mock-up of this label in Appendix 5

- This label would be displayed on any communication the customer reviews including, from their existing supplier, or with respect to product comparisons for switching decisions

81. A standardised price structure is extremely important. Consumers can balance price against other product characteristics, but price should be expressed in a consistent format across all products in the market

    - Consumers are used to comparing products with mixes of standard and variable charges e.g. in the telecoms and holiday markets and different consumers have different preferences for mixes of fixed and variable charges. Some consumers prefer the certainty of a higher fixed charge and lower variable rates, whilst some prefer to be in control by monitoring consumption carefully
    - We recommend that all products should be mandated to have this simple structure i.e. a standard charge and a variable (unit rate) charge, but suppliers should have the ability to set these charges as they see fit, in order to provide a choice of options that meet different consumers' needs

82. The naming of products is an area that can create confusion when comparing products. In addition to a standard structure for comparing products (the energy label), we propose that products are categorised under consistent categories e.g. standard, fixed, green, tracker.

83. Consumers are confronted by a number of customer service surveys. We believe that it is better for Ofgem to undertake a regular customer service survey, properly regulated, which is then used as part of the energy label comparison.

84. Our research tested whether a p/KWh or £/MWh metric gave consumers a better indication of the potential savings available. The result clearly indicates that £/MWh was favoured by most consumers.

85. We believe that consumers will require some guidance in the relative impact of p/kWh or £/MWh savings messages for electricity and gas. This is likely to be relevant to all consumers in some respect, but may be particularly relevant to vulnerable consumers.

    - As the typical consumption of gas is around five times greater than that of electricity, a very clear message needs to accompany any prices to indicate that the consumer need to multiply the unit rate saving with the consumption in order to generate the real monetary difference that they are faced with.
    - We see this as a potential cause of harm due to the ability for consumers to become confused and anxious about the multiplication of price by units.
    - Due to these difficulties, we propose that all comparisons show an annual £ message alongside the p/KWh (£/MWh) in order to provide a clearer example of the differences in price to consumers and that a message indicating that gas and electricity unit rate differences are not comparable due to consumption is included on any product price comparisons.

Maintaining Choice for Consumers

86. As we have stated earlier, we see choice as a positive rather than a negative and wish to see it maintained for consumers.

87. We recommend that suppliers are allowed to continue to offer choice in evergreen products in order to satisfy those customers that desire these products, but do not want to fix their prices

88. We do not recognise the number of tariffs that are shown in the graph (fig 2.1 p22 of the RMR Findings and Initial Proposals document) and we would value the sharing of the

supporting detail. We would like Ofgem to mandate a simple decision tree for all suppliers and switching services to use in order to help guide consumers to the type of product that they want i.e. fixed, tracker etc. before a comparison of specific options utilising the energy label is performed.

89. Ensuring future developments in smart metering are facilitated by these proposals is very important. The market has the opportunity to change significantly in the coming years and, alongside the mydata proposals by government, offer consumers the chance to obtain energy deals that are specific to their own requirements. We, therefore, feel that choice in evergreen products is essential to ensuring these changes can be facilitated without the need for further changes in the future.

Improving Consumer Confidence in Suppliers and Trust in Information

90. We feel it is critical to show consumers that we, as a supplier and Ofgem, as the regulator, are working together for the best interests of consumers. This is crucial if we are to engender trust in consumers and engage them in our market. Our research shows that some consumers are disengaged as they fear that they will end up on a worse deal if they switch. Therefore we recommend the Annual Review and Renewal is dual branded between suppliers and Ofgem with wording that provides consumers with confidence that they can interact in a risk free manner

91. Our research tells us that consumers do not trust switching sites to be impartial and therefore need to check several sources of information in order to determine the best option for themselves. We recommend that Ofgem overcomes this by establishing an independent switching service, which would provide consumers with an impartial, point of reference and will allow consumers to engage with confidence at minimum personal cost. We believe that commercial switching sites should be allowed to co-exist.

92. Our research also confirms that perceptions of the switching process being "too much hassle" prevent many consumers from engaging with the market. The annualised statement and the Ofgem switching service would both provide opportunities for allaying the fears of consumers and promoting the benefits of engaging with the market to find a better deal.

93. We believe more can be done by both Ofgem and the industry to set consumers minds at rest re the level of profitability most suppliers make in the supply of energy and its relationship to other UK retail markets. We think this would help consumers to set realistic expectations of how much they are able to save. Our research shows that, on average, consumers desire to save more than even the extremes of the market can offer as a real saving

    - We propose that Ofgem clarify the expected level of profitability it sees as reasonable to make by suppliers and publicly states this in the response to this Retail Market Review.
    - Following the publication of segmental results, we would support Ofgem commenting, in a non-sensationalist and responsible manner on suppliers' profitability.
    - Where criticism of excess profitability is warranted, we have no objection to Ofgem making this point in the media, but we feel strongly that Ofgem should do much more to explain that the overall level of profitability by suppliers is less than in other major UK retail markets citing Ofgem's own analysis and explain that there are marked differences in profitability across the industry.

94. We propose that Ofgem introduce a process whereby suppliers can challenge Ofgem media statements and, if inaccurate Ofgem would publish a correction, as per the Press Complaints Commission. This would help ensure that media statements are fair and accurate.

More Support for Vulnerable Customers

95. We do not think that Ofgem's proposals do enough to encourage vulnerable consumers to engage and get the best deal for themselves.

96. Ofgem's analysis confirms that the least engaged consumers are the lower socio-demographic groups, the young and the old. We would wish to see more done to encourage these groups to actively participate with the market.

97. We believe our recommendations above with respect to Annual Renewal Reminders and an Ofgem switching service go some way towards helping those most disadvantaged, who find it hardest to understand and compare their bills:

    - However, we would like to see Ofgem mandate that all products must be available through all channels, so that vulnerable consumers have an equal ability to access the best deals
    - It costs more to service consumers through offline means, so suppliers should be able to surcharge the incremental cost to serve that is incurred, or offset this cost against the supplier social obligation. We anticipate that for suppliers this is a small cost relative to the total discount available and, therefore, vulnerable consumers stand to gain significantly from this proposal
    - In addition to having equal access to discounted products, it is critical that vulnerable consumers have easy access to information and help to guide them through the switching process. We see the latter as being fulfilled by Ofgem's switching service. The former requires tariff information to be made available in media that is accessible to vulnerable consumers. We would recommend that the BBC publish details of best prices as they do for financial products, but other forms of media may also be helpful. We would also like to see all energy supply switching information for this Ofgem service available through public community centres, such as libraries and council offices

A Measured Approach to Change

98. Ofgem have made some significant changes to the supply market over the last three years, since the 2008 Probe. Many of these have had a positive impact on consumers and we welcome them. We have always attempted to work with Ofgem to implement beneficial changes and we are very happy to continue to engage in a constructive and open manner in order to improve the market in which we operate:

    - However, we believe that Ofgem has not allowed sufficient time to determine the effectiveness of these changes and that more needs to be done to assess the impact of these, both now and into the future. We particularly refer to the changes to statements and the changes around sales procedures.

99. We urge a note of caution with respect to future change as it is clear, with such wide reaching and radical proposals, that there may be significant unintended consequences.

100. Therefore, we favour an incremental approach, with a full review and post implementation impact assessment of each change before making further changes that may produce unclear cause and effect relationships.

101. The proposal on setting the standardised charge needs careful consideration. Whilst we understand the driver behind the proposal, we can see significant problems with its implementation.

102. There are both fixed and variable elements to transport and distribution costs and this would add further complications for consumers to understand i.e. a charge of £x per year plus £y MWh. Vulnerable consumers especially will find this difficult to deal with.

103. Because non-energy cost charges vary throughout the year, it would be necessary to change the charge each time these costs changed, otherwise the relative profitability of suppliers would be impacted dependent on the changes in specific areas and the weighting of product accounts across the country (a worked example is shown in Appendix 6):

- It would not be possible to levy differences between actual charges and Ofgem's standardised charge through the p/KWh (/MWh) rate, as this would lead any negatively impacted supplier to be uncompetitive and therefore lose market share;
- Therefore, we do not see that it is right for Ofgem to influence relative supplier profitability, as its impartiality could be called into question as a result.

104. We can see that a standardised charge (or set of charges) could be made to work in an impartial manner, if Ofgem takes responsibility for setting the charge, settling the actual charges and allowing any over or under recovery to flow though into the following year's charge;

- In this model, suppliers would collect the standardised charges from consumers on behalf of Ofgem and pass the monies to Ofgem
- We would anticipate that this would work in a similar manner to that used for VAT recovery, which is another pass-through cost for suppliers

105. However, on balance, we consider that the downside risks of the standardised charge proposed by Ofgem far outweigh the upside benefits. We prefer our recommendation of a simple structure of fixed and variable with suppliers defining the different rates in a competitive manner. This has the advantage of being a simple, easy to understand and easy to administer option

Summary of responses to consultation questions

Question	**Question 2: Do stakeholders consider that Ofgem should take action to reduce the complexity consumers face and enhance engagement with the energy market?**
EDF Energy response	EDF Energy wishes to operate in a market where each consumer is empowered to make the right choice for his or herself and suppliers are able to compete on a fair basis that creates robust competition We are keen to ensure that the market works to the benefit of consumers and therefore we believe that action needs be taken. EDF Energy agrees that Ofgem is trying to tackle the problem in a constructive way.
Question	**Question 3: Do stakeholders agree with our initial proposal for intervention to reduce the complexity consumers face and enhance engagement in the energy market?**
EDF Energy response	We agree with many of Ofgem's proposals, however, through analysis and customer research, we can see significant unintended consequences if the proposals are implemented as they stand. Therefore, we believe that some modifications are required in order to achieve the outcomes that are sought. See sections above for details of our concerns with Ofgem proposals.
Question	**Question 4: If not, then do stakeholders have alternative suggestions for proposals to reduce the complexity consumers face and enhance engagement in the energy market?**
EDF Energy response	We believe that some modifications are required in order to achieve the outcomes that are sought. We have grouped these under the following headings: a) Encouraging all consumers to engage, especially the vulnerable

	b) Empowering consumers to make well informed decisions c) Reducing complexity, preserving choice and increasing competition d) Improving trust in suppliers and confidence in the sector See sections above for details of our proposals.
Question	**Question 5: We are proposing to standardise evergreen contracts across suppliers. Do stakeholders agree with the proposed contents of the standardised charge?**
EDF Energy response	We believe that consumers must be offered a simple means of comparing all key elements of products used for decision making purposes, not just price. A standardised price structure is therefore extremely important. However we do not agree with the details of Ofgem proposed contents of the standardised charge and propose an alternative structure. See sections above for details of our proposals.
Question	**Question 6: We are proposing to create a standardised metric to allow consumers to compare evergreen and fixed term contracts across suppliers. Do stakeholders agree with our proposal for a standardised metric?**
EDF Energy response	EDF Energy does not agree that the best way to get consumers to engage is simply to compare offers on the basis of a simple price metric. See sections above for details of our concerns with Ofgem proposals.
Question	**Question 7: Do stakeholders have any comments on the costs and risks of our proposal, or any alternative suggestions that you have put forward, to reduce the complexity consumer face and enhance engagement in the energy market?**
EDF Energy response	We urge a note of caution with respect to Ofgem's proposals. These are wide reaching and radical and it is clear that there may be significant unintended consequences, particularly with respect to the removal of choice in evergreen products and the setting of a regional standardised charge. See sections above for details of our concerns with Ofgem proposals.

Proposal 2 – Enhance liquidity

Summary

106. EDF Energy has developed proposals focused on delivery two key outcomes:

- The creation of a robust reference price in order to encourage financial trading.
- The reduction of barriers to entry for small suppliers and other participants.

