

Giving Customers a Choice - The Introduction of Competition into the Domestic Gas Market



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Executive summary

1 Some 20 million domestic customers in Great Britain spend around £6 billion a year on gas. Between April 1996 and May 1998 competition was introduced into the domestic gas market and all customers can now choose from whom they buy their gas. By February 1999, 25 new companies were selling gas and over four million customers had exercised their choice and switched from British Gas Trading, the former monopoly supplier. Introducing competition throughout Great Britain within two years is a major achievement for the Office of Gas Supply (OFGAS), the industry's regulator, and could not have been done without the co-operation of Transco, the owner of the principal gas pipeline network, and the rest of the gas industry.

2 The then Government decided in 1993 to introduce competition for domestic gas customers so that they could benefit from the lower prices, greater choice and improved services being enjoyed by large business users of gas, who were already able to choose their supplier. OFGAS have been responsible for overseeing the introduction of competition to ensure that it secures the benefits for customers expected of it. A key aim has been to secure effective competition, i.e. a real and lasting choice for customers, to ensure that competition is strong enough to protect the interests of customers.

3 This report examines how far the introduction of competition has benefited customers in the four key areas of price, choice, service, and safety. The expert economics consultancy London Economics advised us in the examination on key economic issues and, with OFGAS, we commissioned MORI to carry out a survey of a representative sample of customers.

Customers now pay lower prices

4 Figure 1 shows that as the market was opened to competition the average price paid by customers for gas fell in both cash and real terms. Since April 1996, British Gas Trading have reduced their prices so that at 1999 prices the annual bill of a typical British Gas Trading customer has fallen in real terms from £348 to £300 - a reduction of £48.¹ The new gas companies have set even lower prices and customers who have changed to a new supplier are making an average annual saving of £78 in real terms compared to British Gas Trading's prices before

¹ All calculations of gas bills include the current rate of VAT (5 per cent). Savings are calculated for a customer using 19,050 kWh of gas a year – a typical amount for a domestic customer.

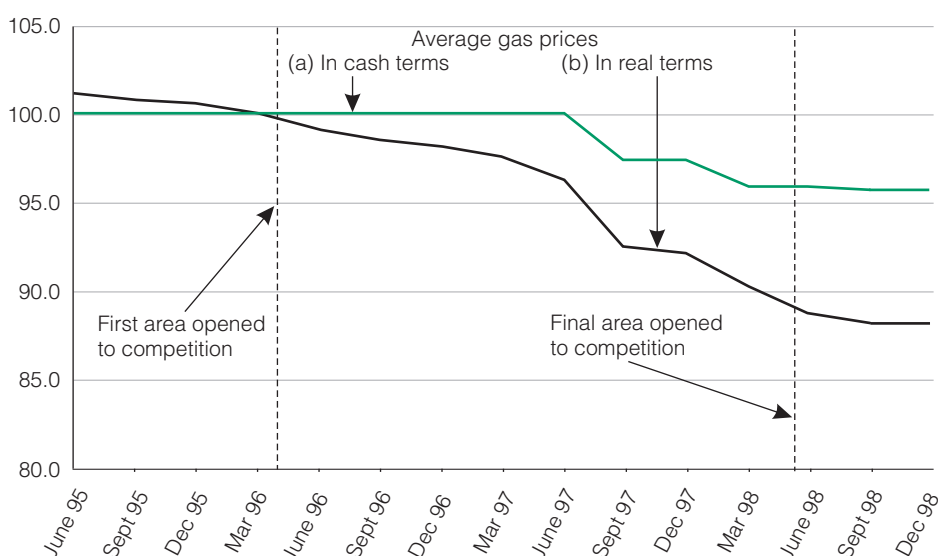
competition was introduced. The total reduction in customers' bills has been some £1 billion a year at 1999 prices. These reductions are partly the result of price controls imposed by OFGAS on Transco and British Gas Trading, but competition has also been an important cause of the reductions, especially for customers who have changed their supplier (paragraph 2.2).

Domestic gas prices and the opening of competition

Figure 1

This figure shows that gas prices have fallen since competition was introduced in both cash and real terms.

Index of gas prices (Jan 1996=100)



Source: Office of National Statistics

Customers' savings vary depending on how they pay for their gas

5 Prices have fallen in real terms for all customers, but the amount customers have saved varies according to the way they pay their bills. Since April 1996, customers who pay by monthly direct debit, for example, will typically have saved £56 in real terms on their annual bill if they had stayed with British Gas Trading, and up to £90 if they had changed to a new supplier. For some payment methods the total saving for a typical customer who has changed supplier might be as much as £101 a year. For the 1.4 million prepayment meter customers – customers who pay for their gas through their meter – the typical annual saving with British Gas Trading since April 1996 has been around £32 in real terms, and between £21 and £50 for customers who have changed to other suppliers (paragraphs 2.3 to 2.17).²

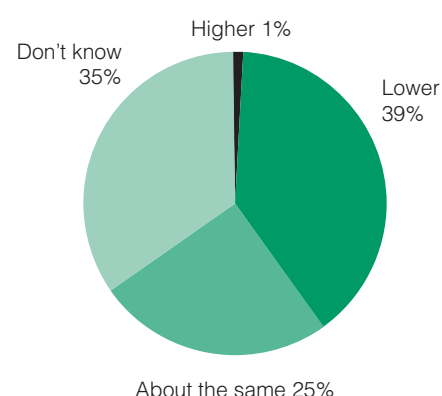
² Changes in bills for prepayment meter customers are based on a consumption of 12,300 kWh, typical for a customer using this payment method.

6 Many customers could save even more. Thirty five per cent of customers in our survey did not know whether the prices on offer from new suppliers were lower than British Gas Trading's and a further 26 per cent thought they were about the same or higher (Figure 2). Fifty seven per cent of customers who pay for their gas by either cash or cheque had a bank account, and therefore appeared to have scope, subject to the agreement of their bank, to change to paying by direct debit, but were not aware that it would be cheaper for them to do so. And while 30 per cent of customers found it easy to compare prices, 27 per cent said they found it difficult (paragraphs 2.32 to 2.37 and 3.2).

Figure 2

How customers think new suppliers' prices compare with British Gas Trading's
(Sample size 2,511)

This figure shows that 61% of customers did not know that the prices of the new gas suppliers were lower than British Gas Trading.



Source: National Audit Office/OFGAS survey of customers (by MORI)

7 There is therefore scope for customers to save more, by either:

- **Changing supplier.** For example, a British Gas Trading customer changing to a new supplier could save an average of £30 a year, and up to £67, even without changing his or her payment method. If 10 per cent of these customers changed, based on the average annual saving of £30, they would save a total of some £50 million a year (paragraph 2.34).
- **Changing their method of payment.** For example, an average customer currently paying by cash or cheque could save an average of £20, and up to £72, a year by changing to monthly direct debit. If 10 per cent of customers currently paying by cash or cheque did so, their total saving, based on the average annual saving of £20, would be some £11 million a year. If half changed, it would be some £53 million a year. If a customer changed both payment method and supplier, as many of the customers who have changed supplier have done, the saving could be even larger (paragraphs 2.35 to 2.37).



Customers now have a choice of gas supplier

8 Twenty six companies are now actively marketing to domestic customers, many of them on a national scale. And since the introduction of competition began in April 1996, over four million customers have changed supplier – more than 20 per cent of all customers. Our survey showed that 95 per cent of all customers said they were aware that competition had been introduced and that 58 per cent considered themselves to be well informed about it (Figure 3) (paragraphs 3.3 to 3.8).

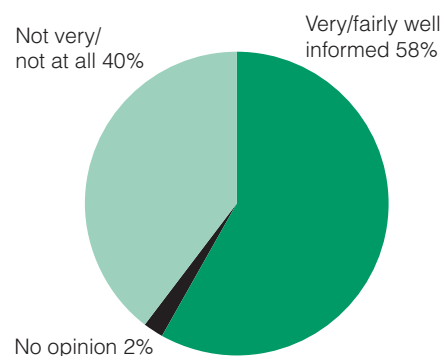
9 Prepayment meter customers have benefited from competition and 14 per cent have changed supplier but the level of price competition among companies for these customers is weaker than for other customers. Few of the new companies offer prices substantially below those of British Gas Trading. And the incentive for new suppliers to seek out such customers is reduced because other suppliers have the right to veto transfers of customers in debt to them, who make up 80 per cent of prepayment customers. Nonetheless 14 per cent of prepayment meter customers have changed supplier, compared to 20 per cent of customers as a whole. OFGAS told us that the number of prepayment meter customers changing supplier appears to be lower because some companies are encouraging these customers to use a different payment method when they change (paragraphs 3.9 to 3.13).

10 In other parts of the market, competition has grown on a very substantial scale. New suppliers have gained customers by offering lower prices, in part because they have been able to purchase gas more cheaply than British Gas Trading currently can do under their long term gas purchase contracts. British Gas Trading's prices remain substantially in line with the requirements of the price controls imposed on them by OFGAS. Except for a period in southern England in 1997, they have not reduced their prices to a level near that of their competitors and, owing to their dominant position, they are restricted by their licence in the degree to which they can reduce their prices below the level needed to cover their

Figure 3

How informed do customers feel about competition?
(Sample size 2,511)

This figure shows that most customers considered themselves to be well informed about competition although a large proportion did not.



Source: National Audit Office/OFGAS survey of customers (by MORI)

costs. The introduction of competition appears to have provided scope for a sustainable reduction in prices for domestic customers of around 10 per cent (paragraphs 2.18 and 2.20 to 2.31).

11 A number of factors suggest, however, that competition alone cannot yet be relied upon fully to protect customers in all parts of the market. A number of issues may inhibit the extent to which new companies may be able to maintain themselves in the market. These include, for example, low profit margins and lack of customer interest, although some of the new suppliers are benefiting from greater profit margins than British Gas Trading and others may have the financial strength to withstand temporary periods of low profitability because they are well established in other industries (paragraphs 3.15 to 3.22).

The quality of the service to customers is improving

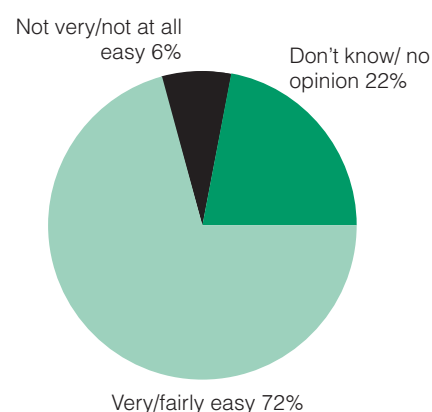
12 Our survey shows that customers generally considered it easy to change supplier if they wished – even among customers who had not changed supplier, 72 per cent said they thought it would be easy (Figure 4). Nonetheless, OFGAS and the Gas Consumers Council received 45,000 complaints about transfers in 1998 (paragraph 4.2).

13 One of the main areas concerning customers in the complaints received was certain aspects of doorstep selling techniques. A number of customers complained that attempts had been made to trick them into entering into contracts, and others complained that salesmen had provided misleading information. In the light of these concerns, OFGAS modified the suppliers' licences to include rules covering marketing which they then enforced, after earlier attempts to secure effective self-regulation by the industry failed (paragraph 4.3).

Figure 4

How easy would it be to switch supplier?
(Sample size 1,708 customers who had not switched supplier)

This figure shows that most customers who had not switched supplier considered it easy to change supplier.



Source: National Audit Office/OFGAS survey of customers (by MORI)

14 Other customer concerns have included the time spent waiting to transfer to a new supplier. At 31 October 1998, 723,000 customers who had entered into contracts with new suppliers were awaiting transfer - indicating an average waiting time of ten weeks. Much of this delay was the result of the build up of demand to change supplier as the market was opened to competition. By 1 January 1999 transfers were taking an average of some five weeks to carry out, with some 260,000 customers awaiting transfer (paragraph 4.3).

