Holders of Gas and Electricity Supply Licences, DECC, Consumer Focus, consumers and their representatives and other interested parties

Promoting choice and value for all gas and electricity customers

Direct Dial: 020 7901 7000
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Date: 26 October 2012

Dear Colleague,

Decision on Standard Condition 25A in the Gas and Electricity Supply Licences

Background

We introduced Standard Licence Condition 25A ("SLC 25A") in September 2009. SLC 25A requires the domestic supplier to ensure that in supplying or offering to supply electricity or gas, the Principal Terms on which it does so do not discriminate without objective justification between one group of Domestic Customers and any other such group. The grounds for objective justification and our approach to the enforcement process are set out in our Guidelines[1] for the condition.

This licence condition does not apply to suppliers with fewer than 50,000 domestic customers per fuel. SLC 25A included a "sunset clause", to allow the condition to lapse three years after its implementation. The introduction of SLC 25A reflected our original expectation that the full implementation of the Probe[2] remedies would ensure retail competition is sufficiently effective to protect consumers from undue discrimination. This provision expired on 31 July 2012. In advance of the expiry of SLC 25A we issued a consultation on whether it was appropriate to retain the condition for a further two year period[3].

On 27 April 2012 we issued a statutory consultation which proposed to re-insert SLC 25A until July 2014, and retain the existing Guidelines associated with the condition[4]. We also set out our intention to review the customer number threshold associated with this condition within a year of the re-insertion of SLC 25A.

Following the consideration of responses to our consultation and further development of our Retail Market Review (RMR) proposals[5], the Gas and Electricity Markets Authority ('the Authority') has decided not to re-insert SLC 25A for a further two-year period or for any other period at this time[6].

[1] See Guidelines on Cost Reflectivity between Payment Methods and the Prohibition of Undue Discrimination in Domestic Gas and Electricity Supply Contracts, 7 August 2009.
[2] The Energy Supply Probe was an investigation into the markets in electricity and gas supply for households and small businesses. A series of remedies were introduced from October 2009. For more information see: http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx.
[3] Consultation on the Undue Discrimination Prohibition standard licence condition, 24 February 2012, 23/11
[4] Statutory notice of proposed modifications of Standard Licence Condition 25A (SLC 25A) of the gas and electricity domestic supply licences, 27 April 2012, Ref (61/12)
[5] "Retail Market Review – Domestic Proposals", December 2011, Ref (166/11)
[6] Standard Licence Condition 27.2A (SLC 27.2A) which requires any difference between payment methods to be cost reflective does not contain a sunset clause, and therefore will remain in effect.

Decision

SLC 25A was primarily introduced to prevent suppliers from charging higher prices for their incumbent customers, compared to their non-incumbent customers without objective justification. We were concerned the less active group of incumbent customers may not be benefiting from competition to the same extent as the more engaged consumers. For example, charging higher prices for their "in-area"[7] customers compared to their "out-of-area"[8] customers.

The defects in the market that led us to introduce SLC 25A are a subset of those we have identified as part of the RMR, namely a lack of effective engagement from a significant proportion of customers which has the effect of failing to place effective restraint on suppliers' pricing and other practices. Given these interactions, we decided to make our decision on whether or not to reinsert the SLC 25A in the context of the RMR. The aim of the RMR package of proposals is to empower consumers so the threat of switching places an effective constraint on supplier pricing and other behaviour. Therefore, we expect if we proceed with our proposals, they are likely to address some of our concerns by limiting suppliers' ability to introduce differences in price which cannot be objectively justified.

While this condition has been successful in significantly reducing the difference between "in-area" and "out-of-area" prices[9], we expect our RMR package, if implemented, would provide greater protection for incumbent customers. In response to the concerns identified in the RMR, many suppliers have already taken remedial steps and launched initiatives to regain the trust of consumers. We therefore would expect suppliers to continue to have regard to the spirit of our proposals and their own individual voluntary commitments when considering pricing strategies, particularly where they may differ between out-of-area and in-area customers.

While we have decided not to re-insert SLC 25A for a further period, we will be monitoring very closely the pricing practices of all suppliers as part of our general market monitoring activities. If at any time we have compelling evidence to suggest pricing practices which are unjustified are returning to the market, we may commence a full review of this area and consider developing new licence conditions to address our concerns. Following consultation, if we do not proceed with our RMR proposals, we would need to revisit the current arrangements to ensure they are suitable to protect consumers. However, if our RMR proposals are implemented, they will need to be in place for a reasonable amount of time before we understand their full impact.

If you wish to discuss any of the issues raised in this letter or any related matters, please email Jemma.Baker@ofgem.gov.uk or contact on 020 7901 7174.

Yours Sincerely

Rachel Fletcher
Partner - Markets

[7] Customers who are (a) supplied by one of the five vertically-integrated supply company groups (EDF Energy, E.ON, RWE npower, ScottishPower and SSE) and (b) **resident** in one of the home regions for that company group. The home regions are the regions of Great Britain that applied to each of the 14 former regional monopoly suppliers that became part of these five company groups.

[8] Customers who are (a) supplied by one of the five vertically-integrated supply company groups (EDF Energy, E.ON, RWE npower, ScottishPower and SSE) and (b) **not resident** in a region that is a home region for that company group

[9] Since the introduction of SLC 25A the average difference between a suppliers "in-area" standard tariff and "out-of-area" tariffs has reduced from over £30 to around £13 in January 2011, per customer, per year. See "Retail Market Review – Findings and initial proposals", page 24.

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