EDF Energy proposes *remedies based on market initiatives*

107. We propose remedies based on maximising the use of existing market initiatives. The basis of our proposal is a renewal of the initial commitment agreed by the major participants of the Power Trading Forum (PTF). The commitment being that all day-ahead volumes should be traded through the N2EX exchange. We set out in our response the reasons why a day-ahead auction is more likely to create a robust reference price than a monthly auction.

Establishment of a Liquidity Forum

108. Secondly, we propose the establishment of an Ofgem/DECC led Liquidity Forum. Drawing on the recent example of the Smart Grid Forum, we believe that this would help create common focus and provide drive and direction on the development of thinking – and action – about liquidity. We set out in more detail how a Liquidity Forum would offer a number of clear advantages to the benefit of all market participants.

Current market initiatives

109. As an industry, we have been focused for some time on trying to improve liquidity. Whilst it is acknowledged that the N2EX implementation has progressed more slowly than hoped for, we believe it is gaining momentum. Sufficient time should be given in order to judge the success of N2EX.

110. EDF Energy has already taken an active role in the industry by participating in the liquidity debate. Our proposal acknowledges that there are barriers to entry for small suppliers and discusses solutions developed by the N2EX aimed at helping small suppliers trade on the exchange. An exchange, such as the N2EX will also be able to assist with collateral issues.

111. In addition, in March 2011 we published a set of EDF Energy commitments to small suppliers. We believe these commitments will give small suppliers access to the market whilst other market initiatives initiated by the N2EX continue to gather momentum. Eventually, small suppliers will have a choice in how they access the market.

If the formation of a robust reference price does not eventuate

112. We agree that Ofgem should continue to monitor the impact on liquidity levels of any market initiatives. Should the existing measures still not establish a robust reference price, and as an industry we still believe this is an important development, then EDF Energy would be prepared to make a formal commitment to submit a proportion of our available capacity at the day-ahead stage to the auction provided this applied to all the major generators, not just companies who have a domestic supply business.

Detailed response

Analysis of liquidity issues

113. The 2008 Energy Supply probe (The Probe) determined that low liquidity is one of the most important barriers to entry in GB supply markets. Ofgem found that low liquidity

may act as a barrier to entry into both the generation and supply market and act as a source of competitive disadvantage to small suppliers and new entrants.

114. EDF Energy does not believe that market liquidity is one of the most important barriers to entry in GB supply markets. There are many other barriers to entry, particularly in the retail market, such as credit and collateral requirements, the cost of trading and billing systems, historic low margins in retail supply, and regulatory uncertainty. In contrast, there have been material levels of entry in B2B supply which also relies on access to market liquidity (e.g. GDF Suez, Haven Power, Opus energy and Total) suggesting that B2C barriers are different.

115. EDF Energy would agree with Ofgem's view that bulk liquidity and contestability (the availability of products and prices to support smaller suppliers) are different issues and as such, any associated problems with either will require different solutions. This distinction was not fully recognised in Ofgem's Summer 2010 Assessment and, in our opinion, this has significantly weakened the conclusions drawn. However, we recognise that Ofgem has now made this distinction.

116. In determining measures to improve either bulk liquidity or contestability, EDF Energy believes that Ofgem should adhere to certain key principles:

- Solutions must be market based with minimum intervention to achieve the desired outcomes. Only when market based solutions are not working, do we see intervention as a potential solution, especially as this is a sign that the market has failed.
- Risks that exist in the market, such as credit and collateral, must be acknowledged and accounted for appropriately, rather than simply being ignored.
- Any intervention must be consistent with wider policy goals.

117. We have concerns over the potential for unintended consequences with the remedies proposed in the RMR and believe more analysis and consultation on any intervention is required with reference to the above principles. If this does not occur there is a substantial risk that Ofgem's remedies will not achieve their goals.

118. In the following sections we present in more detail our views regarding bulk liquidity and contestability.

Bulk Liquidity

119. EDF Energy believes there is currently sufficient liquidity available for market participants to trade and balance their portfolios, particularly in the prompt (day-ahead) market but also further out on the curve. However, we do recognise that liquidity is traded on multiple platforms (OTC, exchanges, bilaterally) and believe this absence of concentration of liquidity is the cause for the lack of a robust and transparent reference price. We are supportive of measures to develop a robust reference price in the prompt as this will encourage further development of financial products in order to hedge price risk further along the curve.

Measures of liquidity

120. In their Summer 2010 Assessment, Ofgem presented 11 metrics to measure the two issues of liquidity and contestability of the market and to determine whether further action is required. EDF Energy highlighted in its response to the Summer 2010 Assessment that Ofgem had made some progress in distinguishing between measures of contestability and those of liquidity. However, we have concerns that the proposals in the RMR do not properly address the liquidity concerns highlighted by Ofgem themselves.

121. Whilst churn is important, we agree with Ofgem that there is no single, agreed definition or statistic by which liquidity can be measured in the electricity market. Ofgem appears to be placing significant weight on a churn metric in order to assess market

liquidity, particularly when comparing with other markets. There is a view amongst a number of market participants that vertical integration itself significantly reduces market liquidity and churn. This belief appears to be driven by a perception that vertically integrated companies internally net a large proportion of their volumes, trading only a relative small net volume in the market. This is certainly not the case for EDF Energy, nor do we believe it to be the case for others. For example, in 2010, EDF Energy sold 90TWh and bought 100TWh against total generation of 54TWh and supply of 64TWh, a much higher churn rate than that proposed in the mandatory auction. This suggests that the proposed market interventions would not in fact increase total market liquidity. Whilst churn has decreased in 2010, we note the positive increases in churn since 2005. It is also worth noting that both in the Nord Pool and the Netherlands market churn rates fell over 2008 and 2009, with the latter actually falling below 2005 levels.

Comparison with other markets

122. We do not believe that meaningful conclusions can be made by simply comparing liquidity measures across European markets without understanding and adjusting for important structural differences. As Ofgem has identified, both Nord Pool and Germany have higher liquidity than the UK electricity market but also have high levels of vertical integration. Other features such as the level of interconnection or participation from large electricity users and financial institutions appear to have supported liquidity. It should also be noted that the UK has a highly liquid gas market and, as the price of gas is currently relatively strongly correlated with that of power, it is regularly used to hedge power positions in the UK. These examples highlight the need for Ofgem to examine the causes of high liquidity in other markets and the structural reasons for this, rather than simply use these markets as a benchmark for comparison. A direct comparison with other countries, especially in a single commodity, cannot be used as a basis for intervention.

123. EDF Energy believes any measures to increase liquidity should be focused on the prompt market, as is the case in other European countries. In addition, trading should be encouraged onto a common platform to aid transparency and to improve contestability. Both Germany and Nord Pool have high liquidity in the prompt market which provides a reference price for power derivatives and financial contracts. This encourages more effective hedging across the forward curve and effectively means market participants are using liquid standard products, rather than relying on bespoke shape contracts, as a means to hedge price risk. At the same time, physical players are able to use the liquid prompt market to balance their portfolio before gate closure.

Giving market initiatives time to develop

124. As an industry, we have been focused for some time on trying to improve liquidity. Whilst it is acknowledged that the N2EX implementation has progressed more slowly than hoped for and that liquidity on the exchange has been less than ideal, we believe it will gain momentum. Sufficient time should be given in order to judge the success of N2EX.

125. Progress has been made and, as we describe in our proposals section, there has been a concerted effort by the N2EX to introduce other initiatives to increase liquidity such as an intraday (spot) market. This development follows the launch In February 2011 of a new cash-settled futures market; EDF Trading has recently signed up as a market maker for UK power futures contracts.

126. It must also be recognised that these market initiatives are taking place against a backdrop of some fundamental changes in the wider market. As a result of the financial credit crisis, risk capital has become a scarcer commodity. Financial institutions are rationing risk capital more selectively, resulting in less trading in general and a withdrawal from some energy markets by individual firms. For example, JP Morgan is no longer active in electricity and Nomura have withdrawn from energy commodities. It needs to be

accepted that when risk capital is scare, as is the case at present, there will be less trading generally both by financial and physical players, particularly in longer-dated products.

Contestability

127. In March 2011 we published a letter outlining EDF Energy's Commitments to Small Suppliers. As part of these, we committed to enter into discussions with any small supplier regarding the provision of an energy purchasing service, or as an alternative, provide an aggregation service if this is more attractive to the counterparty. We believe these commitments will give small suppliers access to the market while market initiatives, such as the N2EX, continue to gather momentum.

128. We recognise that there are features in the current market which may cause issues for smaller players. We do though believe that the majority of these can be remedied without the need for extensive and intrusive intervention.

- Small clip sizes: the size of smaller players means that they need access to smaller clip size than that which is readily available in the market. We believe that we have addressed this for bilateral trades through our commitment to small suppliers, as outlined in our letter to Ofgem on 16th March 2011. In addition, N2EX is intending to offer a clip size 0.1MW and the brokers have indicated that their systems are capable of managing such smaller clip sizes.
- A perceived lack of transparency around trade volumes and price: there is a view that existence of a brokered market reduces transparency around trading activity. Data publishers such as Argus provide a list of all trade prices and volumes each day transacted through the brokers, together with closing prices. The cost of accessing this data may be prohibitive to some small players and EDF Energy would support the publishing of this information and its being made available to all market participants.
- Trusted reference price: we believe that this can best be achieved through a day-ahead auction and discuss this further in our proposal.

129. Our view is that a major barrier to entry for small players is the issue of credit and collateral and we do not believe that there are any simple solutions to this problem.

130. We would not support any form of socialisation of credit and collateral requirements and believe that this would be contrary to the trend in other sectors such as banking. We do though support measures to ensure margin calculations are identical for all participants who trade on an exchange. British Energy had significant experience of collateral issues and worked with counterparties to develop innovative solutions. As a result, we believe that EDF Energy has a good understanding of the issues facing small suppliers and we have committed to work with them to understand their individual credit situation and to develop appropriate solutions.

Reasons for lack of domestic shaped products

131. Some small suppliers have expressed a desire to purchase long-dated shape products to hedge their positions. It has further been suggested by Ofgem that vertical integration is the primary reason for the lack of availability of shaped products. We do not believe that this is the case. The reason that shaped products are not available in the market is due to the lack of natural sellers. Although coal and gas units can follow a demand load shape, in reality each unit tends to run flat across periods such as baseload, peaks or extended peaks. This is because the demand shape is most economically met by scheduling the most efficient units first and scheduling less efficient units only for the short periods that they are required rather than by having a number of generators all increasing and decreasing their output in response to changing demand.

132. As a result, no single generator, or indeed those with a portfolio of assets, is likely to generate a customer demand shape. If a generator sells shape out of its portfolio, it will be exposed to risk as the shape will not match its probable output. The generator would therefore need to be paid a premium to cover this risk and, given that this shape includes significant exposure to Block 5 (which is highly volatile) this premium will be substantial. As an example, in the last 3 years, the out-turn price for Block 5 for winter averaged £84/MWh in 2008, £47/MWh in 2009 and £61.55/MWh in 2010 driven by variations in system margin together with underlying fuel and carbon prices.

133. Given that in general selling shape is a poor hedge for generation assets and has a high operational overhead associated with its pricing, generators sell forward using standard products which better match their running pattern.

How we manage shape today

134. EDF Energy has two business units, B2B and B2C, with customers all of whom have shaped electricity demand. Neither of these business units has control of generation assets and they source the power either from the generation businesses within EDF Energy or the external market (via EDF Trading). In an ideal world, the B2B and B2C businesses would prefer to buy shaped electricity products as this would minimise their risk. However, in practice the vast majority of B2B and B2C trades are executed using standard tradable products, regardless of whether the counterparty is another business unit within EDF Energy or the external market. For example, in B2C when hedging begins it will be in season baseload products with the shape being refined only when peaks become liquid. Refinement to an EFA Block shape begins with the months, with half-hourly shape only traded in the prompt. The introduction of the N2EX auction has been an important development for EDF Energy as it has provided a route to market for hourly shape at the day-ahead stage, which we use extensively to balance our portfolio.