15 Our survey also showed that customers were generally happy with the service provided by their supplier. Sixty five per cent of customers who had changed supplier said they were very or fairly satisfied with the service they received (compared to 7 per cent who were dissatisfied), as did 90 per cent of customers who have remained with British Gas Trading (compared to 3 per cent who were dissatisfied). Most customers did not think the quality of service had changed since competition was introduced, but of those that did, more said that service has got better than said it has worsened (Figure 5) (paragraphs 4.4 to 4.6).

**How customers
rate the service of
their gas supplier**

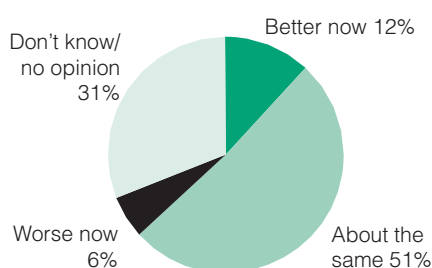
Figure 5

This figure shows that although most customers feel service is about the same more feel it has got better rather than worsened.

How does the service provided by your new supplier compare with that provided by your previous supplier?

(Sample size 762 customers of suppliers other than British Gas Trading)

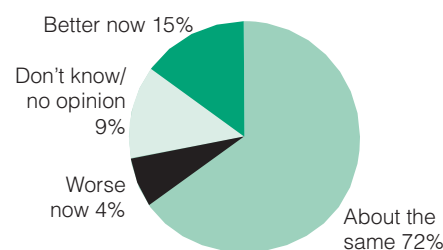
a) Customers of new suppliers



How does the service provided by British Gas Trading now compare with that of two years ago?

(Sample size 1,749 British Gas Trading customers)

b) British Gas Trading customers



Source: National Audit Office/
OFGAS survey of customers
(by MORI)

16 Some companies have introduced new services, such as loyalty points and dual fuel deals (lower prices when a company provides both electricity and gas). The elderly and the disabled are being offered the special services, such as replacement heating if their gas supply is disrupted, required of companies under their licences. But the take up of special services by this group of customers is only 9 per cent nationally, and 17 per cent in Scotland, and has not changed significantly since competition was introduced (paragraphs 4.8 and 4.9).

Safety has been maintained

17 The Health and Safety Executive, who regulate the safety of the gas industry, believe that the new gas safety regime put in place to support the introduction of competition in the domestic gas market is generally working well and has achieved its aim of maintaining safety standards. A key safety improvement has been the establishment of a single national emergency telephone number, and our survey showed that more than 90 per cent of customers knew about it. At the request of the Health and Safety Commission, the Executive are, however, reviewing the safety regime for the use of gas once it has been supplied to customers, for example with regard to the installation and maintenance of gas appliances. They plan to complete the review by the end of 1999 (paragraphs 5.1 to 5.10).

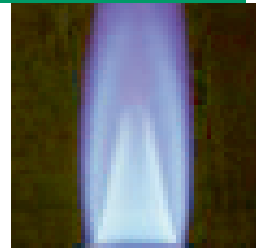
Recommendations

18 The benefits for customers already achieved by competition reflect well on OFGAS, Transco and the rest of the gas industry. But customers could benefit even more. We recommend, therefore, that OFGAS should:

- 1. Seek to improve customers' knowledge** of the impact on their bills of their choice of supplier and of payment method. While it is for companies to advertise their prices and terms, OFGAS should consider the scope for measures to make it easier for customers to make comparisons. These might include encouraging companies to provide information on prices in a standard format (paragraphs 2.32 to 2.37).
- 2. Consider how competition to supply customers using prepayment meters might be strengthened** to ensure that these customers benefit from competition as much as others. In particular, OFGAS should consider the scope for customers to move their debts with them when they change company, whilst safeguarding the rights of suppliers to whom money is owed (paragraphs 3.9 to 3.13).
- 3. Continue to monitor developments in competition** in the market closely. There has been encouraging progress in developing competition, as is shown by the savings that customers can make by changing supplier and the number of customers who have changed. But the extent of competition is greater in some parts of the market than others. It is too early to say whether it will be possible for new gas suppliers to maintain themselves successfully in the market to provide a real choice of supplier to all customers, although some of the new suppliers are benefiting from greater profit margins than British Gas

Trading and others may have the financial strength to withstand temporary periods of low profitability. OFGAS therefore need to continue to keep the development of competition under careful review (paragraphs 3.15 to 3.22).

- 4. Review the process by which customers are transferred to a new supplier** to establish if this could be done more quickly. OFGAS should also consider whether companies should be set targets for the time taken to carry out transfers. OFGAS should continue to monitor companies' performance and act quickly to prevent backlogs recurring (paragraphs 4.2 and 4.3).
- 5 Establish why there is a low take up of the special services for the elderly and disabled by customers of the new suppliers.** OFGAS should also consider what action might be taken to increase take up, for example by seeking improvements to companies' publicity campaigns (paragraph 4.9).



Part 1: Introduction

1.1 This part examines:

- i) why we examined the introduction of competition;
- ii) how competition is intended to benefit customers;
- iii) the rôle of OFGAS in introducing competition;
- iv) how the competitive gas market works.

i) Why we examined the introduction of competition

1.2 The introduction of competition in the domestic gas market in Great Britain is without precedent. With 20 million domestic customers spending some £6 billion a year on gas, the competitive gas market in Britain is the largest such market in the world. The model of competition adopted – which separates the business of transporting gas from that of buying and selling it, supported by records linking every customer with their supplier – has been possible only since the development of modern information technology systems.

1.3 Figure 6 shows how competition in the domestic gas market compares with the other utility industries. The introduction of competition in gas supply is being closely followed by the introduction of competition in the even larger market of electricity supply, where 25 million domestic customers in Great Britain are becoming able to choose their supplier between September 1998 and, on present plans, the middle of 1999.

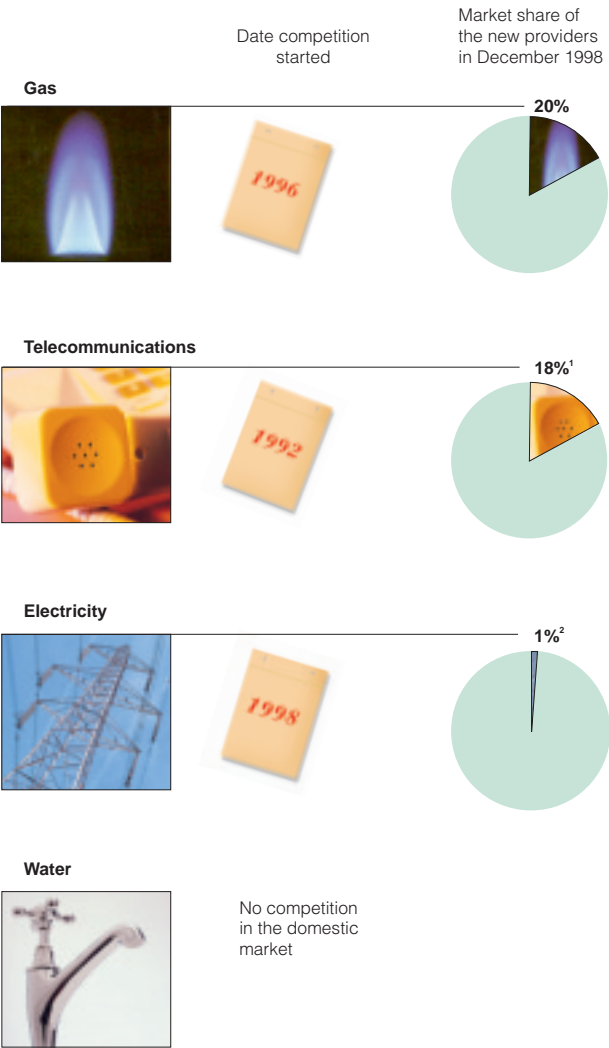
1.4 The aim of introducing competition was to benefit customers. We examined the four main ways in which they could benefit from competition, to assess whether:

- prices for customers are lower as a result of competition (Part 2);
- customers now have a real choice of supplier (Part 3);
- the quality of the service received by customers has changed (Part 4);

Competition to provide domestic customers with utility services

Figure 6

This figure shows that the market share of the new providers of utility services in December 1998 was greatest in the gas market.



- Notes
- 1. This figure represents the share of the fixed line residential market and excludes mobile telephones.
 - 2. Competition was only introduced in September 1998 and as it develops new providers are expected to gain greater market share.

Source: National Audit Office, OFGAS, OFTEL and OFFER

- satisfactory arrangements have been made to maintain a safe and secure gas supply (Part 5).

1.5 Appendix 1 describes our methodology in detail. In brief, we:

- collected and evaluated information from OFGAS relating to the part they played in implementing competition;
- appointed London Economics, expert economics consultants, to assess the effect of competition on gas costs and prices and the effectiveness of competition;
- jointly with OFGAS, commissioned MORI to carry out a survey of a representative sample of gas customers (details of the survey are provided in Appendix 2);
- consulted the 25 companies who in July 1998 were supplying gas to domestic customers to seek their views on the way competition was introduced and to collect information on prices and services (Appendix 5);
- met four domestic gas companies and two gas companies who might have been expected to enter the domestic market, but had not, to establish why they had not done so;
- analysed the complaints received by OFGAS and the Gas Consumers Council, and reviewed OFGAS's responses;
- consulted the Health and Safety Executive on gas safety;
- consulted selected third parties, such as consumer groups who are members of the Public Utilities Access Forum, with an interest in the domestic gas market;
- assembled a panel of experts (Appendix 1) to advise and assist us.

ii) How competition is intended to benefit customers

1.6 When British Gas were privatised in 1986 (see chronology) they had a complete monopoly in supplying gas to domestic customers by pipe. It was illegal, therefore, for anyone else to supply domestic gas customers. Other companies could supply larger business customers³ but they could only do so by using British Gas's pipes to transport their gas and initially British Gas dominated this market as well.

1.7 To protect customers against the risk of British Gas abusing their position, the Gas Act 1986 established a system of regulation centred on the Office of Gas Supply (OFGAS). It gave OFGAS and the Secretary of State for Trade and Industry duties to protect customers' interests and to enable companies to compete in supplying large customers. All gas companies had to be licensed and OFGAS had powers to enforce the terms of licences and, in certain circumstances, to amend them or to refer matters relating to them to the Monopolies and Mergers Commission. The Office of Fair Trading and the Secretary of State could also act under fair trading and competition legislation, for example, by referring competition issues to the Commission.

1.8 At the time of privatisation, the then Government considered that competition in supplying gas would benefit customers through, for example, lower prices, greater choice and better service. They intended that following privatisation competition would develop initially in the market to supply large customers. It would then be extended to the domestic market at a date to be determined later.

1.9 At first, competition in supplying large customers was slow to develop and a number of regulatory actions and investigations were undertaken to further competition in this market. These achieved substantial success but continuing difficulties culminated in an examination by the Monopolies and Mergers Commission in 1992-93, which led to the Commission recommending that British Gas's monopoly in supplying domestic customers should end in the near future. The then Government accepted this recommendation in December 1993 and in conjunction with OFGAS developed proposals for introducing domestic competition in stages between 1996 and 1998.

³ Initially competitors could supply only customers using more than 732,000 kilowatt hours (kWh) a year. The limit was reduced to 73,200 kWh a year in 1992. A kWh is the total energy received when power is delivered at the rate of one thousand watts for one hour. The average domestic customer uses around 19,050 kWh of gas a year.

Chronology of key events



July 1986 Gas Act 1986. This provided for the appointment and functions of a Director General of Gas Supply, the establishment and functions of a Gas Consumers Council, and the sale of the British Gas Corporation.



December 1986 Privatisation of British Gas plc. At this point they were the monopoly supplier of gas through pipes, although third parties could negotiate to use their pipeline system.



October 1988 Monopolies and Mergers Commission report found extensive discrimination by British Gas plc in the pricing and supply of gas to non-domestic customers. The Government welcomed the report and announced steps to accelerate competition to supply very large customers using over 25,000 therms (732,000 kWh) per year.



October 1991 An Office of Fair Trading review of progress in the development of competition to supply very large customers found that the steps taken in 1988 had been ineffective in encouraging self sustaining competition. British Gas plc agreed with the Office of Fair Trading to a further set of measures in March 1992.



March 1992 Competition and Service (Utilities) Act 1992 provided for the Secretary of State to reduce the gas monopoly threshold. The threshold was lowered from 25,000 therms (732,000 kWh) to 2,500 therms (73,200 kWh) in July 1992.



August 1993 The Monopolies and Mergers Commission recommended that British Gas plc should divest themselves of their trading activities to ensure that the transportation and storage of gas was available to all gas shippers without undue discrimination and that competition should be introduced into the domestic market.



May 1994 The then Government published their proposals in a joint Department of Trade and Industry/ OFGAS consultation document to liberalise the domestic gas market.



November 1995 Gas Act 1995 prepared the way for the phased extension of competition into the domestic market between 1996 and 1998. It also provided for the business of British Gas plc to be split up (this was completed in February 1997).



April 1996 Start of the phased introduction of competition in the domestic market. Other domestic gas suppliers are allowed to compete with British Gas Trading in Devon, Cornwall and Somerset.



May 1998 Completion of the phased introduction of competition in the domestic market. Greater London and Surrey are the final areas to be opened to competition.

Source: National Audit Office

In twelve years the gas supply industry in Great Britain was transformed from a state monopoly to a competitive market of private suppliers.

1.10 The then Government and OFGAS took the view that in introducing competition, issues such as safety would need to be carefully addressed. But they believed that opening the domestic market to competition would enable domestic gas customers to benefit from the lower prices, greater choice and improved services already being enjoyed by large business users of gas.

1.11 The Gas Act 1995 established the legislative framework for introducing domestic competition. It amended the Gas Act 1986 in several ways. It:

- **Strengthened the duty of OFGAS and the Secretary of State with regard to competition**, which became “...to secure effective competition...”. This change reflected the greater importance of competition under the new Act.
- **Reformed the system of licensing gas companies**. Existing licences were replaced by three new types of licence, corresponding to the three distinct types of business envisaged in the new competitive market.
- **Provided for the Secretary of State to set a date** - the end of 1998 - by which time domestic competition should be in place throughout Great Britain.

The three gas businesses

Transporters transport and store gas.

Shippers trade in the wholesale gas market, buying gas from producers and other shippers, contracting with transporters for its transportation and/or storage, and selling it on to suppliers.

Suppliers retail gas to domestic and other customers.

Many gas companies hold licences as both shippers and suppliers. But companies licensed in either capacity may not also be licensed as a transporter.

iii) The rôle of OFGAS⁴ in introducing competition

1.12 Although the Gas Act 1995 made it possible to introduce competition in the domestic gas market, actually implementing competition while maintaining a satisfactory service to customers required a great deal of action by many organisations, as Figure 7 shows.

Key actions needed to implement competition

Figure 7

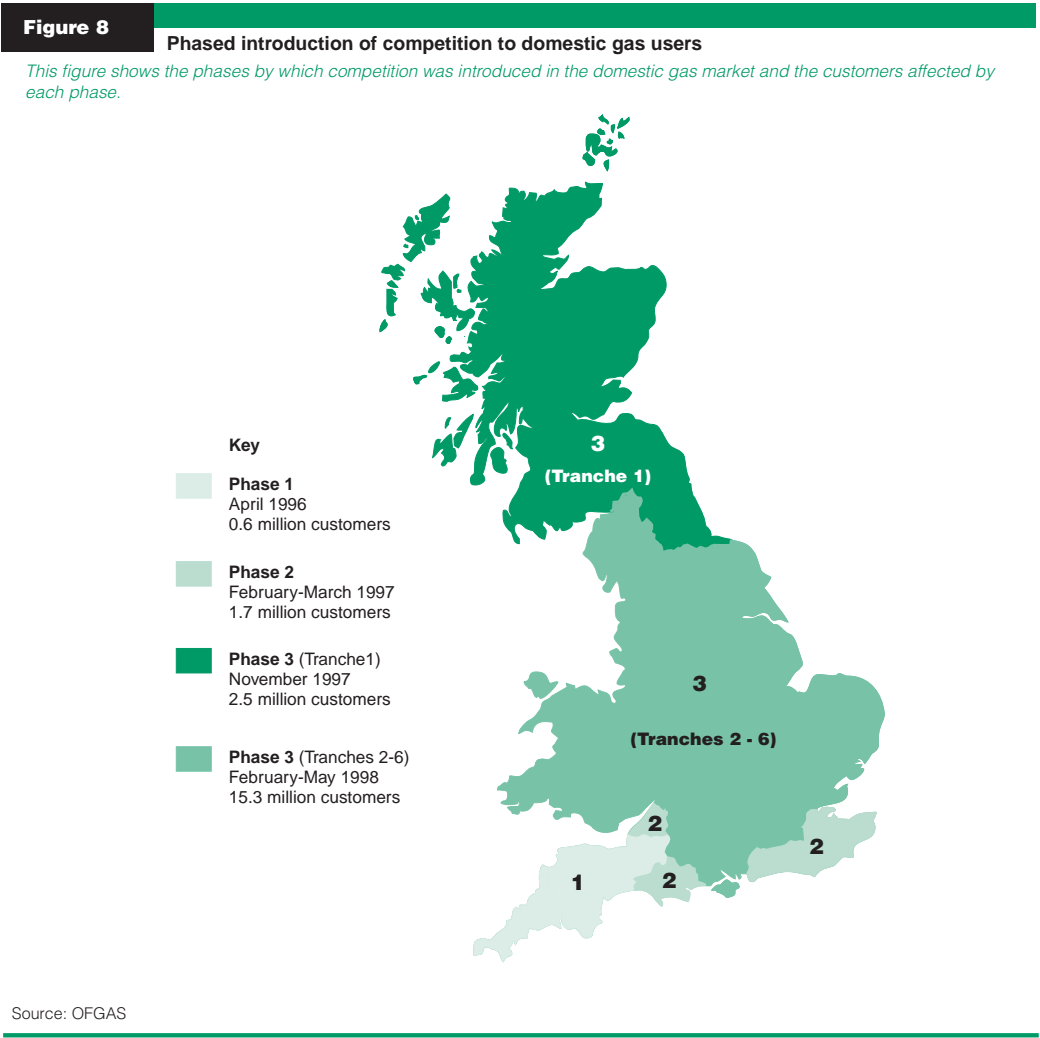
Organisation		Action
The Department of Trade and Industry	→	Draft legislation and licences for the new types of companies.
Transco	→	Develop computer systems (for example to record which gas company supplies each customer in the country), and acquire, check and correct details of every home and business to which gas is supplied.
Gas suppliers and shippers	→	Develop computer systems to link with Transco's and for companies' own purposes (for example for billing); recruit and train staff; secure supplies of gas needed to meet customers' demands.
Gas shippers and Transco	→	Agree terms on which Transco will transport gas and rules and systems for operating the gas transportation system safely (for example to ensure that enough gas is put into it to balance that used by customers).

1.13 OFGAS also had a number of activities to carry out, such as vetting applications by companies for licences and setting the timetable for introducing competition in different parts of the country, within the limits set by the Secretary of State. Their primary rôle, however, has been to ensure that conditions are in place to secure effective competition. These conditions include price controls, measures to prevent anti-competitive behaviour, an effective system to transfer customers to new suppliers and the publication of information on competition.

1.14 The introduction of competition in different areas has taken place in phases (Figure 8). The timetable laid down by the Secretary of State for Trade and Industry provided for it to be introduced first in a pilot exercise in Devon, Cornwall and Somerset in April 1996, followed by further pilot stages in Dorset, Avon, Kent and

4 OFGAS have 120 staff. The core team of four staff directly concerned with the implementation of competition were assisted by specialists from within OFGAS and elsewhere. From January 1999 the Director General of OFGAS also headed OFFER, the electricity regulator. The Government intend to merge OFGAS and OFFER to allow the regulator to deal more effectively with issues resulting from the growing convergence of the gas and electricity industries.

Sussex in February and March 1997. Initially, extension to the whole of the rest of the country was intended to take place on a single day in 1998. But OFGAS later decided to carry out this extension in a series of “tranches” between November 1997 and May 1998 in order to even out the work of transferring the large number of customers from British Gas Trading to new companies as each area was opened to competition.



1.15 By February 1999 there were 26 companies marketing to supply gas to customers; 19 operated nationally while the number marketing in different regions varied from 19 in Scotland to 21 in South East England.

iv) How the competitive gas market works

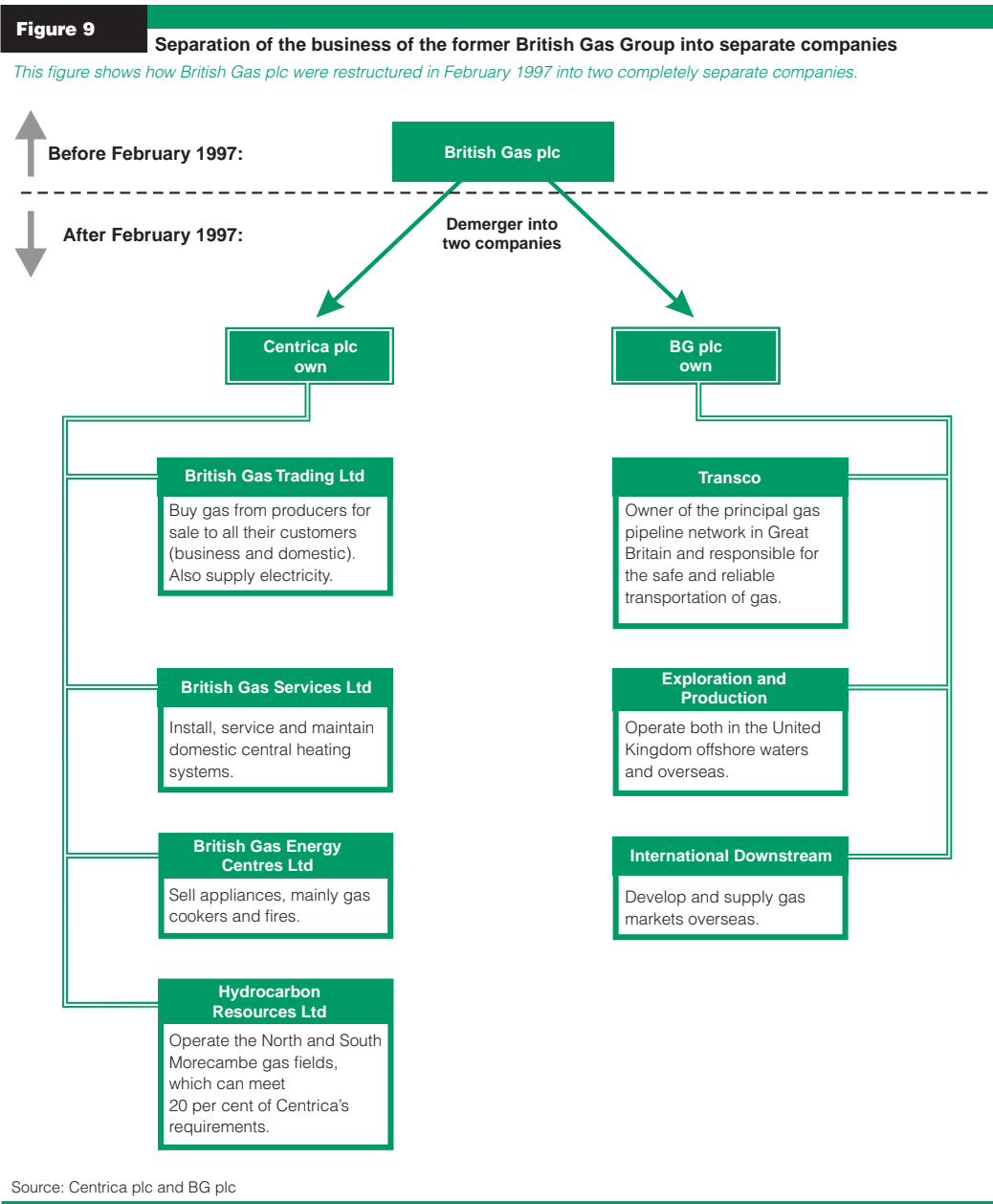
1.16 For many years the gas industry in Great Britain was widely thought of as a natural monopoly, that is, an industry in which economies of scale and scope make it economically inefficient for the industry to be operated by more than one company, at least in any given geographic area. Once one company had laid gas mains in an area, for example, the expense of laying more in order to reach customers might put off potential competitors. And the advent of North Sea gas, which is transported by a national system of high pressure pipelines to the main centres of population, extended this argument on a national scale.