135. Although the majority of trading is as outlined above, there are EFA Block shape trades between generation and B2B or B2C within year. These trades are executed at a price agreed by both business units.

Critique of Ofgem's proposals

136. Ofgem's stated objective is to provide the electricity market liquidity that market participants, in particular independent and small market participants, require to compete effectively against existing players and to encourage competition between vertically integrated players.

137. Ofgem have stated that their proposed remedies are intended to address two separate issues:

- Mandatory Monthly Auction – "Help to drive reference prices and support the ability of independent market participants – including potential supply market entrants – to access the bulk of the wholesale products they need."
- Mandatory Market Maker - "To ensure that market participants are able to trade continuously and mitigate imbalance risks. We expect that MMM would particularly benefit participants who have difficulties accessing the market at present."

138. While we agree that a recognised reference price is an important tool for all market participants, including potential new entrants, we do not agree that Ofgem's proposed remedies will deliver this. Similarly, while we agree on the importance of facilitating market access for small suppliers, we do not believe that the mandatory market maker is the best solution.

139. We provide specific comments on Ofgem's proposals below followed by alternative proposals that we believe will improve overall liquidity and reduce the barriers to entry for smaller suppliers and other participants.

Mandatory Monthly Auction (MMA)

140. The key to developing a robust reference price is to focus sufficient liquidity into a single timeframe (such as the prompt) so that market participants are confident that the reference price itself is not readily open to manipulation. This is the aim of the N2EX initiative and other similar day-ahead auctions such as the PowerNext in France.

141. It is not clear how the mandatory monthly auction proposed by Ofgem would create a robust and transparent reference price compared to that produced by a day-ahead auction such as the N2EX. In the day-ahead auction, all volume clears against the 24 individual hourly auction periods whether it is submitted to the auction as baseload, peaks or shape. As a result, a robust reference price is created for each hour. These prices can then be averaged to obtain a reference price for peaks, baseload or indeed any shape that participants wish to trade.

142. This contrasts sharply with the proposed monthly approach where longer-dated standard or shaped products would be auctioned rather than individual hours being traded. If there were a month-ahead auction, this would be the logical approach as the auctioning of individual hours at any time period other than the prompt is impossible due to the high degree of risk. The proposed monthly approach could create an individual reference price for each of the products traded, but the volumes and therefore the robustness of each reference price are likely to be lower as liquidity will be split between products. For example, a season-ahead peak trade would not contribute to the reference price for season-ahead baseload and vice versa.

143. If a key aim of Ofgem is to create a robust reference price, it is the view of EDF Energy that this will be better achieved through a day-ahead auction such as the N2EX rather than the proposed monthly approach.

144. EDF Energy is also particularly concerned with the proposed regulatory interference in the setting of reserve prices as determining what is a 'reasonable' is far from straightforward. A large number of factors beyond purely the fuel and carbon costs influence the price at which a market participant is willing to sell any particular product. These include start-up costs, minimum on and off times, constraints on running hours, fixed costs and how good a hedge the product is for the portfolio. Unless low load factor plant can recover fixed costs and the shadow cost of constraints, it may become unprofitable and close, leading to a security of supply issue. As a result, any test of "reasonableness" is likely to be very complex and result in high administrative overheads and ultimately lead to higher costs for the consumer. Such a degree of regulatory intervention could also deter financial players from participating in the auction.

145. The month ahead auction goes against our key principles of a market based solution with minimum intervention. Consistent with its better regulation objectives, Ofgem's approach should be based on the minimum intervention necessary to achieve its policy objectives. We believe that any intervention to create a robust reference price should involve remedies with the least unintended consequences and should build on current market initiatives. The N2EX has taken several years to develop and it will be more cost effective and timely to build on this rather than to develop a new solution from scratch.

146. A major concern of EDF Energy regarding the month-ahead auction is that of credit and collateral requirements and in our view this has not been sufficiently acknowledged by Ofgem. By definition, longer-dated products have higher collateral requirements because there is more time for prices to move from their current level resulting in a larger potential future exposure if the counterparty defaults. Trading significant volume beyond 1-2

seasons requires substantial risk capital, a commodity that is becoming increasingly scarce. It is our view that a reduction in available risk capital is the primary reason for the reduction in liquidity in longer-dated products.

147. Credit and collateral terms must be cost and risk reflective and it is not clear how an auction makes products more accessible than the current market to small suppliers, who tend to be particularly collateral constrained.

Mandatory Market Maker (MMM)

148. Ofgem's proposal for a mandatory market maker is attempting to deal with reducing the barriers to entry for smaller suppliers and other participants by providing continuous trading. We agree that there should be continuous liquidity available for all participants, including small suppliers, in order for participants to trade and optimise their portfolios prior to gate closure. However, we believe that current market initiatives already deal with continuous liquidity without the need for an unnecessary intervention in the market again the potential for unintended consequences.

149. EDF Energy is not against the principle of market makers but believe that this should be a voluntary rather than a mandatory arrangement. Indeed, EDFT have recently signed up as a market maker for UK power futures contracts on the N2EX and also act as a market maker in other European markets, on a voluntary basis, including France.

150. In a voluntary market making arrangement there is a negotiation between the market maker and the exchange on volumes to be posted, products, bid offer spreads and the appropriate reduction in fees for providing the service. This is a market approach in which two participants come to an agreement and is therefore likely to result in appropriate risk and reward for both parties. In addition it is relatively flexible and can adapt as market requirements change.

151. A mandatory obligation replaces the negotiation and dialogue between parties with mandatory rules imposed by a trustee who is almost certainly not actively involved in the market. This approach is therefore much more likely to result in bid offer spreads for products which do adequately affect the risks or indeed a requirement to provide products which are not appropriate for the market. In addition, a mandatory approach will be much less flexible and adaptable compared to the voluntary approach if the requirements of the market change.

152. We also believe that it is important that Ofgem does not progress with its proposed mandatory market making obligation in isolation from the Commission's review of MiFID as this could result in unintended consequences that are inconsistent with Ofgem's liquidity objectives and have wider implications for the GB energy markets. There is the possibility that, under the market making as envisaged by Ofgem could become a MiFID investment activity, with the result that those mandated would be forced into becoming MiFID investment firms and therefore exposed to the costs associated with operating under the MiFID licensing regime including capital requirements under the Capital Requirements Directive. This would tie up significant levels of capital at a time when unprecedented investment in the UK power market is needed with consequent implications for the Government's low carbon and climate change objectives.

153. Ofgem's proposed mandatory market making obligation could also potentially result in the vertically integrated companies themselves being subject to the same licensing regime as a financial institution. This could have very significant regulatory and market participation costs and it is not appropriate for Ofgem to impose requirements on the industry that could fundamentally change the regulatory framework under which firms operate at an EU level.

154. The EC will be bringing forward legislative proposals on MiFID this summer followed by around 12 months of further negotiation. Until this review is concluded, and it becomes

clearer how the exemptions under the licensing regime will operate, it would not be appropriate to impose mandatory market making obligations on any firm in the UK.

EDF Energy's Proposed Remedy

155. EDF Energy has developed proposals focused on delivering two key outcomes:

- The creation of a robust reference price in order to encourage financial trading.
- The reduction of barriers to entry for small suppliers and other participants.

EDF Energy proposes remedies based on market initiatives

156. We propose remedies based on maximising the use of existing market initiatives. The basis of our proposal is a renewal of the initial commitment agreed by the major participants of the Power Trading Forum (PTF). The commitment being that all day-ahead volumes should be traded through the N2EX exchange.

Establishment of a Liquidity Forum

157. Secondly, we propose the establishment of an Ofgem/DECC led Liquidity Forum. Drawing on the recent example of the Smart Grid Forum, we believe that this would help create common focus and provide drive and direction on the development of thinking - and action - about liquidity.

158. We believe that the creation of the Liquidity Forum would offer a number of clear advantages to the benefit of all market participants:

- It provides a vehicle through which Ofgem and DECC can lead developments and ensure co-ordination with other policy issues;
- It would secure engagement with a broad range of stakeholders including small players and customer groups;
- It provides a focal point to ensure senior-level discussion of issues around liquidity and the necessary participant commitments – something that is currently missing;
- It would provide transparent monitoring of progress against a clear target timetable, and visibility of success.

159. Although EDF Energy believes that it has delivered on the commitments to support the N2Ex made at the PTF, we recognise that the results in the market overall have been disappointing. Hence a further benefit of the Liquidity Forum would be to provide a vehicle for those who have not been able to meet their initial commitments to receive additional encouragement to do so.

Current market initiatives

160. EDF Energy has already taken an active role in the industry by participating in the liquidity debate. We have been fully committed to the development of, and participation in, the N2EX, the industry-led solution to liquidity issues in the market. On average we currently make up c. 20% of all day-ahead volume.

161. Our proposal acknowledges that there are barriers to entry for small suppliers and the fact that participation to date in the N2EX by small suppliers has been low. This issue has been recognised by the N2EX, who has released discussion papers with solutions aimed at helping small suppliers trade on the exchange. The proposal to introduce a clip size of 0.1 MW, simplification of the sign-up arrangements, improvements to the collateral rules, the simplification of the cash settlement arrangements and the introduction of a more efficient direct debit solution could all encourage entry. We believe that it is essential for the industry to work together which should deliver these solutions successfully and at the same time speed up their development.

162. In addition, in March 2011 we published a set of EDF Energy commitments to small suppliers. In this, we committed to enter into discussions with any small supplier regarding the provision of an energy purchasing service or as an alternative provide an aggregation service where this is more attractive. We believe these commitments will give small suppliers access to the market whilst other market initiatives initiated by the N2EX continue to gather momentum. Eventually, small suppliers will have a choice in how they access the market.

Benefits of a day-ahead auction

163. EDF Energy supports the development of a robust reference price to encourage financial trading and provide a more transparent means of assessing the cost of shape. EDF Energy strongly believes that a robust reference price is best delivered through a day-ahead auction as opposed to the monthly approach proposed by Ofgem. We are supportive of initiatives that build on the N2EX as we believe that this is in the interests of customers as it will be more efficient, cost-effective and deliver results more rapidly than developing a brand new solution.

164. Some concerns have been voiced in the industry that the introduction of an auction could reduce liquidity in the continuous market and this has led to a general suspicion of auctions. As a company, we have found the day-ahead auction to be a very effective way of managing our shape whilst continuing to balance our portfolio in real time on the continuous markets. We understand these fears of liquidity in the continuous market being affected by the auction and indeed this would be a severe issue for EDF Energy given the inflexible nature of our portfolio. However we have been reassured that in other countries such as Germany where there is an active auction there is still significant volumes of continuous trading.

165. In order to further facilitate continuous trading and complement the services provided by brokers, N2EX has recently introduced an intraday (spot) market so that the platform now provides market participants with access to a complete offering for trading both short-term and longer term physical power contracts. This development follows the launch in February 2011 of a new cash settled futures market. Whilst these and other market initiatives will take time to develop they will play an important role in the development of market liquidity going forward and represent a major step towards attracting new players to the market. Following this launch, EDF Trading has signed up to be a market maker for UK power futures contracts. This demonstrates our commitment to the development of market initiatives that are designed to promote liquid wholesale markets without the need for direct regulatory intervention.

166. An exchange, such as the N2Ex will also be able to assist with collateral issues. As discussed, the margin calculations are identical for all participants who trade on an exchange, with the obvious exception of individual trade size. This means that small participants pay the same margin rates as large ones. We believe any obligation where trades are to be cleared on an exchange may help to remove credit risk from the market and potentially enable a wider range of participants to become involved.

Additional measures to address the formation of a reference price

167. We agree that Ofgem should continue to monitor the impact on liquidity levels of any market initiatives but believe that sufficient time should be given in order to judge their success, including recent initiatives by the N2EX and EDF Energy's commitment to small suppliers.

168. Should the existing measures still not establish a robust reference price, and as an industry we still believe this is an important development, then EDF Energy would be prepared to make a formal commitment to submit a proportion of our available capacity at the day-ahead stage to the auction provided this applies to all the major generators, not

just companies who have a domestic customer base. The commitment needs to be on all large generators as the ability to provide sell volume into the auction is not driven by vertical integration but the size of the generation portfolio. If the commitment were only on vertically integrated companies then we believe that it should be in proportion to the size of our residential businesses.

169. As we are frequently net buyers at the day-ahead stage, any commitment would be contingent on us being free to access both sides of the market in the auction and the adoption of an appropriate fee structure which is based on net volume traded (as is the case in the NordPool).

170. EDF Energy strongly supports voluntary commitments over that of licence conditions and believes that the commitments should be met by all of the relevant participants, not just those identified as vertically integrated players. Voluntary commitments are quicker and easier to implement and will enable greater flexibility around what products will deliver the required liquidity levels to form a reference price.

Summary of responses to consultation questions

Question	**Question 8: Do stakeholders consider that low electricity market liquidity constitutes a barrier to entry in the domestic retail supply market?**
EDF Energy response	No. EDF Energy does not believe that market liquidity is one of the most important barriers to entry in GB supply markets. There are many other barriers to entry, particularly in the retail market, such as credit and collateral requirements, the cost of trading and billing systems, historic low margins in retail supply, and regulatory uncertainty. EDF Energy believes there is sufficient liquidity available for market participants to trade and balance their portfolios particularly in the prompt (day-ahead) market but also further out on the curve. We believe this lack of concentration of liquidity is the cause for the lack of a robust and transparent reference price. See section above for more details.
Question	**Question 9: Do stakeholders consider that our two proposed interventions (the MA and the MMM) could improve the ability of the wholesale electricity market to meet independent participants' needs, and will ultimately improve the likelihood of retail supply market entry?**
EDF Energy response	No. We have concerns over the potential for unintended consequences with the remedies proposed and believe more analysis and consultation on any intervention is required with reference to the principles we describe in section XX. If this does not occur there is a substantial risk that Ofgem's remedies will not be fit for purpose. See Section above on specific comments on the MA and MMM.
Question	**Question 10: Subject to the results of our further wholesale market assessment, do stakeholders consider that both interventions could be necessary to meet the objectives stated in questions 8 and 9?**
EDF Energy response	In discussing the issue of market liquidity, EDF Energy agrees that bulk liquidity and contestability (the availability of products and prices to support smaller suppliers) are different issues and as such, any associated problems with either will require different solutions, which we highlight in our proposal in Section above. We provide specific comments on Ofgem's proposals in Section above
Question	**Question 11: Do stakeholders consider that there are other intervention options we should be developing?**
EDF Energy response	Yes. We provide alternative proposals that we believe will lead to a successful outcome to improve overall liquidity and reduce the barriers to entry for smaller suppliers and other participants in Section above
Question	**Question 12: On the basis that we could decide to take forward these interventions, do stakeholders have comments on the indicative design choices we have made, as set out in Appendix 2. In particular, views are welcome regarding our initial position on each of the following: Volume**

	requirements • **Product requirements** • **Frequency** • **Governance arrangements** • **Participation** • **Platform**
EDF Energy response	*Mandatory Auction* • If a key aim of Ofgem is to create a robust reference price, it is our view that this will be better achieved through a day-ahead auction with all volume cleared against the 24 individual hourly auction periods whether it is submitted to the auction as baseload, peaks or shape. • EDF Energy are particularly concerned with the proposed regulatory interference in reserve prices as determining what is a 'reasonable' is far from straightforward • If after a suitable period of time we still do not have a robust reference price, and as an industry we still believe that this is an important development, then we would be prepared to make a formal commitment to submit a proportion of our available capacity at the day-ahead stage to the auction. • Any commitment would be contingent on us being free to access both sides of the market in the auction and be on all large generators. • We support the use of current market initiatives; therefore the N2EX should be used to develop the day-ahead auction. *Market Maker* • We are not against the principle of market makers but believe that this should be a voluntary rather than a mandatory arrangement where volumes to be posted, products, bid offer spreads and the appropriate reduction in fees for providing the service should be negotiated between the market maker and the exchange, • EDF Trading has recently signed up as a market maker for UK power futures contracts on the N2EX.
Question	**Question 13: Do stakeholders have any comments on the costs and risks of our proposal, or any alternative suggestions that you have put forward, to take action to improve wholesale electricity market liquidity?**
EDF Energy response	We provide alternative proposals that we believe will lead to a successful outcome to improve overall liquidity and reduce the barriers to entry for smaller suppliers and other participants in Section above

Proposal 3 – Strengthen Probe remedies

Summary

- EDF Energy has fully implemented the probe remedies, but we recognise that clearer guidance on interpretation and implementation for all suppliers may help customers
- We believe that it is essential that Ofgem allows time for the probe remedies to have an effect in the market, and also that Ofgem takes a holistic view of all the obligations being placed on suppliers
- We also suggest that enhancements are made to the investigatory process to help increase the openness and transparency of the regulatory regime.
- EDF Energy shares Ofgem's desire to improve domestic consumers' experience of the retail energy market and will support targeted and proportionate reforms necessary to achieve this.
- We agree with Ofgem that more needs to be done to improve consumer trust in the use of switching sites.

Question 14: Do stakeholders consider that Ofgem should strengthen licence conditions around suppliers' communications and interactions with their customers, to give suppliers less freedom in how they interpret these obligations?

171. Ofgem proposes to give suppliers less freedom in how to interpret the Probe Supplier obligations "in order to ensure suppliers abide with both the spirit and intention of the measures". We would support Ofgem giving clearer guidance on how suppliers should interpret and implement the obligations and in the past have requested clearer guidance in relation to the Probe remedies, and specifically in relation to SLC25A. Clearer guidance would lead to greater certainty for supplier and consumers alike.

172. Suppliers should not be placed at risk of non-compliance with "the spirit" of new regulations which are easily open to different or changing interpretation by Ofgem, consumer bodies, and suppliers etc.

Question 15: Do stakeholders consider that Ofgem should increase its monitoring and enforcement activity to enhance suppliers' compliance with licence conditions?

173. Ofgem also has a key role in building trust in the energy market which has not been evidenced through its recent media activity.

174. We are disappointed that Ofgem has, on a number of occasions, referred to its various compliance investigations as if these amount to evidence that suppliers have not implemented the existing probe remedies fully. Such an approach is highly misleading and encourages consumers to mistrust energy companies, when in fact no wrong-doing has been proven.

175. We also believe that Ofgem should have given time for the full suite of probe remedies to be in operation and for consumers to adjust their behaviour in response. Launching compliance investigations, on the basis of little evidence (in respect of investigations of EDF Energy) serves to damage consumer trust and probably the effectiveness of the probe remedies as a result. For example, Ofgem's investigation into our compliance with Supply Licence Condition (SLC) 25 was launched in September 2010, seemingly driven by a small number of complaints arising in April 2010. However, the implementation of changes to SLC31A (which included the introduction of historic consumption on bills and the requirement to issue annual statements) was not until 1 July 2010. SLC 31A is recognised as key to enabling consumers to better understand their annual consumption and charges when entering in to a sale, including face to face sales and telesales (the subject of the SLC25 investigation).

176. A more constructive approach would have been for Ofgem to raise any implementation concerns directly with us so that they could be assessed, and any implementation changes agreed.

177. Ofgem has an important role through in its monitoring and enforcement activity in ensuring that suppliers are compliant with their obligations and in doing so that consumers are protected. We believe that this is best achieved by an open and transparent regulatory regime that works in the best interests of its consumers, rather than one that rushes to take enforcement action. Such precedents already exist in other regulatory bodies, for example the Office of Fair Trading (OFT), including Trading Standards and the Information Commissioner's Office (ICO). Relevant extracts from OFT and ICO publications are provided below:

- **Office of Fair Trading:** "Preventing harm in the first place is better for consumers than taking enforcement action afterwards. One of the ways we do this is by equipping consumers and businesses with the knowledge they need to protect themselves against unlawful practice. We also encourage businesses to improve their trading practices by educating them about their duties under the law and by encouraging self-regulation."
- **Information Commissioner's Office:** "The ICO here to help you understand these obligations and keep you updated as and when they change.
    - Providing an enquiry service for individuals and organisations.
    - Publishing guidance and information to encourage organisations to achieve good practice and help individuals to understand their rights.
    - We speak to groups to raise awareness of the law and how it works.
    - We influence thinking on privacy and access issues.
    - We have produced detailed guides that will tell you what you need to do to comply with the obligations in your sector."

178. These models are designed to take preventative measures to protect consumers and businesses. We have ourselves, on a number of occasions, received detailed advice on steps to take which has influenced the decisions we have taken in the best interests of consumers.

179. We believe, therefore, that any guidance issued by Ofgem should include a two stage investigatory process. Where potential regulatory concerns exist, Ofgem should undertake informal bespoke discussions with licensees (using the model provided by SLC25A) with a view to resolving any potential compliance issues or concerns, without the need to move to a second stage process involving formal enforcement proceedings.

Question 16: Would stakeholders welcome the extension of some elements of the Standards of Conduct into domestic supply licence conditions?

180. We believe that Ofgem's overarching standards of conduct should be enforceable, but we do not believe they would work well in their current form as licence conditions since they are high level statements which inevitably would be open to interpretation and legal challenge. Given this uncertainty, we believe that Ofgem guidance would need to be developed in consultation with the industry and consumer bodies in order to provide greater clarity and certainty for suppliers. As indicated in earlier correspondence, we believe that this could be achieved either through self regulation, which would involve the development of and Energy Supply Code, similar to the Banking Code, or through additional formal Ofgem guidance.

Question 17: Do stakeholders agree that more needs to be done to improve consumer trust and use of switching sites?

181. We agree with Ofgem that more needs to be done to improve consumer trust in the use of switching sites.

182. We believe that Ofgem should regulate the switching sites that sell energy in the same way as it regulates the sale of all other energy products. A switching site is merely a channel to market and should have the same rules applied as face to face and telesales.

183. We believe that the rules with respect to the advertising of all products available to a consumer need to be tightened to ensure that consumers are being provided with the best information. The advice given by some switching sites to indicate tariffs that, whilst available to customers, cannot be accessed through the switching site, needs to be tightened, so that equal weighting is given to products that are commission free and those whereby the site earns a commission.

184. We believe that consumers have a right to know the commission earned on a sale by a switching site (and indeed any other channel). We propose that the fee should be shown on the consumer documentation in the same way as is common practice for financial services products. Consumers are familiar with this practice in other sectors and it would therefore provide an impartial view of switching sites.

185. Many consumers see switching sites as completely impartial and have a high degree of trust in them. We believe that Ofgem should undertake regular and extensive reviews of switching sites, including an audit of their algorithms and publish an independent review of these twice annually. This would provide consumers with the confidence to use sites in the knowledge that they are operating in the consumers' interest.

186. Ofgem should then introduce a seal of approval that can be displayed by a switching site following a successful review by Ofgem, in order to give the consumer confidence.

187. We believe the cost of acquisition of consumers is unsustainable for suppliers. The cost is effectively borne by all consumers, not just those switching and we estimate that this cost is of the order of £20p.a. for a dual fuel consumer. This figure goes without note by Ofgem in its quarterly updates, yet is around twice as large as the average EBIT/Dual Fuel account for suppliers.

188. We believe Ofgem should provide a low-cost internet switching site and telephone service for vulnerable consumers and that suppliers should be required to pay the costs of this.

189. We believe that where products are unavailable on a switching site, the site should provide a link through to the supplier's site in question, in order to save the consumer time and effort in the decision process, an obvious example of consumer harm.