1.17 The model of competition underlying the Gas Act 1995 retained British Gas plc's monopoly of the transportation of gas in most areas, but allowed trading in gas – purchasing gas from producers and selling it on to customers and other traders – to be wholly competitive. The Act also distinguished between two types of gas traders – shippers, effectively wholesale traders; and suppliers, marketing gas to domestic and other customers.

1.18 In order to stop gas transporters from unfairly favouring a linked trading business, the Act prohibits transporters from also trading in gas, although transportation and trading can still be carried out by separate companies within the same group. But in 1997 British Gas decided that their shareholders' interests were best served by demerging their trading business into a separate company, with a separate stock market listing. And the business of the former British Gas group is now carried on by two completely separate companies (Figure 9):

- BG plc, one of the divisions of which, Transco, operate the gas transportation business of the former British Gas group, and transport gas to around 99 per cent of domestic households.
- Centrica, whose subsidiary, British Gas Trading (branded as British Gas Home Energy in England and Wales, and Scottish Gas in Scotland), now carry on the gas trading business of the former group and currently remain the largest supplier of gas to domestic customers.

1.19 OFGAS consider that the separation of gas transportation from gas trading was key in the successful introduction of domestic competition.

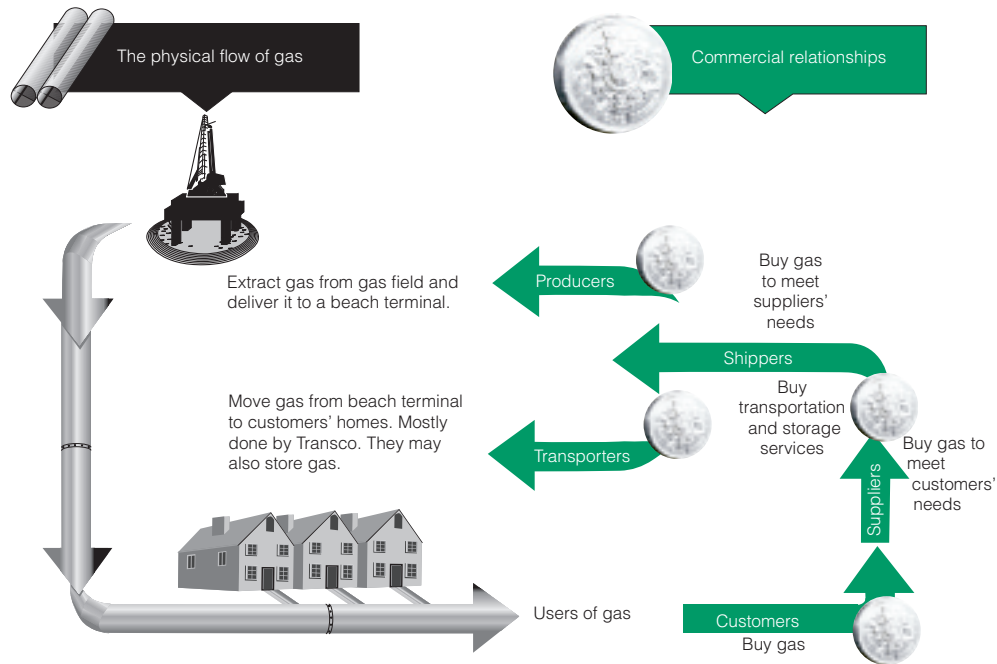


1.20 Figure 10 shows the commercial relationships needed to effect the physical flow of gas from producer to customer. Individual customers buy their gas from a supplier who is then responsible for making all the arrangements necessary to provide gas where and when the customer wants it. This includes making sure that enough gas is put into the gas transportation system to match the amount used by the customer.

Figure 10

Getting gas to customers

This figure shows who is responsible for producing and transporting gas and the commercial relationships between gas companies and customers.



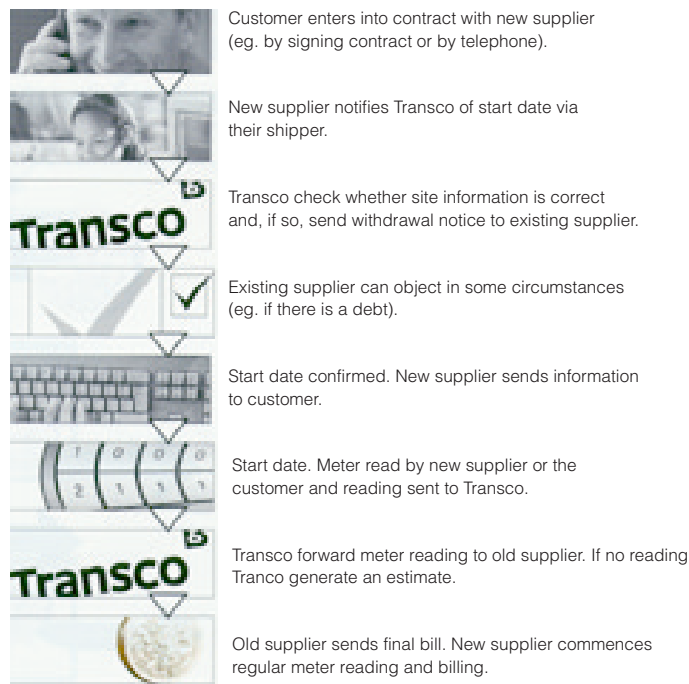
Source: National Audit Office

1.21 When a customer wishes to change his or her supplier, the customer enters into a contract with the new supplier and at a later date the new supplier takes over responsibility for serving the customer. Figure 11 shows the process involved. But even if a customer changes his or her supplier, the customer remains with their existing transporter – in most cases Transco - and there is no need for new pipes to be laid to the customer's home.

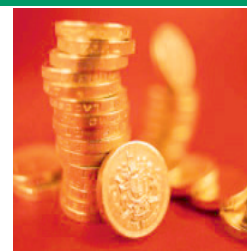
How customers transfer to a new gas supplier

Figure 11

This figure shows the process carried out in transferring a customer to a new supplier. It should be noted that the customer receives a gas supply throughout the transfer process.



Source: National Audit Office



Part 2: Price

2.1 One of the key areas in which competition is expected to benefit customers is lower gas prices. To assess how far competition has benefited customers we examined:

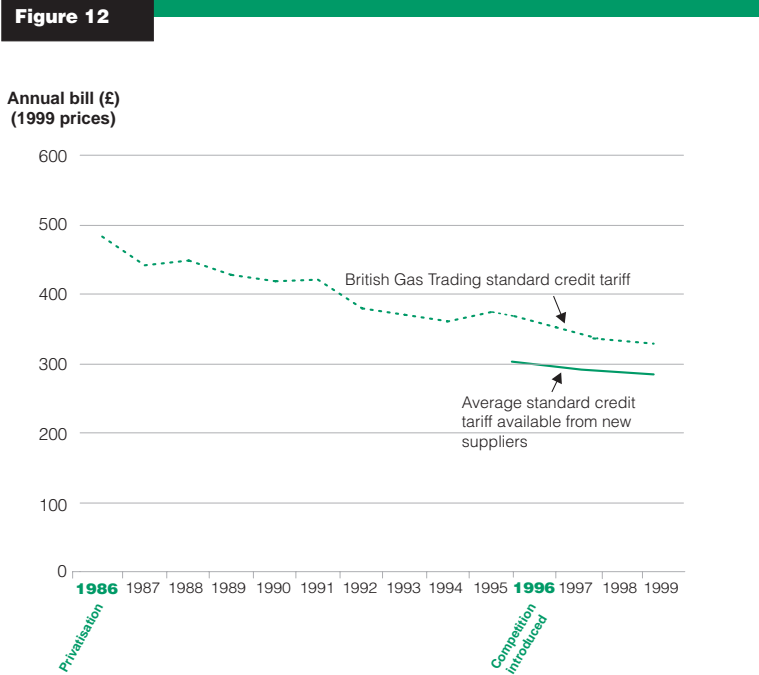
- i) the financial savings made by customers in their gas bills;
- ii) how the new suppliers have been able to offer lower prices than British Gas Trading;
- iii) the extent to which the savings made by customers are sustainable;
- iv) whether there is scope for some gas customers to save more.

i) The financial savings made by customers in their gas bills

2.2 Between 1986, when British Gas were privatised, and April 1996, when competition began to be introduced, the average annual gas bill of a typical domestic customer fell by around 24 per cent in real terms (Figure 12). Since then, British Gas Trading have further reduced their prices in line with the price controls imposed on them by OFGAS, while all companies entering the market have offered even lower prices. These reductions are partly the result of price controls imposed by OFGAS on Transco and British Gas Trading, but competition has also been an important cause of the reductions, especially for customers who have changed their supplier. As a result of the lower prices, customers have secured reductions in their gas bills in two ways:

- The 16.1 million customers who at 1 February 1999 have stayed with British Gas Trading are currently saving an average of £48 a year each (around £800 million in total) from lower gas prices, compared to before competition was introduced in April 1996.
- The 4 million customers who have changed to new suppliers are saving an average of £78 a year (that is, an average of £30 each from the lower prices of the new suppliers in addition to the £48 reduction in British Gas Trading's prices). Customers using some payment methods with some suppliers are saving £101 a year. In total customers who have changed to new suppliers are saving around £310 million a year from reductions in gas prices compared to before competition was introduced. (All figures are at January 1999 prices. Appendix 3 shows how we arrived at these savings estimates). Our customer survey found that 84 per cent of customers who had changed supplier did so mainly to take advantage of cheaper gas prices (Figure 13).

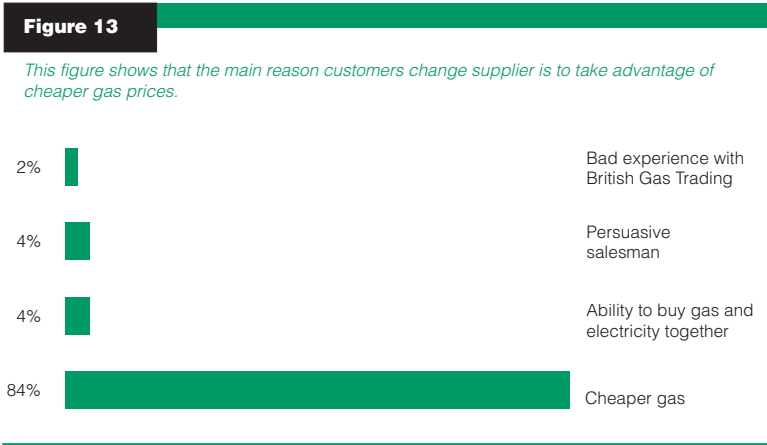
Average annual bill of customers on British Gas Trading's standard credit tariff 1986 - 1999 (1999 prices)



Between 1986, when British Gas were privatised, and 1996, when competition was introduced, the average bill of customers paying by standard credit (cash, cheque or debit card) fell in real terms by £118 (24 per cent) and since 1996 has fallen even further.

Source: National Audit Office

The main reasons for customers changing supplier



Source: National Audit Office/ OFGAS survey of customers (by MORI)

2.3 All suppliers are now charging prices lower than those in place before competition was introduced but the amount by which customers' bills have reduced varies according to how they pay for their gas. For example, Figure 14 compares the annual gas bill charged by British Gas Trading for four different payment methods in April 1996 (before competition) and January 1999 and shows average savings in real terms in annual bills ranging from £56 for direct debit customers to £32 for standard credit and prepayment meter customers.

How customers pay for their gas

- **Standard credit.** Customers pay their bills by cash, cheque, credit or debit card. Approximately 11 million domestic customers (53 per cent of all customers) pay for their gas by this method. Some companies give a discount for prompt payment.
- **Direct debit.** The bill is paid automatically from the customer's bank account each month or each quarter. Approximately 8 million domestic customers (40 per cent) pay for their gas by this method.
- **Prepayment meter.** The customer inserts coins, mechanical tokens or an electronic card into a meter before using the gas. Approximately 1.4 million domestic customers (7 per cent) pay for their gas by this method.

Reduction in real terms
in the typical annual gas
bill of British Gas Trading
customers by payment
method since competition
was introduced
(1999 prices)

Figure 14

This figure shows that those British Gas Trading customers who pay by monthly direct debit have received the largest saving in their annual gas bill.

	Monthly Direct Debit	Quarterly Direct Debit/ Prompt Payment ³	Standard Credit	Prepayment Meter
	ANNUAL BILL	ANNUAL BILL	ANNUAL BILL	ANNUAL BILL
	£	£	£	£
April 1996	342	357	366	266
January 1999	286	303	334	234
	Saving £56	Saving £54	Saving £32	Saving £32

Note 4

- Notes:
1. Bills based on typical consumption of customers using each payment method: 19,050 kWh for direct debit and standard credit and 12,300 kWh for prepayment meters. April 1996 bills are expressed in January 1999 prices using the retail prices index excluding mortgage interest payments.
 2. All bills include 5% VAT.
 3. Prompt payment customers are those on the standard credit tariff who pay within 10 days of their billing date.
 4. Excludes an annual prompt payment discount of £31.50 to customers who pay within 10 days of their billing date.

Source: British Gas Trading and
National Audit Office

2.4 Figure 15 compares the prices offered by the new suppliers in January 1999 with those of British Gas Trading, again for four different payment methods. The average savings in annual bills from changing to a new supplier range from between £14 to £32 for customers paying by monthly direct debit to between £38 and £64 for customers paying by standard credit. For prepayment meter customers the prices on offer range from being £11 more expensive to £18 cheaper.

Comparison of British Gas Trading's tariffs with nationally available tariffs of new suppliers for typical customers

Figure 15

This figure shows the minimum, maximum and average savings customers can make in their gas bills, depending on which gas supplier they select, for each payment method.

	Monthly Direct Debit	Quarterly Direct Debit ³	Standard Credit	Prepayment Meter
	ANNUAL BILL £	ANNUAL BILL £	ANNUAL BILL £	ANNUAL BILL £
British Gas Trading	286	303 ³	334 ⁴	234
Highest new supplier	272	277	296	245
Average new supplier	264	276	283	235
Lowest new supplier	254	259	270	216
Potential annual savings available by changing supplier				
	£	£	£	£
Minimum	14	26	38	-11
Maximum	32	44	64	18
Average	22	27	51	-1

- Notes:
1. Bills based on typical consumption of customers using each payment method: 19,050 kWh for direct debit and standard credit and 12,300 kWh for prepayment meters. All bills shown are based on suppliers' prices in January 1999 and include 5% VAT.
 2. New suppliers' tariffs are the highest and lowest of those available nationally.
 3. Also includes British Gas Trading standard credit customers who pay within 10 days of their billing date.
 4. Excludes £31.50 annual prompt payment discount to customers who pay within 10 days of their billing date.

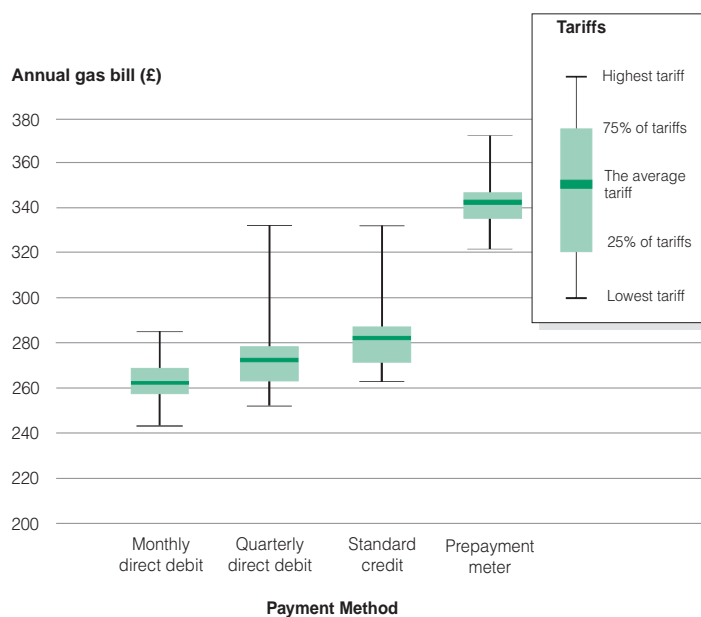
Source: OFGAS and "Which?" Factsheets

2.5 Figure 16 shows the range of prices offered by all suppliers for each payment method, and shows that prepayment meter customers normally pay higher prices for gas than customers that pay in other ways. While the average price offered by all suppliers for customers paying by standard credit and direct debit fell by 23 per cent between the introduction of competition and January 1999, the average price offered to prepayment meter customers fell by 12 per cent.

Effect on a customer's bill of varying payment method, tariff and region

Figure 16

This figure shows how customers' bills can vary depending on which payment method and tariff they choose.



Notes: 1. Bills are for the consumption of the same amount of gas - 19,050 kWh per year, to allow comparison between payment methods.

Source: National Audit Office

2. The tariffs shown include some available only in certain areas of Great Britain.

2.6 Since January 1996, the number of customers using prepayment meters has increased by 66 per cent, to around 1.4 million - 7 per cent of all customers. And the Gas Consumers Council and the Public Utilities Access Forum told us that they were concerned about the growing number of prepayment meter customers who have to pay higher prices for their gas than other customers. We therefore examined:

- a) why prepayment meter customers pay higher prices;
- b) whether higher prices for prepayment meter customers are justified.

a) Why prepayment meter customers pay higher prices than others

2.7 Most prepayment meter customers pay for their gas using an electronic card. The customer pays to charge the card at a charging machine, typically in a post office or shop. The customer then obtains gas by inserting the card in a special meter, which reads the card to determine how much the customer has paid, and allows the customer to use gas until the charge on the card is exhausted. In addition, a few British Gas Trading customers still use older meters operated by coins or tokens.

2.8 Providing and operating the charging machines, and collecting coins and tokens from the older types of meter is, for the gas supplier, among the most expensive ways to collect payments from gas customers. To reflect this British Gas Trading had for many years prior to October 1998 charged higher prices to customers using prepayment meters, and many other gas suppliers continue to do so.

b) Whether higher prices for prepayment meter customers are justified

2.9 Two linked developments in 1997 caused OFGAS to scrutinise British Gas Trading's prices for prepayment meter customers more closely than before. Firstly, British Gas Trading announced on 11 September that they proposed to reduce their prices from 12 January 1998 for most customers. The reduction would be around 9 per cent for customers paying by monthly direct debit, 8 per cent for those who pay either within 10 days of receiving their quarterly bill, by quarterly direct debit or by standing order, and 1 per cent for standard credit customers. They did not propose to reduce their prepayment meter tariff at all pending the outcome of an OFGAS review of the prepayment meter system.

2.10 Secondly, the Gas Consumers Council responded to British Gas Trading's announcement by making a formal reference to OFGAS asking them to investigate whether the proposed tariff change constituted undue discrimination against prepayment meter customers. At the same time the Minister for Energy and Industry called for the gas industry to find ways to bring down the costs of manufacturing, installing and operating prepayment meters and to look at alternative ways of meeting customers' needs.

2.11 These matters were of concern for OFGAS because undue discrimination is prohibited in British Gas Trading's licence. OFGAS also needed to satisfy themselves that the proposed changes complied with British Gas Trading's price control (see box). OFGAS therefore conducted a detailed examination of how the costs involved in supplying customers vary according to the method of payment.

British Gas Trading's price control

OFGAS control the maximum price that British Gas Trading can charge their customers by placing a price cap on each of the tariffs they offer. The part of the price control that covers supply costs rises in line with the retail price index minus a specified percentage "x" each year (the National Audit Office reported on the Gas Cost Index in 1996 – HC287 1995-96). The caps are applied to both the standing charge and price per unit of gas used.

2.12 A key issue in OFGAS's examination was customer debt. Prepayment meters are one of the main methods used by British Gas Trading for controlling customer debt and they estimate that around 80 per cent of their prepayment meter customers have some debt. Many other customers choose to have prepayment meters installed to avoid further debt building up which could result in their gas supply being disconnected. Prepayment meter customers are therefore seen by many suppliers as being associated with high costs in recovering debt and with the risk of bad debt.

2.13 OFGAS were concerned, however, that British Gas Trading should manage debt in the most efficient manner possible and that there should be no artificial incentive for the company to make customers in debt use a prepayment meter because the tariff was higher than other payment methods. OFGAS believed that reducing the prepayment meter tariff to the level of the standard credit tariff would remove this incentive and encourage the company to find alternative ways of preventing and managing debt. British Gas Trading told us that they did not believe that such an incentive ever existed. They said that they install prepayment meters only at the customer's request or after all alternative methods for managing a customer who has payment difficulties or is in debt have been exhausted.

2.14 OFGAS's examination showed that there are offsetting cost reductions when customers pay by prepayment meter, which had not previously been recognised. The reductions arise because prepayment meter customers cannot get any gas unless they first pay for it, which means that there is no risk of them not paying for their gas, and no need to incur costs in pursuing unpaid bills. OFGAS found that, when prepayment meter customers were compared with standard credit customers, these previously unrecognised savings entirely offset the extra costs of prepayment meters described above. They concluded that the total cost of serving prepayment meter customers was therefore about the same as that of

serving standard credit customers and that the price caps were therefore no longer consistent with British Gas Trading's licence requirement not to show undue discrimination.

2.15 As a result, during 1998 OFGAS agreed with British Gas Trading two price reductions totalling 6 per cent, which brought the prices for prepayment meter customers into line with those for standard credit customers. The reductions were equivalent to a decrease in the annual bill of such a customer using 12,300 kWh of gas a year (a typical amount for a prepayment meter customer) of around £16 – a total of some £22 million for the 1.4 million prepayment meter customers.

2.16 While British Gas Trading have reduced their prepayment tariff from 1 October 1998, the reductions offered by new suppliers to customers paying for their gas by this method are more limited. Of the 21 other companies marketing to such customers in February 1999, ten offered tariffs for prepayment meter customers costing about the same as British Gas Trading's tariff, while five had tariffs that would cost more. Six companies had tariffs that would provide a saving, the largest saving being £18 a year or 8 per cent (using 12,300 kWh of gas, a typical amount for such a customer). In contrast an average standard credit customer can expect to save between £38 and £64 or between 11 per cent and 19 per cent a year (using 19,050 kWh, of gas, a typical amount for such a customer) by changing from British Gas Trading to another supplier.