Question 18: Do stakeholders have any comments on the costs and risks of any of our suggested policies under Proposal 3?

190. The costs and risks of introducing mandatory changes are not insignificant. This is particularly the case where changes impact the ways in which suppliers communicate and bill their customers. The costs to EDF Energy of rolling out the original Probe remedies (primarily IT) were circa £3M in addition to those costs absorbed through normal business activities. It is difficult to assess exactly what the financial impact of further changes would be without better information as to the impact of those proposals. However, costs are unlikely to be less than those previously incurred for similar measures.

191. The impact of regulatory intervention which brings about, often significant, IT change requirements is not confined to spend. IT resources are stretched so that business innovations such as new products and services are delayed or even cancelled in order to accommodate and promote mandatory changes, often within very tight timeframes which expose companies to the additional risk of non-compliance.

192. Ofgem's RMR proposals sit alongside a number of government led proposals to provide customers with additional information on their bills. In developing proposals for amendments or additions to the original probe remedies, Ofgem must take a holistic view of the many obligations being placed on suppliers including Green Deal, cheapest tariff and consumption comparisons with energy efficient properties.

Proposal 4 – Strengthen Probe remedies – non-domestic

Summary

- We support Ofgem's recommendation to not extend the tariff simplification onto the non-domestic market
- We believe extending scope of SLC7A would constrain commercial innovation for larger businesses
- We would support a review of the micro-business definition to ensure it protects the necessary customer
- We believe extending elements of the standard of conduct to licence conditions would not be appropriate for large parts of the non-domestic market:
- We believe Ofgem should preferably address concerns about objections using existing powers
- We have concerns over the transparency of TPIs activities and we would support the development of a suitable regulatory framework

Question 19: Do stakeholders consider that Ofgem should strengthen licence conditions to prevent unfair contracting practices in the non-domestic sector?

193. As described in our response to Ofgem's information request on SLC7A in 2010, we do consider all our business customers as micro-businesses for the purpose of this licence condition.

194. We would have no objection to extending the application of some elements of the SLC7A to a wider group than micro-business customers such as the requirement to provide principal terms prior to the contract, a copy of the terms and conditions within 10 days after agreeing to a contract and a statement of renewal.[5] However there are elements in the current licence condition that could constrain commercial innovation in the rest of the non-domestic market such as the fact that at least one renewal offer must be open for 30 days and that any new roll over contract cannot exceed 12 months.

195. Non-domestic customers run a business and are therefore able to deal with supply contracts whether this is for insurance, leases, telecoms, energy or anything else. We can understand that customers who are running very small businesses may be less expert with regards to energy contracting matters and that extra protection on roll-over contracts and rules around information is appropriate, however this should not be an obstacle to product innovation for other business customers.

196. We note that in the consultation Ofgem do not define which group the SLC7A should be extended to and this raises the question of whether the current definition of micro businesses is appropriate. First of all does it cover the customer types Ofgem consider should get additional protection? Which issues is Ofgem aiming to tackle and is a unique definition of micro-businesses the best approach to respond to a group of customers with very different profiles, concerns and realities? Secondly should Ofgem agree to review the way we define a target group which needs additional protection, we would favour a definition which allows a straightforward identification process that can be implemented by suppliers and be easily audited for enforcement purposes.

[5] We already comply with these requirements when contracting with all of our non-domestic customers.

Question 20: In particular, would stakeholders welcome additional licence conditions surrounding the objections procedure?

197. We are not aware of any issue at industry level concerning the objection process and would not support additional regulation which would add complexity to the customer transfer blocking process especially as the switching process is currently being reviewed as part of the implementation of the EU Third package SLC14.A. The issue mentioned by Ofgem in their consultation could be related to discrepancies in the interpretation of the current regulation. If this is the case, we believe this could be resolved by discussing the existing regulation at an industry meeting and then by enforcing the regulation directly with the suppliers falling short.

Question 21: Would stakeholders welcome the extension of some elements of the Standards of Conduct into non-domestic supply licence conditions?

198. We see the standards of conduct as expressions of our core company values of (a) integrity and (b) putting social and environmental responsibility at the heart of everything we do. They are also consistent with our brand promises and in particular with the promise to reward customers for choosing us by delivering beyond their expectations.

199. The diversity of products and customer profiles in the non-domestic market means however that it would be an extremely subjective judgement as to whether suppliers were compliant with a requirement to "not sell a product or service that he or she does not fully understand or that is inappropriate for their needs and circumstances" and to "not to offer products that are unnecessarily complex or confusing" should these elements be extended to supply licence conditions. What may seem inappropriate or complex for one customer can be a requirement for another one and this is true regardless of the size of the company. Also, many non-domestic customers receive additional advice from their consultants.

200. We therefore believe that standards of conduct should only be placed into licence conditions where there is a clear justification in the context of Ofgem's statutory duties

Question 22: Do stakeholders agree with our position, at this stage, not to extend our proposals on tariff simplification into the non-domestic sector?

201. We agree with Ofgem's position not to extend the proposed tariff simplification into the non-domestic sector. In the non-domestic market, EDF Energy – and presumably other suppliers – do not sell any evergreen contract without an initial fixed price period. The only time where a new customer can be on an evergreen contract is for deemed contracts where the customer would not have negotiated or actively signed up to a contract. In all other cases, they have signed up to the contract with a fixed price period. At the end of that period customers are reminded by account managers and by letter that their contract is due for renewal. This constitutes a natural time for negotiating a new contract with their current supplier or to go to competitive tender. The proposed tariff simplification detailed by Ofgem for the domestic market would therefore not be appropriate or relevant for the non-domestic market.

Question 23: Do stakeholders agree that Ofgem needs to look further at the role of third party intermediaries (TPIs) in the non-domestic market?

202. EDF Energy welcomes Ofgem's proposal to examine the role of TPIs and to consider what action is needed to address the two recurring themes of mis-selling and the lack of transparency surrounding commissions.

203. Concerning the lack of transparency, we shared with Ofgem at a meeting on 1st March 2011 our initiative to add a statement to our contractual agreement with customers that they may be paying a commission should they be contracting via a Third Party (where the third party is the agent of the customer). We also sign an agreement with TPIs which

includes a provision stating that the intermediary must disclose to the customer that the prices charged will include a commission. Intermediaries are further required to disclose the fee rate to the customer if requested. We are pleased to say that most of the TPIs we work with have signed up to this agreement, but not all. Among those not signing are some of the largest and most established TPIs.

204. Our action will only have a limited impact on the market unless this approach is adopted by all the other suppliers. In order to ensure a level playing field between all suppliers but also TPI and brokers, we think more transparency of the services customers are supplied by TPIs and how their cost is cascaded to customers is required under some form of obligation. Previous examples of self regulation in this area have not so far been very successful.

205. With regards to the mis-selling issue, we are aware of anecdotal stories suggesting mis-selling within the industry. For larger customers we do not accept verbal contracts and all contracts are only formed where we accept the customer's contract offer ie once the customer has signed the contract which includes the full T's and C's and all the information on the products, services, duration and prices.

206. For smaller customers we have processes in place to protect against mis-selling. We have recently changed our sales process so that our agents are only paid commission if the customer they have signed-up goes live on supply. This is an effective incentive to reduce mis-selling as agents will not be paid for customers who object at any stage of the contracting process (which is likely to occur if they have been mis-sold).

207. We would not be in favour of recording the whole phone conversation of brokers who represent different suppliers. We have concerns about potential confidentiality and competition issues as these calls will capture discussions relating to products and prices of a range of suppliers. Due to the diversity of offers on the market the calls may also be difficult to follow and therefore monitor.

208. Cornwall Energy recommended mandated accreditation of TPIs by the end of 2011. Although we would support any initiative that would raise the TPI standards, this may not be the most adequate solution in addressing mis-selling. This proposal also raises practical questions (in terms of costs, responsibility, etc) that would have to be considered prior to taking such decision.

Question 24: Do stakeholders have any comments on the costs and risks of any of our suggested policies under Proposal 4?

209. As expressed in our responses, we believe that adding more regulation to the objection process would only add complexity to an already quite complex process. Depending on Ofgem recommendations, this could potentially lead to process and system changes. The customer transfer blocking process is currently being revised and amendments to comply with EU Third package SLC14A are currently being implemented. Changes on the objections process could delay and inflate the costs of current projects.

Proposal 5 – Improve reporting transparency

Summary

- We welcome the appointment of a leading accountant to bring confidence in the reporting.
- We do not support an overly prescriptive approach to segmental accounting which would impact on a choice of business model.
- However, we believe that it is important that stakeholders have confidence in the segmental statements
- We would therefore support a requirement to demonstrate that trades are based on verifiable market prices

Question 25: Do stakeholders agree with Ofgem's proposal to appoint a leading firm of accountants to review the transfer pricing and hedge accounting practices of the vertically integrated suppliers?

210. The segmental accounts should be primary method by which Ofgem understands the profitability of energy supply and generation licensees.

211. Ofgem's quarterly retail and wholesale market reports provide an unsatisfactory approach to assessing margins. They only focus on averages, and ignore the different cost levels faced by each individual company. They are also based on simplified and hypothetical hedging assumptions. Ofgem's quarterly reports are unrepresentative of the low margins being earned by EDF Energy's retail business, and as a result mislead consumers as to the profits we are earning.

212. EDF Energy's segmental accounts are based on market based transfer prices. We are confident that our approach is robust and will be happy to discuss it with any appointed experts.

213. We would appreciate the opportunity to comment on the proposed terms of reference for the appointment of the "leading firm".

Question 26: Do stakeholders have views on how Ofgem could improve segmental reporting in future years?

214. We do not support an overly prescriptive approach to segmental accounting which would impact on a choice of business model, or which would undermine competition by revealing commercial strategies. We believe that Ofgem's shares this view.

215. However, we also believe that it is important that stakeholders have confidence in the segmental statements so that they can assess for themselves the benefits (or otherwise) of market entry/expansion.

216. We believe that an appropriate solution would be to continue to allow licensees the freedom to choose an approach to segmental accounting which best suits their business model, but in the context of a new regulatory requirement to be able to demonstrate that transactions between licensed businesses are valued at verifiable market prices.

Other questions

Question 27: Do stakeholders consider that our proposals will be sufficient to protect the interests of consumers, including vulnerable consumers, or are additional consumer protections measures necessary?

217. The BIS/Cabinet Office paper "Better Choices better Deals", considers the particular needs of vulnerable consumers. In this context, consumers are vulnerable in relation to the

different skills that contribute to making them empowered (e.g. knowledge of consumer law, numeracy skills, ability to compare prices). Poor computer/internet skills, people who have difficulty paying bills, and the elderly, are among the groups likely to give rise to such vulnerability.

218. An important part of the government's approach is building both access to the internet and confidence online. Participation is being encouraged by the Government's "Race Online" campaign, led by the UK Digital Champion, Martha Lane Fox. However, it is recognised that some consumers will not have access to, or wish to use new technology to help them make decisions, and therefore will need additional types of support.

219. The paper notes (as echoed by the European Consumer Empowerment Survey) that the growing evidence base for behavioural science in the UK suggests that some individuals are more prone to behavioural biases than others (e.g. individuals with a relatively low income are more likely to choose immediate benefits at the expense of future rewards).

220. Reviewing support for the most vulnerable consumers is therefore seen as a complex area because of the ways in which different groups are affected in different markets. Citizens Advice, Citizens Advice Scotland and Consumer focus have been asked to identify the groups of people and the type of transactions where more help and support for the most vulnerable consumers would make the greatest difference.

221. The government's approach is not focussed on banning complexity, but rather identifying the specific needs of vulnerable customers in the context of the particular market in question. We believe the government's approach contrasts strongly with Ofgem's one-size-fits-all proposals (e.g. imposing a single p/kWh comparator because some customers have poor numeracy skills).