2.17 Although 14 per cent of prepayment meter customers have changed supplier, consumer groups told us that they have been concerned for some time that new suppliers have been making insufficient efforts to attract prepayment meter customers through offering lower prices. They believe the lack of price competition in this particular market has given prepayment meter customers little financial incentive to change supplier. And while British Gas Trading reduced their prices for prepayment meter customers they only did so after regulatory action following a review of the costs involved and not because of competitive pressures (paragraphs 2.10 to 2.15).

ii) How the new suppliers have been able to offer lower prices than British Gas Trading

2.18 All gas suppliers have to meet certain costs out of the prices they charge customers (Figure 17) and British Gas Trading are prevented by their licence from reducing their prices below the level needed to cover costs. Suppliers need to pay gas producers to produce the gas and deliver it for injection into Transco's transportation network, and they need to pay Transco to transport the gas to

The costs and profits of delivering gas to domestic customers

Figure 17

This figure shows an indicative breakdown of the components making up the price of domestic gas.

% of the price paid by the customer (see Note)	Stage of the process	Type of gas company
52	Exploration and extraction	Producer
43	Transportation and storage	Transporter
5	Supply	Supplier
<u>100%</u>		

Source: National Audit Office and London Economics

Note: The figures shown are indicative and the exact breakdown of costs and profits will vary by company.

customers, and possibly also to store gas to meet peaks in demand. Suppliers also need to meet their own costs, such as marketing and issuing bills to customers, and seek to make a profit.

2.19 With the help of our expert economics consultants, London Economics, we assessed how these costs have changed with the introduction of competition. One important change has been a reduction in transportation costs as a result of price controls imposed by OFGAS. These controls have reduced the cost of gas by about 18 per cent since 1994, the first year in which a separate price control was operated for transportation. But because Transco remain a monopoly, transportation costs have been the same for all suppliers and reductions in them cannot account for the new suppliers being able to charge lower prices than British Gas Trading. Our analysis therefore focused on two areas in which there has been scope for new suppliers to reduce costs compared to British Gas Trading:

- a) the cost of buying gas for injection into Transco's transportation system;
- b) suppliers' own costs and profit margins.

a) The cost of buying gas for injection into Transco's transportation system

2.20 Following 1993, when the then Government announced their intention to introduce domestic competition in 1998, the amount of gas available from producers grew much faster than demand. This occurred for several reasons. Some suppliers of gas to business customers lost contracts to sell gas as a result of competition and found they had contracted to buy more gas than they could sell on to customers. Other suppliers entering the market had contracted to buy more gas than in the event they were able to sell. And demand for gas was lower than expected because some gas fired power stations did not start production when planned and because mild winter weather reduced the amount of gas used for heating.

2.21 As a result of the over-supply of gas at the prices previously prevailing, the cost of gas fell from around 24 pence a therm⁵ (out of a total price to customers of around 45 pence a therm) to around 10 pence a therm. The cost of gas has remained low since then, varying between around 10 pence a therm in summer and around 18 pence a therm in mid-winter.

2.22 At first, British Gas were not able to gain much benefit from the lower costs. This was because all of the gas they purchased was bought under long term contracts signed before competition was introduced. These contracts (known as take-or-pay contracts) committed British Gas to buy minimum quantities of gas, the cost of which on average remained in the region of 24 pence a therm. In addition, because British Gas had lost some market share to competitors, they were committed to pay for more gas under these contracts than they could sell to customers.

2.23 Since 1996, however, British Gas (since 1997, British Gas Trading) have renegotiated many of these contracts, both reducing the amount of gas bought under them and the average costs incurred. These changes have started to allow British Gas Trading to take advantage of the lower market prices.

2.24 Other suppliers did not have these long term contracts and they have therefore been able to take advantage of the low market costs to buy cheaper gas. While British Gas Trading and their competitors are now both able to buy gas at

5 A therm is a unit of energy in the imperial system of measures, equivalent to 29.3 kilowatt-hours (kWh). Although the kilowatt-hour is now used to measure the amount of gas used by customers, therms are still the normal measure used in the wholesale gas market.

average costs substantially below those current before domestic competition was introduced, the latter continue to have a significant cost advantage, of approximately five pence a therm, against the overall cost of British Gas Trading's portfolio (Figure 18).

Reductions in wholesale gas costs since 1993

Figure 18

This figure shows that since 1993 wholesale gas costs have fallen for both British Gas and their competitors but the latter have seen much larger reductions

Purchaser	Estimated average wholesale cost of purchasing gas to supply domestic customers (pence per therm at 1998 prices)	Percentage reduction on 1993 costs
British Gas (1993)	24.1	–
British Gas Trading (1998)	21.8	10
Competitors (average) (1998)	16.5	32

Source: London Economics analysis for the National Audit Office

b) Suppliers' own costs and profit margins have also fallen

2.25 Suppliers' costs include such activities as reading meters, issuing bills and providing special services to elderly and disabled customers. Companies newly entering the market do not publish the costs they incur in these activities, so precise comparisons are not possible. But estimates can be made by comparing the prices they charged customers with the amount they pay to buy and transport gas.

2.26 On this basis, London Economics estimated that the prices of the new suppliers suggested that their supply cost and profit margin was lower than British Gas Trading's, but precise quantification was difficult.

iii) The extent to which the savings made by customers are sustainable

2.27 The immediate cause of the reduction in the cost of buying gas for injection into Transco's transportation system since 1993 has been an excess during this period of supply over demand at the prices previously prevailing. It has also, however, been supported by long term reductions in costs which fall into four main categories:

- lower gas production costs as a result of new technology, for example the development of unmanned production platforms;
- lower taxes, mainly due to the abolition of the Gas Levy;
- lower profits for gas producers;
- lower cost and profit margins for suppliers.

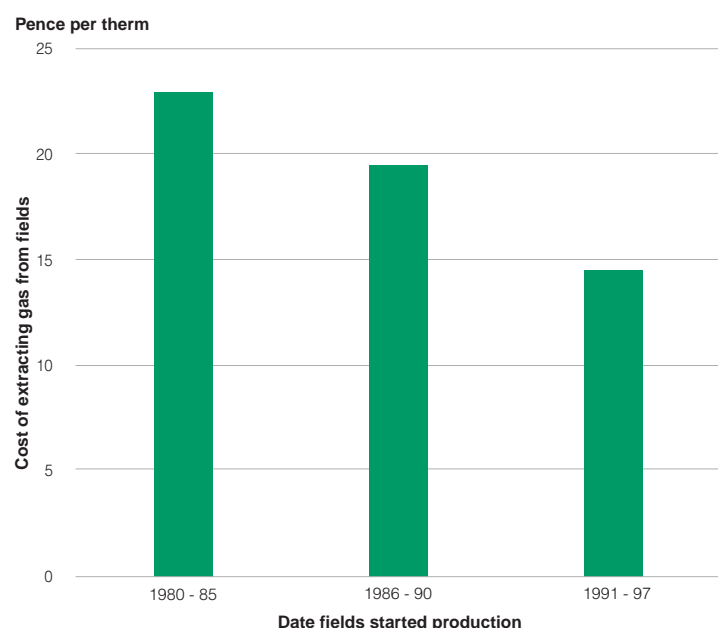
2.28 Most of the reductions appear to be sustainable in the long term. With regard to production costs, for example, oil and gas are worldwide industries and technological developments in one part of the world are normally quickly taken up elsewhere. The reduction in production costs is therefore more likely to be attributable to technological innovations than to short term changes in the British gas market due to the excess of supply over demand (Figure 19). The abolition of the Gas Levy was prompted partly by a concern that it was paid only by British Gas Trading, and therefore put them at a competitive disadvantage to their competitors, and was therefore also independent of the short term supply and demand position.

2.29 The lower profits of gas producers have been largely a consequence of the imbalance between gas supply and demand at the prices previously prevailing. Because this imbalance was caused partly by short-lived factors such as mild weather and delays in the construction of gas fired power stations, it may not be a permanent source of lower gas costs in the long term. The existence of competition, however, has allowed the lower gas costs caused by this imbalance to feed through into lower prices for customers, and has been an important source of price reductions in the short term.

Unit cost of extracting gas from new fields

Figure 19

This figure shows the reduction in the unit cost of extracting gas from new fields starting production between 1980 and 1997.



Source: Department of Trade and Industry

2.30 With regard to suppliers' costs, comparisons with regional electricity companies suggest that competition might expose potential supply cost reductions of between 20 per cent to 50 per cent compared to past levels (although British Gas Trading have reservations about the accuracy with which some electricity companies report their supply costs). At present these reductions will be partially offset by increased marketing costs as companies seek to establish themselves in the market. But in the longer term such reductions could allow prices to customers to fall by between 1 to 3 pence per therm on a sustainable basis.

2.31 Taking into account all of these factors, the introduction of competition in the domestic market appears, therefore, to provide scope for a sustainable reduction in prices for domestic customers of around 4 pence a therm – around 10 per cent. At current levels of consumption, this would be a net customer benefit of some £500 million a year – some £25 to £30 per customer.

iv) There is scope for some customers to make further savings in their gas bills

2.32 Competition means that gas customers can choose their supplier and take advantage of the lower prices on offer. Our customer survey indicated, however, that customers' knowledge of the savings available is variable. For example:

- 35 per cent of customers did not know whether the prices on offer from new suppliers were lower than British Gas Trading's and a further 26 per cent thought they were about the same or higher;
- 57 per cent of customers who pay for their gas by standard credit - cheque, cash or budget plan - and should be able to pay by direct debit (i.e they can, subject to the agreement of their bank, make direct debit payments from their account) are not aware that direct debit is the cheapest form of payment offered by their gas supplier.

2.33 There are therefore two ways by which customers might pay less for their gas. They might:

- a) change to the supplier in their region offering the cheapest price for their preferred method of payment, or
- b) change to the cheapest method of payment for their current supplier. Many customers might change both supplier and payment method.

a) Changing to a different supplier

2.34 Based on the average price in January 1999 offered by all of the new suppliers, regardless of the method of payment, if a further 10 per cent of customers changed to a new supplier they could achieve reductions in their gas bills averaging £30 a year, and customers in some areas could save £67 a year each. The total saving they would make based on the average annual saving of £30 would be in the region of £50 million. If 20 per cent changed, total savings could be in the region of £100 million. Even if the 61 per cent of customers in our survey who did not know whether cheaper prices were available from other suppliers, or thought they were about the same, were to become aware that cheaper prices were available, there is no certainty that they would decide to change.



b) Changing methods of payment



2.35 Based on the average of the tariffs of the companies in January 1999, a typical customer paying by monthly direct debit tariff (the cheapest method of payment) would pay £20 a year less than if he or she were paying by the standard credit method of payment. Based on our customer survey, there are around 5 million customers who could pay by monthly direct debit (i.e. they have a bank account) but are paying the standard credit tariff and are not aware that monthly direct debit is the cheapest method. If these customers became aware of this, they might change their payment method to monthly direct debit to realise further savings in their gas bills. We calculated that if 10 per cent of these customers changed to monthly direct debit their total saving would be some £11 million a year. If half changed, it would be some £53 million a year (Appendix 4 shows how we arrived at these savings estimates).

2.36 For customers to change payment method they have to be sufficiently credit worthy to be allowed to do so by their supplier, and a change to direct debit may be subject to the agreement of their bank. In addition, some customers may not want to change to monthly direct debit even once they know it is the cheapest payment method. Our customer survey revealed that those who (a) did not use monthly direct debit, and (b) were aware that it was the cheapest method, did not change because: they liked the convenience of their current payment method (22 per cent); they disliked direct debit (18 per cent); they preferred to have control over their payments (16 per cent); some preferred to pay for their gas when they used it (6 per cent).

2.37 Customers can also reduce their gas bills by taking advantage of prompt payment discounts. For example, British Gas Trading give a discount on the next bill of £7.87 (including VAT) to customers who pay their quarterly standard credit bill within ten days of the billing date – equivalent to an annual discount of £31.50 – although customers would normally save even more by changing to monthly direct debit.