222. We believe that this is the right approach to take as it should result in the minimum intervention needed.

Question 28: Do stakeholders consider that our measures to simplify tariffs will reduce the ability for suppliers to price discriminate between regions and so reduce the need for a licence condition prohibiting undue discrimination?

223. As explained elsewhere, EDF Energy have proposed alternative measures to simplify tariffs which we believe will deliver superior results and also create less consumer detriment.

224. EDF Energy supports retention of the current undue discrimination condition in order that Ofgem can ensure cost-reflectivity without having to make arbitrary interventions such as setting regional standing charges.

Appendix 1

EDF Energy Consumer Research

We have undertaken quantative and qualitative research to support our response. The research findings are summarised below and these are the key findings:

- Substantial savings are required before consumers will switch supplier – implying that tariff simplification will only have a limited effect
- Tie-ins with boiler insurance are a barrier to switching
- Consumer's value choice, suggesting detriment is they are deprived of such choice
- Entrants face a reputational barrier

Our quantitative and qualitative research shows the following:

- Our quantitative research found that the average saving a dual fuel consumer requires in order to switch has increased significantly since we last undertook this research in 2007 and is now £174 (2007 = £81).
- Our qualitative research shows consistent results with a range of £100-£250 in terms of real saving required in order to switch
- The majority of consumers calculate these required savings from a percentage of their monthly or annual bill plus a time cost of involvement from themselves
- Cashback offers are favoured, as they provide an instant saving, but consumers do not necessarily engage further with the market following this "instant gratification"
- Our quantitative research showed that the main inhibitor to switching is that savings required by consumers outstrip savings expected. Also, consumers worry about ending up on a more costly tariff. Our qualitative research showed something of a regional bias to this latter effect with consumers in the more northerly location more disposed to being content with their latent provider
- The qualitative research also showed that the switching process and the problems associated with it were a major cause of frustration and concern. This is a key reason for consumers not to look to switch supplier
- For those with energy boiler insurance, 40% think it would make them either a little or a lot less likely to switch energy supplier
- 79% of consumers would prefer the same or a greater level of choice of energy suppliers and tariffs.
- 45% of consumers thought a larger choice of suppliers in the market would make them more likely to switch. The mean consumer estimate of suppliers was 14, offering 16 tariffs each.
- 48% thought it was unlikely that they would switch to an unknown supplier, even if they had the best deal.
- The mean increase in saving needed to switch to an unknown supplier over a known supplier was £36.
- Consumers suggested that the energy supply market would benefit from learning from the insurance industry in terms of engaging consumers, where annual renewal letters prompt continuous search and review. The energy market is currently not seen to encourage this process

- In addition to driving more engagement, annual renewal notices are also considered key to improving the understanding of expenditure. There is preference for annual notices to have some link with Ofgem
- Consumers were also looking for clear comparisons between suppliers and tariffs – the current model is seen to be quite convoluted
- The Ofgem evergreen proposal appealed to those consumers motivated purely by price. However, engagement was expected to be only at point of sign up and it was thought that there would be limited ongoing assessment of other tariffs in the market (except for the few serious 'Deal Hunter' types). Some participants highlighted the business risk of a model which encourages collaborative behaviour amongst energy companies and believed they would be more disengaged as a result
- The concept of a contract with a defined end point supported by an annual renewal letter was seen to work well in prompting people to review their options
- Consumers' preference is to have Ofgem involved in the setting of the standardised charge
- When offered the alternative of allowing suppliers to fix the variable and fixed elements at any level i.e. offer choice akin to contract and pay as you go, there was a heavy bias for options at the extremes of the scale
- Consumers could understand the savings between tariff options much more clearly if values were shown in terms of £ per MWh rather than p/KWh

Our research methodology is outlined below

Quantitative

Undertaken by ICM Research

Sample = 2027 Online Interviews weighted to be Nationally Representative

Fieldwork 21st-24th April 2011

Qualitative

Undertaken by Relish Research

4 Focus Groups amongst a broadly representative sample of the general public

Fieldwork 12th May, 16th May

Our appraisal of the research undertaken by Ofgem is as follows:

- Overall we find much to agree on in the research carried out by Opinion Leader on behalf of Ofgem. There are some themes that we have seen frequently in our own research connected to complexity, trust and the associated desire to switch between different energy deals. The methodology followed by Opinion Leader both raised and explored these topic areas, and we would concur with the overall conclusions up to and including Section 9, particularly in the consumer trade-off between dislike of complexity, and desire for personalisation and choice. However as the research went on to exploring differing tariff structure options as a potential stimulus for switching, we believe the methodology moved towards over-simplification of consumer perception and choice mechanics, and ultimately introduced significant flaws into the final conclusions.
- The nature of the deliberative session methodology is that facilitators would have needed to take people through each of the tariff structures to help them understand what the benefits are. Within these discussions facilitators are likely to have pointed out what the differences are rather than having people reviewing the energy decision making process on their own and within a more typical environment and channel. For instance the Behavioural Insight processes at work as a consumer uses a Price Comparison site would be fundamentally different to the process of a Face-to-Face sale, or indeed a proactive

telephone call to a supplier. The methodology could not replicate the true decision-making process and as such it hard to ascertain to what extent a “Research Effect” governed the reaction to the proposed tariffs and by extension the conclusions to their likely effect if implemented. If done again, perhaps a more longitudinal approach would work better in a one-on-one or ethnography-based environment.

- It is clear from the research that many people wouldn’t really understand the current model and the number of tariffs the industry provides, let alone any proposed model. By proposing solutions within the framework of the OFGEM panel, the bias for consumer reaction would be to anticipate consumer-focussed “solutions” from the regulator to a market “problem”, and though perhaps able to compare between models, all would be likely to be perceived as an improvement on the current system.
- Overall it seems that the research took a fairly linear approach to a multivariate consumer issue, and lacks critical integration around components such as visual design of billing/tariff information, channel context, attitudinal segmentation etc. – all of which could potentially drive “engagement” more effectively than the solution put forward from the consumer research as carried out.

Appendix 2

Factors not considered by Ofgem

Challenges with use of Behavioural Economics

Our detailed comments of the use of Behavioural Economics (BE) in energy regulation are set out in Appendix 3. In summary, we believe that:

- The application of BE is a useful development in the understanding of consumer behaviour in retail markets.
- BE cannot reveal everything Ofgem needs to know. For example, there may be clear economic benefits in "complexity" as it leads to cost reflective charging and reliable price signals.
- BE may only partially define consumer detriment as it perceives markets from the consumer experience alone and without reference to the actual economics of the industry.
- Ofgem has not convincingly integrated its behavioural insights, market research, and policy proposals. In particular it is not able to identify the number of customers in each perceptual bias category, and there is no explanation as to why or how customers that have switched in the past have overcome these barriers.
- This means that Ofgem may be unable to correctly target its remedies to different consumer groups if there is evidence to suggest that different biases require different solutions.

Lessons from Competition Economics have been forgotten

By using competition economics as a guiding framework for the assessment of the retail market, EDF Energy believes that there are some important features that so far have been underplayed in Ofgem's competitive assessment, yet are critical in understanding the market as a whole.

The definition of relevant market is an important starting point. Is it a dual fuel market or single fuel? Are there different markets or segments of one retail market? Should they be treated differently as they clearly have a different set of participants?

The number of suppliers is an important metric in the assessment of the market. Six players are enough to guarantee a competitive outcome (putting aside concerns about the scale effects) if they are not able to collude, and Ofgem has repeatedly found that no collusion is taking place between suppliers. However, there are more than six suppliers in the market. It is also the case that the more competitors there are, the greater the number of products on offer.

Switching is an indicator of competition in the market and should not be discounted as a metric of retail competition. Ofgem has, over the last ten years, consistently found evidence that customers know that they can switch supplier (around 95% in 2001 and 96% in 2010). It has also by its own evidence shown that up to 20% of customers are willing to switch supplier. The threat of customers switching away from suppliers is not trivial and cannot be ignored. The market is clearly not stagnating as some have suggested, despite the issues identified elsewhere in this response.

There are a number of features associated with the economics of energy supply industry that need to be considered.

Economies of scale are both stepped and to a large extent consist of sunk costs. If a firm was to grow organically, it would have to focus on billing systems in the first instance to gain revenue and would require the ability trade in the wholesale markets. Initially, it may well be possible to use spreadsheets at very little cost to achieve this. However, if the business was to expand, a bespoke billing system would be required. This would entail a step change in cost but without the incremental revenue to cover costs or to repay the required finance. This would be vital as customer relationship systems would be required to maintain good customer service. This investment is a sunk cost as billing systems are difficult to transfer to other sectors, along with any goodwill. Essentially the supplier could risk going through a period of negative fixed costs relative to its customers until the business was able to expand to recover the investment. These characteristics are an unavoidable feature of the market.

We have also seen a number of market assessments which indicate that the sector as a whole is competitive. We note that we are the first and most highly liberalised market in Europe. Using the older approach to market assessment in 2007, Ofgem concluded that "our analysis and review of developments in the domestic energy supply market over the past 12 months suggests that the market remains dynamic and highly competitive".

Issues associated with new entry have been overstated by Ofgem

Firstly, Ofgem's assessment of the existing players in the market segments as new entrants should be acknowledged. In retail there are six players in the domestic market who are different from the I&C market. Yet when it comes to assessment we would expect Ofgem to class I&C suppliers as at least potential new entrants into the domestic market. They present a credible threat with both financial backing and the technical expertise to quickly gain market share if they choose to do so. There are generators who do not have a significant retail business. Again they pose a credible threat to the existing market structure. In fact, Drax Power is developing its own I&C supply activities, and IP has interests in Opus Energy.

There are also other perspectives derived from competition economics which provide a significant in understanding new entry and are probably more realistic scenarios of market development. The market for corporate control creates a significant discipline on managers. We have seen Entergy and CSW holdings own London Electricity and Seeboard respectively in the past, and then exit the market. According to this mainstream Industrial Economics theory, a new entrant could potentially buy the existing assets and run them more efficiently. This is curious as Ofgem in the past have used the concept during the distribution price controls as a discipline for DNOs to reduce their costs, but seem to disregard it when considering the retail market.

An application of transaction cost economics and its role in understanding new entry would help Ofgem understand how the complexity of the energy industry deters entry.

World energy markets determine the UK's Energy Bill

It is crucial for Ofgem's assessment of the market to consider the contextual factors that shape the retail market and in particular input costs.

Retail energy prices are driven primarily by our input costs and in particular our activities in the wholesale market.

Energy is purchased by suppliers in the GB wholesale market but prices are driven by global forces such as Chinese demand for primary fuel or geopolitical instability that could threaten production. The UK is competing for finite resources and we have seen coal, gas and oil prices have exhibit a shallow but upward trend over the last ten years.

The market has also been volatile, which creates particular risks for suppliers. For example, since the price shock of 2008, coal price for the API2 coal contract for 2012 went from a peak of $210.5/t on 1st July 2008 to $81.15/t just over eight months later (16th March 2009). We are now experiencing more stable prices at around $128/t.

It is not possible for companies in the UK to insulate their customers from underlying global trends even with sophisticated hedging strategies.

In this context, rising prices do not equate to rising margins – indeed quite the opposite, since competitive pressure make suppliers reluctant to pass on increased input costs for as long as possible.

Appendix 3

Understanding the application of behavioural economics to the retail energy sector

Summary

- Application of BE is a useful development in the understanding of consumer behaviour in retail markets.
- BE will not reveal everything Ofgem needs to know. It may be the case that there are some benefits in "complexity" as it leads to cost reflective charging and reliable price signals.
- BE may only partially define consumer detriment as it perceives markets from the consumer experience alone without reference to the economics of the industry.
- However, Ofgem has not convincingly integrated its behavioural insights, market research and policy proposals
- In particular it is not able to identify the number of customers in each perceptual bias category. There as no explanation as to why or how customers that have switched in the past that have overcome these barriers
- This means that Ofgem may be unable to correctly target its remedies to different consumer groups if there is evidence to suggest that different biases require different solutions
- A better solution would be to keep the benefits of complexity yet provide an accurate but simple way of comparing tariffs

1. BE as a regulatory perspective

EDF Energy broadly supports the application of BE (Behavioural Economics) to the sector but like all policy tools the context and research design that supports the theory will determine the results and more importantly the nature of consumer detriment. BE sets out a new regulatory agenda in terms of looking at the subjective experience of consumers which leads to questions about brand and non-price offerings. However, in this subjective world of consumer's experience the degree of certainty a regulator has in terms of its understanding consumer dynamics will be significantly reduced and the need for a moral framework to make judgements increased. This is particularly important for defining what constitutes a "fair" deal for consumers in the context of retail competition in the UK.

The BE literature requires a degree of interpretation from the regulator. BE did not ever claim to produce iron laws of human behaviour but rather identify biases in human activity by using insights of psychological analysis. In fact as the sub discipline develops we may find either different emphases or new insights that might lead to different forms of intervention. Ofgem must therefore be cognisant of changes in a fast moving research area.

We note that where the experimental approach is cited in the literature review it almost inevitably leads to limited testing of a number of controlled variables (e.g. citation of Kahneman *et al* 1990 or Mardin and Shea 2001 (p7)). It is difficult to create a composite picture from what are highly specific and therefore in total fragmented studies. Furthermore, we saw limited number of review articles cited in the academic literature review which attempted to integrate research findings. This was a disappointment but is consistent with the difficulties in making grand theories from a subject area dominated by experimental literature alone.

If BE cannot identify specific contexts than it is only able to identify the possibility that a bias may exist. A founding experiment of the discipline concerned the trading of college mugs by students to identify loss aversion in 1990. This insight is devoid of context. The precise meanings associated with UK energy are not captured by knowledge of the existence of behavioural traits alone. Other research evidence suggests for example, that some customers have a fear of having their supply cut off if they switch suppliers. This finding for example, could be part an important part of the loss aversion bias. At present the context is under researched with Ofgem's rather limited survey of 98 consumers which attempted to perform this task.

In conclusion the application of BE has the following limitations-

- The application of BE is only effective if it is backed up by detailed research that can be developed into policy solutions.
- We cannot readily identify specific behavioural bias using Ofgem survey results alone.
- Even if we could it would not indicate what trait and at what time customers are experiencing it. Is it the case consumers exhibit multiple traits? If so a number of policy solutions are required.
- It is unclear how any energy consumers have ever switched if these behavioural biases are deep rooted or persistent? A more interesting piece of research would be to understand the processes by which active consumers have switched or what changes occurred to prevent further activity.
- BE needs to be placed in the context of UK energy consumers in 2011 or it will have little value.

2. Application of BE

The behavioural traits identified by BE are derived from psychology but do not have the status of rules only biases. However for policy making purposes it is important to know not only the different types of market behaviour but their relative proportions in energy consumer population and under what timings and circumstance they exhibit this behaviour. On page 9 of the document we find that Ofgem claims consumers fall into five categories of consumers- "passive", "disengaged" or "permanently disengaged" that do not match or are particularly useful for identifying the four behavioural biases mentioned on page 5- "limited consumer capacity", "status quo bias", "loss aversion" and "time inconsistency." We also see that any one of these traits for example, "loss aversion" cannot explain pro and reactive customer groups which could total up to 20% of the market (Figure 3.1 p9). In summary, the research needs to fully integrate the BE insight into the empirical findings.

3. Complexity and search costs: the real issue?

Explicitly defining the process by which customers choose energy suppliers would have been a more useful approach. In fact as we have argued it would have also been sensible to identify what factors caused those customers to be active in the market. Our own research found that when asked about the tariffs currently available that 69% were happy or wanted more choice:

35%	wanted more choice
34%	neither nor
21%	wanted less choice

If there were more suppliers it would only increase the willingness to switch by 3% over those neither nor less likely to switch their existing supplier.

More likely to switch if there were more suppliers in the market	45%
Neither nor	42%
Less likely	13%

Figure 3.2 (p12) of the document suggests that tariffs causes complexity and we to a certain extent agree. However the number of effective choice of tariffs a consumer has will not be over 300. Instead fundamental choices about the tariff will reduce the number considerably. For example a consumer can make a decision to enter a green contract or choose payment

type such as PPM. For these customers the choice is much narrower than suggested by the graph.

Furthermore the existence of "inherent complexity" was acknowledged by the OFT in its pricing paper. What BE cannot do alone is to define the nature and scale of intervention. It for example cannot identify why complex tariffs arise in the first place only their impact on consumers in understanding the market. This is critical in electricity as it is valued real time and there are substantial benefits in cost savings for the industry and consumers in reducing consumption at certain times in the day. BE may only partially define consumer detriment as it perceives markets from the consumer experience alone without reference to the economics of the industry. There can also be scope for what could be termed consumer detriment of sorts due to cross subsidies between different types of customers.

An example of this could be the application of uniform tariffs to consumers who do not consume as much electricity as others at certain times in the day but pay exactly the same charges. Yet one group of customers could have a dramatic impact on the market as they will be defining the expensive marginal prices for the whole market. Equally customers who change their consumption to off peak times will not receive any benefit from shifting their consumption. A multi-tier tariff acts to equalise this situation and give proper price signals for generators. The present application of BE to energy is therefore only a *partial* theory of detriment in the multi tiered tariff debate.

4. Conclusion

We would like to have seen some further discussion on the importance of brand and values which BE inevitably introduces into the understanding of the retail market. The report acknowledges this:

"Value is an abstract concept and so people use cues from the world around them to make sense of whether a particular offer is a good or bad deal"

Appendix 4

EDF Energy comments on Ofgem's assessment of Retail Market

Conduct	Recognised by EDF Energy?	Commentary on evidence and diagnoses	Likely detriments from Ofgem proposals
Complex tariffs	**Partially**	Complexity overstated and it reflects competitive innovations, not objective to "bamboozle". Other barriers to switching key	Forces some customers into repeated market engagement, reduces non-price innovation, and impacts on smart-metering benefits
Poor response to probe remedies	**No** - EDF Energy has fully implemented	May apply to other Suppliers but arguably premature conclusion given limited time and open investigations	Clear guidance on interpretation and implementation may help customers – but Ofgem media approach likely to damage confidence
Market segmentation	**Partially**	Inevitable feature of efficient supplier behaviour in **all** competitive markets	Ofgem formalises segmentation into evergreen and fixed term
Co-ordinated effects	**No**	No evidence of collusion. EDF Energy has independent strategy for growth – winter price freeze	Ofgem inadvertently encouraging co-ordinated effects by limiting choice and validating cost base
High self-supply	**No**	Adequate liquidity in prompt; liquidity concerns reflect shortage of shape further out; EDF Energy puts significant volumes through markets; issues of collateral is critical	Mandatory month-ahead auction risks significant market distortion/regulatory risk, and risks inconsistencies with EMR outcomes
Failure to engage with small suppliers	**No**	EDF Energy always prepared to offer terms, and has made specific proposals in terms of commitment to small suppliers in 16 March letter	Mandatory market making may result in MiFID status as investment firm, with significant cost impacts and would not reducer barrier to entry for small suppliers
Excessive retail margins hidden	**No**	EDF Energy uses market based transfer prices and is losing money in residential retail	Over-transparency could undermine competition, e.g. by revealing hedging strategies
Inadequate transparency	**Partially**	Root issue is lack of confidence in reports provided, not absence of reports	Review welcomed if it builds confidence – should confirm that trades based on verifiable market prices

EDF Energy's perspectives

EDF Energy recognises the dimensions used by Ofgem, but does not agree with Ofgem's interpretation of the evidence in all cases. As a result, we do not share Ofgem's assessment of the harm done, and therefore we do not believe that Ofgem's proposed remedies, which themselves would lead to significant levels of consumer detriment, can be justified.

Each of the above elements is discussed in turn below.

Complex tariffs

We share consumers' concerns regarding the complexity of energy tariffs. This is one of the reasons why we have already removed unit price banding for standard metered customers.

EDF Energy does not have any policy of seeking to "bamboozle" customers, and has developed products to compete effectively. However, we recognise that the combined effect of such innovation across all suppliers has created difficulties for some customers.

Poor response to Probe Remedies/poor supplier conduct

EDF Energy has fully implemented the Probe remedies. We note that the key elements of the Probe package only came into effect last year, and hence it is premature to conclude what effects they have had.

On a procedural point, Ofgem is wrong to use the existence of compliance investigations as evidence of poor supplier behaviour when those investigations have yet to be concluded.

We also note that many of the implementation issues referred to in Ofgem's paper could have been addressed constructively through simple dialogue with the industry.

We comment further on each of the Probe remedy licence conditions below:

- SLC7A (information to micro-business customers): Ofgem accepts that the licence condition has been successfully implemented. The relatively minor issues set out in Appendix 8 of Ofgem's consultation paper could be easily addressed through dialogue with the industry.
- SLC25 (marketing to domestic consumers): Unproven allegations do not amount to evidence of bad behaviour. EDF Energy has fully implemented the licence condition and continues to work constructively with Ofgem's investigation team to demonstrate that this is the case.
- SLC25A (non-discrimination): Ofgem concludes that suppliers have implemented the requirements of this condition.
- SLC27A (payment method differentials): We have fully implemented the requirement. We cannot comment on Ofgem's investigation into Scottish Power's compliance, but as with Ofgem's investigation into our compliance with SLC25, it would be inappropriate to conclude that poor behaviour has taken place until the investigation has been concluded.
- SLC31A (bills and annual statements): We have fully implemented the requirements of SLC31A and have received no adverse comments from Ofgem. In July 2010 Consumer Focus ranked EDF Energy as Good for both bills and annual statements. .

Standards of conduct (domestic) – Ofgem finds that suppliers are presenting clear written information. High numeracy requirements are not evidence of bad behaviour if complex products offer consumers other benefits (for example cost reflectivity).

Market Segmentation

The retail energy market is highly competitive and EDF Energy must offer discounts in order to attract new customers.

Co-ordinated effects between suppliers

Ofgem has repeatedly found that no collusion has taken place between suppliers.

Energy retailers are subject to the same movements in primary fuel costs, and have limited ability to shape these through hedging.

EDF Energy has an independent business strategy, and was the only company to have a 'Winter Prize Freeze Guarantee' last winter. EDF Energy also has ambitions to grow its customer base. This is in contrast to Ofgem's assumption that suppliers are focused on consolidating their positions.

No evidence of excessive profits

We also note that Ofgem's analysis of supplier profits (Appendix 9 of its consultation paper) finds that they are on average below those earned by other retail sectors (p.16). Even if evidence of price asymmetry existed, it is therefore hard to see how any consumer detriment has arisen when average energy retail margins have been low.

Given that the presence of asymmetry or otherwise on its own says little about the state of competition in the market, it is a pity that Ofgem referred to it in its 21 March 2011 press release and its associated media interviews without giving appropriate warnings at the qualified nature of its findings. Such an approach is unlikely to have a positive effect on consumer confidence in the retail market.

Price differentials

Ofgem has examined the range of dual fuel direct debit annual bills available between March 2004 and March 2011. It notes a decline in the range from the end of 2006 (nearly £200) to around £40 for the majority of 2009 and 2010. Ofgem's chart (Figure 2.12) shows that the 2006 figure was very much a spike.

It is not clear whether Ofgem's analysis takes into account non-standard products (fixed term deals etc). If these are not included then the analysis cannot represent the differential actually available to customers,

SLC25A (non-discrimination) has undermined suppliers' ability to set prices independently of costs, so it is not surprising that differentials have fallen.