Giving Customers a Choice - The Introduction of Competition into the Domestic Gas Market

Part 3: Choice

3.1 If competition is fully to benefit customers, customers need a real choice of supplier and suppliers need to be able to compete on equal terms. Accordingly, the Gas Act 1995 requires OFGAS to secure effective competition, rather than simply to “enable” competition, as the Gas Act 1986 had required.

3.2 To assess the progress made in achieving this aim, we examined:

- i) how far customers have practical scope to change their supplier if they wish;
- ii) whether effective competition now exists in the domestic gas market.

What customers say: key findings from our customer survey

In our survey of customers, we found that:

- 95 per cent were aware that competition had been introduced
 - 58 per cent considered themselves to be well informed about competition
 - 35 per cent had information about prices and terms from more than one supplier
- But:
- 59 per cent had not considered changing their supplier
 - 20 per cent of those who had received a call on their doorstep from a gas supplier were dissatisfied with the contact
 - only 30 per cent said it was easy to compare prices and 27 per cent said it was difficult
-

i) How far customers have practical scope to change their supplier if they wish

3.3 The most dramatic evidence that customers now have a choice of supplier is the number who have exercised that choice and changed their supplier. By 1 February 1999 over four million customers, 20 per cent of the total of some 20 million, had transferred from British Gas Trading to another gas supplier. In the areas covered by the first two phases of the introduction of competition – the South West of England, Sussex and Kent – the market share of the new gas suppliers had risen to some 25 per cent by February 1999.

3.4 Many customers, therefore, both already have a real choice of suppliers and have exercised that choice. We therefore focused our examination on two issues:

- a) the extent to which all customers are aware of the scope they have for exercising choice;
- b) whether some types of customer have less choice than others.

a) The extent to which all customers are aware of the scope they have for exercising choice

3.5 To date, OFGAS have licensed 146 companies to supply gas, of which 26 companies are licensed to supply domestic customers. Our survey of the 25 companies who, in July 1998, were licensed to supply domestic customers showed that they were using a wide range of marketing methods with doorstep selling the most widely used (Figure 20).

How new suppliers have sought to recruit customers

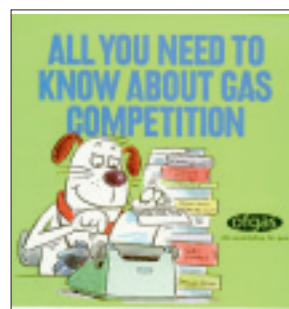
Figure 20

The methods used by companies have included:

- Doorstep selling
- Leaflets
- Direct mail
- Television and newspaper advertising
- Direct contact with developers of new housing

Source: National Audit Office survey of gas suppliers

3.6 OFGAS carried out a publicity campaign during the period when competition was being introduced, based on the theme “Cheaper gas is in the pipeline”. They also produced a leaflet “All you need to know about gas competition”, which was delivered to a million homes; produced a range of factsheets on the main aspects of competition; and contracted the Consumers’ Association to produce regular “Which?” factsheets comparing the prices of the gas suppliers. They also set up a freephone enquiry number, which customers can telephone for information and to request copies of the OFGAS and “Which?” leaflet



and factsheets. The Gas Consumers Council produced their own leaflet on gas competition, in conjunction with Transco, one million copies of which were distributed free through post offices.

3.7 Consumer groups told us, however, that despite the work done by OFGAS and the Gas Consumers Council to provide the public with independent information, more needs to be done to enable customers to make an informed choice about companies and payment methods. They suggested, for example, the information contained in "Which?" factsheets should be disseminated more widely. They believe the limited availability of information contributed to some uninformed customers being misled by sales representatives of gas companies and could be a substantial barrier to increasing the number of customers who change company.

3.8 In our survey of customers we explored their understanding of the competitive gas market, focusing on their price awareness and understanding of how easy it is to change supplier. Key findings were:

- **Awareness of competition.** Ninety five per cent of customers in the survey said that they were aware of competition and 58 per cent said that they considered themselves to be very or fairly well informed about it. The way customers had found out about competition included television programmes (mentioned by 45 per cent of customers), visits from a gas supplier or suppliers (38 per cent), advertising and promotional material from gas suppliers (35 per cent) and national newspapers (30 per cent).
- **Customers' perceptions of how easy it would be to change supplier.** Customers who had changed supplier appear to have encountered few major difficulties: 88 per cent of these customers said that it had been very or fairly easy and only 5 per cent said that it had been difficult. And even customers who had not changed supplier did not expect great difficulty if they chose to change supplier: 72 per cent said they thought it would be very or fairly easy and only 6 per cent thought it would be difficult. Ten per cent of customers who had changed supplier said, however, that they felt they had been misled, the most common reasons cited being that they were paying more than they had expected, or that they felt they had been pressurised into changing.
- **Knowledge about the level of prices.** Thirty five per cent of customers had information on prices and/or other payment terms from more than one supplier and a further 36 per cent had such information from one

supplier. More than a third of customers thought that the prices of the new gas suppliers were lower than British Gas Trading's, on average by about 16 per cent, but 25 per cent of customers thought the new suppliers' prices were about the same, and 35 per cent did not know. Customers who had not changed supplier were markedly less likely than those who had to think that the new suppliers' prices were lower than British Gas Trading, and more likely not to know (Figure 21). In addition, 30 per cent of customers said that they found it easy to compare the different prices available from the various gas suppliers. Among customers who had not considered changing their supplier this figure fell to 23 per cent.

Figure 21

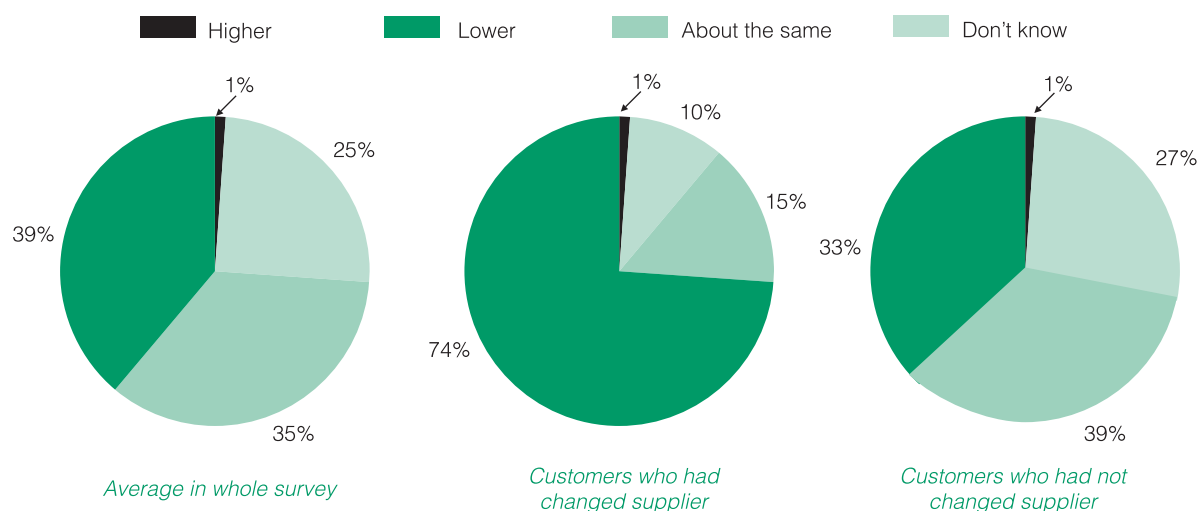
Customers' perceptions of price differences

This figure shows customers who had not changed supplier were less likely than those who had to believe that new suppliers' prices were lower than British Gas Trading, or not to know.

In our survey we asked customers:

“Do you think the prices offered by the new gas suppliers are higher or lower than those offered by British Gas or are they about the same?”

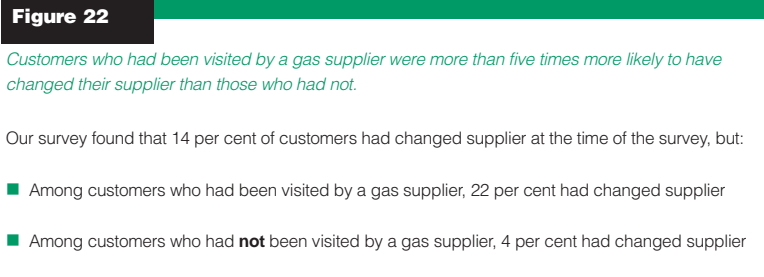
The response was:



Source: National Audit Office/OFGAS survey of customers (by MORI)

- **Customers' consideration of whether to change supplier.** At the time of our survey in August 1998, 14 per cent of customers had already changed supplier and we found that a further 19 per cent had considered changing but had not yet done so. But 59 per cent had not considered changing at all, mainly because they were happy with British Gas Trading and saw no reason to change.
- **Customers' experience of doorstep selling.** Some 55 per cent of customers (70 per cent in Scotland) had been contacted by at least one supplier knocking at their door. And the survey showed that this was an important factor influencing customers' decisions to change supplier: customers who had been visited by a supplier were five times more likely to have changed their supplier than those who had not been visited (Figure 22).

Visits from suppliers and the likelihood of customers changing supplier



Source: National Audit Office/OFGAS survey (by MORI)

Nearly half of customers who had been visited by a gas supplier told us that they were very or fairly satisfied with the contact they had had with the supplier. But 20 per cent said they were very or fairly dissatisfied with the contacts. The reasons given for the dissatisfaction included “too pushy” sales techniques (cited by 47 per cent of those dissatisfied), lack of information (20 per cent), and reservations about the honesty of the sales representative (9 per cent). Doorstep selling is discussed in more detail in paragraph 4.3.

b) Whether some types of customer have less choice than others

3.9 The proportion of customers who have changed their supplier differs considerably between different parts of the country, reflecting the different dates at which competition was introduced. It is lowest in those areas opened to competition most recently but is increasing rapidly in these areas and catching up those that have been open for longer.

3.10 Our customer survey showed that there are only a few differences between customers who have changed supplier and those that have not. The two main differences were:

- **Occupation.** In occupational category AB only 11 per cent of customers had changed supplier compared to 15 or 16 per cent in categories C1, C2 and DE (Figure 23). This may in part reflect the greater extent to which doorstep selling activities have been concentrated on the latter: for example, 67 per cent of customers in category DE said they had been visited by at least one supplier, compared to 40 per cent of AB customers. Among customers who pay by prepayment meter, 77 per cent said that they had been visited.
- **Payment method.** Customers paying by direct debit were more likely to have changed their supplier than those using other methods. For example, 17 per cent of customers who paid by direct debit had changed whereas only 14 per cent of those who paid by prepayment meter had done so.

Professional status used
to define occupational
categories

Figure 23

AB	Managerial, administrative or professional
C1	Clerical, junior administrative or professional
C2	Skilled manual workers
DE	Semi and unskilled manual workers, pensioners, low wage earners

3.11 The lower proportion of prepayment meter customers who have changed reflects partly the limited scope for such customers to save money by changing their supplier. As explained in paragraph 2.16, the reductions offered by new suppliers to customers paying by this method are limited. As a result such customers changing to the new companies can expect to make little or no saving by doing so, and could pay more. Of the 21 companies marketing to such customers in January 1999, ten offered tariffs that for the average prepayment meter customer would cost the same as the British Gas Trading tariff, while five had tariffs that would cost more. Six had tariffs that would provide a saving, and the largest saving was only £18 a year – 8 per cent of an average prepayment meter customers' bill.

3.12 An additional factor is that approximately 80 per cent of customers who use prepayment meters do so because they owe money to British Gas Trading (paragraph 2.12). Any supplier that is owed money by a customer can veto any application by that customer to transfer to another supplier until the customer pays off the debt. To date 8 per cent of such applications have been vetoed for this reason.

3.13 In practice, therefore, price competition among companies for customers using prepayment meters, or who are paying off debt, appears currently to be relatively weak in two senses. First, the tariffs offered by companies suggest that they are not seeking out prepayment meter customers vigorously. And second, the right of all suppliers who are owed money to veto a transfer reduces the incentive for new suppliers to seek out such customers. The real choice available for such customers is correspondingly reduced.