Limited growth ambition

Contrary to Ofgem's assertion that "Suppliers pricing strategies are also driven by the need to retain customers", we have ambitions to grow our customer base. EDF Energy was the only supplier to offer a 'Winter Price Freeze Guarantee' and this is evidence of its ambition and independence of approach.

It is clearly wrong to treat the main suppliers as a homogeneous group. Not only does EDF Energy have an independent business strategy, it is in fact a relatively small player in the domestic market and does not benefit from the economies of scale (or margins) enjoyed by its larger competitors (particularly British Gas). Economies of scale are an important driver of EDF Energy's growth ambitions, and they are an important dynamic which cannot be ignored.

The companies also differ in terms of their share of gas and electricity customers, in terms of regional/national focus, and with regard to the range of other services provided (e.g. boiler maintenance). Real or perceived tie-ins between energy and other services are an important barrier to switching not recognised in Ofgem's analysis.

The gas and electricity industry continues to have one of the highest switching rates of any energy market across the world (Ofgem 2008 Probe Findings p44). In our case, EDF Energy experiences a domestic annual churn rate of around 17%. The competitive effort and cost needed to replace these customers should not be dismissed and nor should it be underestimated by regulators.

Similar hedging strategies

We have no knowledge of the hedging strategies of our competitors.

High levels of self supply/ vertical integration

EDF Energy carries out the majority of its energy selling and purchasing through the market.

The relative lack of liquidity in some parts of the market (forward shape) is because there are few natural providers of shape, significant levels of uncertainty (e.g. impending Electricity Market Reform, carbon prices), and relatively high collateral costs. The perceived lack of liquidity, as far as our trading activities are concerned, is not the result of vertical integration.

EDF Energy's primarily nuclear fleet provides baseload energy and provides relatively little natural hedge for its retail businesses. We must manage shape through the wholesale market (particularly through the prompt, N2EX day-ahead auctions, and within-day trading).

Cross-subsidisation of supply and generation/ lack of transparency

EDF Energy uses market prices as transfer prices. Profits are not hidden upstream.

EDF Energy's segmental accounts reconcile to its statutory accounts, are based on market prices, and comply with Ofgem's requirements. They contain the same information as that used by our directors to manage the business.

Appendix 5

Example of Annual Renewal and Reminder

OFGEM
LOGO HERE

Save today. Save tomorrow. EDF ENERGY

Mr A B Sample
1 Any Road
Any Village
Any Town
A99 9AA

Account Number 000000000000

31 May 2011

Helping you get the best value for your Electricity and Gas

Dear A B Sample

This Letter is sent to you by Ofgem and you energy supplier ABC Energy. It shows the details of your current product and consumption and provides you with all the details you need in order to make sure whether this is still the right product for you.

1. You should review your choice of supplier and tariff every year

Rovid eatur quae conem rerio is arum ut imoluptur. Quis illuptation corpore pa autaspiti dolore, ut rererum enistia vid quo optat eum elicianis sollandi arum aut eatestis ped ut quatiur.

2. There are various tariffs to choose from

Rovid eatur quae conem rerio is arum ut imoluptur. Quis illuptation corpore pa autaspiti dolore, ut rererum enistia vid quo optat eum elicianis sollandi arum aut eatestis ped ut quatiur?

3. You can choose to take your gas and/or electricity from any supplier

Rovid eatur quae conem rerio is arum ut imoluptur. Quis illuptation corpore pa autaspiti dolore, ut rererum enistia vid quo optat eum elicianis sollandi arum aut eatestis ped ut quatiur? Nime quiae et experum aceaquis peri nistiisi od que officilla idictior sapis ma sim qui ipsundae.

4. Prices can vary by as much as £xxx for a typical year's gas & electricity

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5. You can compare options through Ofgem's switching service, commercial switching services, or directly with suppliers

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6. You are free to switch electricity and/or gas, regardless of any other products your energy supplier provides. Be careful of any penalty payments you may be liable for if you have signed up to a special deal

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Yours sincerely

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Your Annual Review and Renewal Reminder

This review provides the key information you need to make the right choice for you

Step 1 - Your current situation

- Your supply address: **1 Any Road, Any Town, A99 9AA**
- Your supplier for gas and electricity is: **ABC Energy**
- Your tariff is: **Economy X**
- Your charges are:

Tariff Supplier	ABC Energy
Tariff Name	Economy X
Tariff Type	Fixed Price
Single or Multiple (Peak/Offpeak) Prices	Multiple (peak/Offpeak)
Price 00:00 - 07:00	4p/kWh
Price 07:00 - 00:00	10p/kWh
Fixed charge per month	£15
The price is guaranteed for	15 months
You agreed to be tied to this supplier (unless you pay the penalty charge) on this product for	15 months
Penalty charge for early termination	£50
The environmental impact of fuels used to generate the electricity you use will be	Rating A B C D E F
Customer Service Rating	★★★★★

TARIFF TYPES
Standard Rate Variable - suits consumers who do not want to fix their price and want to shop around for the best deal on a regular basis
Tracker - suits consumers who do not want to fix their price but want to link the price they pay to a known reference for peace of mind
Fixed Price - suits consumers who wish to fix their price for an agreed period of time

SINGLE OR MULTIPLE (PEAK/OFFPEAK) PRICES
Single - suits consumers who have consumption throughout the day
Multiple - suits consumers who have a large consumption in an off-peak period and wish to gain a lower price for this period. Most suppliers will charge a higher rate than the single price for peak periods

Step 2 - Your rights

- You can switch supplier as often as aseatur quae conem rerio is arum ut imoluptur aseatur quae.
- You can switch tariff with your supplier as often as aseatur quae conem rerio is arum ut imoluptur aseatur qua.
- Beware penalty costs aseatur quae conem rerio is arum ut imoluptur aseatur qua conem rerio is arum.

Step 3 - Your estimated costs for the next 12 months

		Last 12 months Consumption	Next 12 months Value
Electricity			
	– Day	2 Units*	£400
	– Night	1 Units*	£100
Gas		16 Units*	£500
Discounts			£50
Surcharges			£25
VAT			£100
Total			**£1175**

*Units in MWh, which is a measure of the quantity of electricity used. I MWh is enough to power a 100w light bulb for 10,000 hours

Step 4 - Useful contacts to help you you consider

Ofgem Tel: 0800 000 000 www.ofgemswitching.co.uk
9 Millbank, London, SW1P 3GE
Details of commercial switching sites and electricity and gas suppliers available via Ofgem

OFGEM LOGO HERE

Appendix 6

Effect of Annual Setting of Standardised Charge

We have a particular concern with respect to the annual setting of standardised charges where there is scope for this charge to result in an under or over charge to the customer and/or creates relative positive and negative profit impacts on suppliers due to their mix of consumers in different regional areas.

The tables below illustrate the impact on supplier DUoS bills of two customer distributions, one where customers are spread evenly across the DUoS regions, and other where they are weighted towards the Midlands. Because there are fixed and variable elements to DUoS charges for domestic customers we have modelled these separately.

Our analysis is based Ofgem setting standardised charges once per year, compared to the variability actually seen in 2010. Our analysis is not supposed to represent any particular supplier but is representative of the level of impact that we believe would be seen.

Fixed DUoS charges

Supplier A – 5m electricity accounts evenly distributed

	Weighting	Products m	Revenue £m	Costs £m	Surplus £m
Eastern	7%	0.4	7.8	5.8	2.0
East Midlands	7%	0.4	7.4	4.4	3.0
London	7%	0.4	5.1	4.4	0.6
Manweb	7%	0.4	5.1	4.3	0.8
Midlands	7%	0.4	8.1	5.4	2.6
Northern	7%	0.4	10.9	5.4	5.5
Norweb	7%	0.4	6.6	5.2	1.4
Seeboard	7%	0.4	8.7	5.7	3.0
Southern	7%	0.4	7.3	4.3	3.0
Swalec	7%	0.4	4.1	4.1	0.0
Sweb	7%	0.4	4.6	4.6	0.0
Yorkshire	7%	0.4	9.7	4.9	4.8
North Scotland	7%	0.4	7.0	6.6	0.4

South Scotland	7%	0.4	7.8	5.6	2.2
Totals		**5.0**	**100.1**	**70.8**	**29.3**

Supplier B – 5m electricity accounts weighted towards the midlands

	Weighting	Products m	Revenue £m	Costs £m	Surplus £m
Eastern	5%	0.3	5.4	4.0	1.4
East Midlands	20%	1.0	20.7	12.3	8.4
London	5%	0.3	3.5	3.1	0.4
Manweb	7%	0.4	5.0	4.2	0.7
Midlands	20%	1.0	22.6	15.2	7.3
Northern	7%	0.4	10.6	5.3	5.3
Norweb	7%	0.4	6.5	5.1	1.4
Seeboard	3%	0.2	3.6	2.4	1.2
Southern	3%	0.2	3.1	1.8	1.3
Swalec	5%	0.3	2.9	2.9	0.0
Sweb	3%	0.2	1.9	1.9	0.0
Yorkshire	5%	0.3	6.8	3.4	3.3
North Scotland	7%	0.4	6.8	6.4	0.4
South Scotland	3%	0.2	3.3	2.4	0.9
Totals		**5.0**	**102.8**	**70.6**	**32.3**

- Supplier A makes £29m more in revenue than it incurs in cost for fixed DUoS charges.
- Supplier B makes £32m more in revenue than it incurs in cost for fixed DUoS charges.
- Supplier B Makes an additional £3m profit over Supplier A through the bias of regional product weighting.

Variable DUoS charges

Supplier A – 5m electricity accounts evenly distributed

	Weighting	Products m	Revenue £m	Costs £m	Surplus £m
Eastern	7%	0.4	12.7	13.9	(1.2)
East Midlands	7%	0.4	12.0	16.0	(4.0)
London	7%	0.4	15.4	16.7	(1.3)
Manweb	7%	0.4	19.0	24.5	(5.5)
Midlands	7%	0.4	12.1	16.9	(4.8)
Northern	7%	0.4	13.3	18.4	(5.1)
Norweb	7%	0.4	14.6	20.6	(6.0)
Seeboard	7%	0.4	10.3	14.6	(4.3)
Southern	7%	0.4	16.5	20.4	(3.9)
Swalec	7%	0.4	29.3	28.8	0.5
Sweb	7%	0.4	27.1	25.9	1.2
Yorkshire	7%	0.4	12.2	16.1	(3.8)
North Scotland	7%	0.4	26.3	29.3	(3.0)
South Scotland	7%	0.4	20.3	25.7	(5.5)
Totals		**5.0**	**241.2**	**287.8**	**(46.6)**

Supplier B – 5m electricity accounts weighted towards the midlands

	Weighting	Products m	Revenue £m	Costs £m	Surplus £m
Eastern	5%	0.3	8.9	9.7	(0.8)
East Midlands	20%	1.0	33.7	44.8	(11.1)
London	5%	0.3	10.8	11.7	(0.9)
Manweb	7%	0.4	18.6	24.0	(5.4)
Midlands	20%	1.0	34.0	47.4	(13.4)

Northern	7%	0.4	13.1	18.1	(5.0)
Norweb	7%	0.4	14.3	20.2	(5.9)
Seeboard	3%	0.2	4.3	6.1	(1.8)
Southern	3%	0.2	6.9	8.6	(1.6)
Swalec	5%	0.3	20.5	20.2	0.4
Sweb	3%	0.2	11.4	10.9	0.5
Yorkshire	5%	0.3	8.6	11.3	(2.7)
North Scotland	7%	0.4	25.8	28.7	(2.9)
South Scotland	3%	0.2	8.5	10.8	(2.3)
Totals		**5.0**	**219.3**	**272.3**	**(53.0)**

- Supplier A makes £47m less in revenue than it incurs in cost for variable DUoS charges.
- Supplier B makes £53m less in revenue than it incurs in cost for variable DUoS charges.
- Supplier B makes an additional £7m loss over Supplier A through the bias of regional product weighting.

EDF Energy
June 2011