3.14 Another area of concern relates to the 60,000 domestic customers served by public gas transporters who use gas networks other than Transco's. The Gas Consumers Council told us that some gas companies will not accept such customers due to the level of charges sought by the independent public gas transporter. The Gas Consumers Council are also concerned about the difficulties being experienced by local authority landlords in establishing which gas company supplies a property when it becomes vacant.

ii) Whether effective competition now exists in the domestic gas market

3.15 In a market in which competition is effective, companies are continually under threat from existing competitors and potential new entrants. In such a market, a company that charges significantly more than its rivals (whether it is doing so to make higher profits or because it is inefficient), or provides a markedly inferior service, will rapidly lose market share. In the long run, therefore, such a market will be driven by the level of costs, quality of service, and the profit margins of the lowest price company able to maintain itself in the market.

3.16 The threat of new entry to a market will also help to ensure more effective competition. In a market in which the existing companies expect to remain without challenge, informal understandings and expectations of "reasonable" prices may develop. New entrants will inhibit such understandings or expectations from forming. They are also likely to provide an important source of innovation.

3.17 Securing effective competition therefore requires two key conditions to be met:

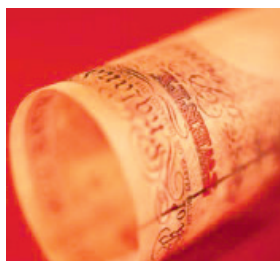
- the possibility of new entry; that is, the existence of a real and credible threat that companies can enter and maintain themselves in the market if they are well managed and efficient in serving customers;
- the absence of dominance, that is, the ability on the part of any company to set higher prices, or provide poorer services, than those of their actual or potential rivals, without a serious loss of market share.

3.18 Our examination showed that progress has been made towards achieving these aims. As noted in paragraphs 3.3 and 3.5 above, some 25 companies, in addition to British Gas Trading, are actively marketing in the domestic market, and they have between them gained over four million customers. Clearly, therefore, new entry is possible, and has occurred on a very substantial scale.

3.19 A number of factors, however, may inhibit the extent to which new companies will be able to maintain themselves in the market. These are:



- **Customer inertia and marketing costs.** New suppliers are reluctant to say publicly how much it costs them to recruit new customers, but the widespread use of techniques such as doorstep selling means that it is an expensive business. Some commentators have suggested that it costs companies around £30 to £40 to recruit a new customer, and Scottish Power recently told investors that it was costing them an average of £35 a customer to do so. Our customer survey also found that many of British Gas Trading's customers would not consider changing to another supplier unless they reduced their gas bill, and that on average they required a reduction of 10 to 15 per cent. The new gas suppliers therefore face marketing costs likely to be greater than those of British Gas Trading, and are unlikely to gain many customers unless they also charge significantly lower prices.



- **Profitability.** As discussed in paragraphs 2.18 to 2.26 our advisers, London Economics, concluded that while the companies entering the market generally had significantly lower gas purchasing costs than British Gas Trading, they might also be accepting low profit margins for a time while they establish themselves in the market. British Gas Trading told us that the OFGAS price control provides scope for them to make a level of profit equivalent to 1.5 per cent of turnover provided that their costs do not exceed the efficient level set by OFGAS. Companies that we spoke to that had chosen not to enter the market said that profitability was a key consideration – their perception was that at present prices were too low to

allow adequate profits. Some of the new suppliers, however, may have the financial strength to withstand temporary periods of low profitability because they are well established in other industries.



■ **Economies of scale.** Companies wishing to serve domestic customers have to incur a range of costs to do so, for example in marketing and in setting up systems to issue bills and collect payments. Some of these costs are largely independent of the number of customers the companies have, especially in the short term, with the result that companies with many customers can spread these costs across a large number of customers while smaller ones cannot. For example those new suppliers who are already established in other industries, such as Public Electricity Suppliers, have the opportunity to spread their costs more easily across their large customer base. Several companies commented to us that they thought that a “critical mass” of around a million or so customers was needed to allow these costs to be spread across a reasonable number of customers, and our consultants London Economics estimated that as many as 2½ million customers might be needed.



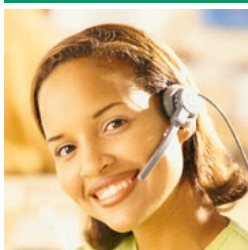
■ **Market share.** In a total market of some 20 million customers there may well be room for one or more competitors to establish themselves in the 1 million to 2½ million customer range. By February 1999, however, only one of the new gas companies had more than 1 million customers. But some companies, such as electricity or water companies, might be able to manage successfully with fewer gas customers if they can share costs with their other businesses or develop a niche market for themselves. The scope for such cost sharing has already encouraged the introduction of “dual fuel” tariffs, in which customers receive a special discount if they buy both gas and electricity from the same company.

3.20 In addition, British Gas Trading retain a degree of dominance in the market. Their prices remain in line with the price controls imposed by OFGAS and, except for a period in 1997 and early 1998 in parts of southern England, they have not reduced their prices below this to match the lower prices offered by their competitors. Although British Gas Trading told us that they had not taken advantage of their dominant position, a number of their competitors said that some of the company’s actions were anti-competitive. Several, in particular, criticised OFGAS’s decision to allow British Gas Trading to reduce further their prices for direct debit customers from January 1998. This was on the grounds that

the size of reduction was not justified by lower costs, but was rather an anti-competitive attempt to retain the type of customer most likely to change supplier.

3.21 In their 1998 review of the competitive gas market OFGAS concluded that British Gas Trading should reduce the difference between their prices for non-direct debit customers and their prices for direct debit customers, which the company have agreed to do early in 1999. OFGAS also concluded, however, that the company's prices remained above the level of their costs, and were not therefore anti-competitive.

3.22 As yet, therefore, it is too early to say that effective competition exists. New gas suppliers are gaining customers and there is no urgent need for radical action to promote competition, other than for OFGAS to react to any alleged or apparent instances of anti-competitive behaviour, should they occur. However, while British Gas Trading retain a degree of dominance, and advantages in some respects over their competitors, it is important that OFGAS continue to monitor the development of the market closely.



Giving Customers a Choice - The Introduction of Competition into the Domestic Gas Market

Part 4: Service

4.1 This part examines:

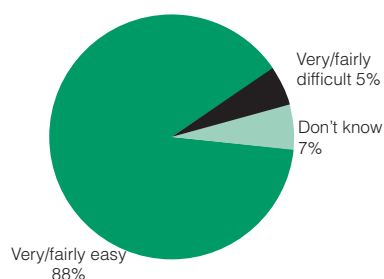
- i) the quality of service customers receive during their transfer to new suppliers;
- ii) the quality of service all customers are now receiving since competition was introduced.

i) The quality of service customers receive during their transfer to new suppliers

4.2 If competition is to be sustainable customers must be able to change their supplier easily. At 1 February 1999, over four million customers (20 per cent) had changed to a new supplier. Our customer survey found that 88 per cent of those who had changed felt that it was easy to change and only five per cent found it difficult (Figure 24). In the first ten months of 1998 OFGAS and the Gas Consumers Council received 45,000 customer complaints about the service they had received in transferring to a new supplier (Figure 25). This represents about two per cent of the customers who transferred in this period.

Figure 24

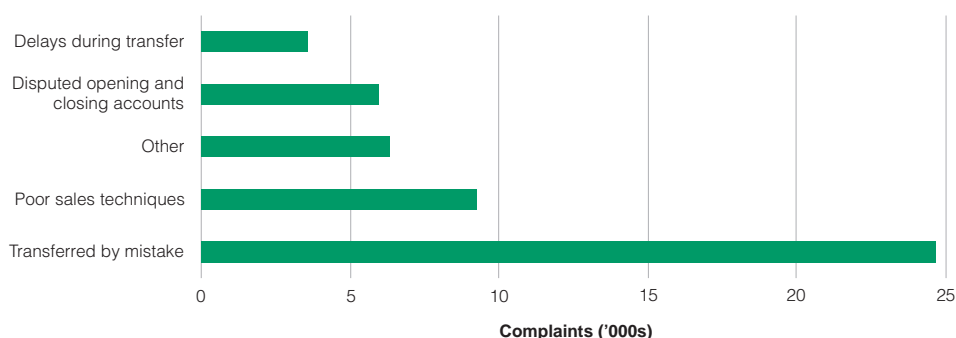
How easy or difficult was it for you to leave your last supplier?



Source: National Audit Office /OFGAS survey of customers (by MORI)

Figure 25

Customer complaints about the transfer to a new supplier



Source: OFGAS and the Gas Consumers Council

4.3 The main areas of customer concern were:

- **Unsatisfactory doorstep selling.** The Gas Consumers Council received complaints about doorstep selling as early as January 1996 – three months before competition started. As a result the Office of Fair Trading obtained a written assurance from the company concerned that their unsatisfactory selling practices would cease, and OFGAS produced a leaflet setting out what were reasonable doorstep selling methods. Customer complaints about other suppliers continued and the Minister for Energy and Industry expressed concerns about doorstep selling to OFGAS and the industry. Failure by the gas industry to introduce self-regulation led OFGAS to modify suppliers' licences in January 1998 to include standards covering doorstep selling. The Gas Consumers Council and the Public Utilities Access Forum told us that they believed that OFGAS should have taken action sooner. But OFGAS consider that it was right to allow the industry time to attempt to introduce self-regulation. And the need to consult publicly and to obtain the agreement of 90 per cent of suppliers extended the time taken to modify licences. In Spring 1998 OFGAS used the licence modification to ensure that two companies took action to improve their doorstep selling practices.

Unsatisfactory doorstep selling practices fall into four broad categories:

1. Misleading customers into entering into contracts, agents lying about other suppliers' terms and intimidation
2. Poor or misleading information
3. Marketing long before the area is opened to competition
4. Use of brokers by suppliers, especially those who require an immediate fee from customers

- **Opening meter reads.** When a customer changes supplier the new supplier needs to have the customer's meter read, or obtain a reading from the customer, and provide the reading to Transco no later than 10 working days after the date of the agreed transfer. Following consultation with suppliers OFGAS set a target that such readings have to be provided in 90 per cent of cases. Many suppliers have, however consistently failed to achieve this target.

Doorstop selling: Aspects covered by January 1998 licence condition modification

1. Standards for the selection and training of sales staff
 2. An independent audit of sales activity
 3. Customer awareness of progress when transfer will take place more than two months after a sale
 4. A ban on using agents who seek payment in advance for arranging a supply of gas
 5. Compensation for victims of misleading sales
 6. A report on supplier's performance
-

- **Inaccurate estimated meter reads.** Transco provide estimated meter readings when companies have not carried out actual readings. When a customer disputes a reading both the old and new supplier have to agree a meter reading. This can be labour intensive; for example, in August 1998, British Gas Trading were processing some 16,000 such cases every week. One of the reasons why customers dispute meter readings is that Transco sometimes have to base their estimates on incomplete or unrepresentative data. Transco rely on suppliers to keep their database up to date and OFGAS have encouraged suppliers to provide the necessary information.

- **Long waiting times.** In October 1998 Transco and the suppliers were processing around 70,000 applications a week to change supplier. Some applications are rejected because of incomplete information, or are vetoed by the customer's existing supplier (e.g. due to debt), and around 50,000-60,000 effective transfers were actually being made every week. At 31 October 1998, however, 723,000 customers were awaiting transfer, indicating that customers were waiting an average of around ten weeks to transfer. OFGAS told us that they expected transfers normally to take around five weeks but that some suppliers were having difficulties in processing transfers promptly and in dealing with rejected or vetoed transfers. By 1 January 1999 transfers were taking an average of some five weeks to carry out, with some 260,000 customers awaiting transfer.

ii) The quality of customer service since competition was introduced

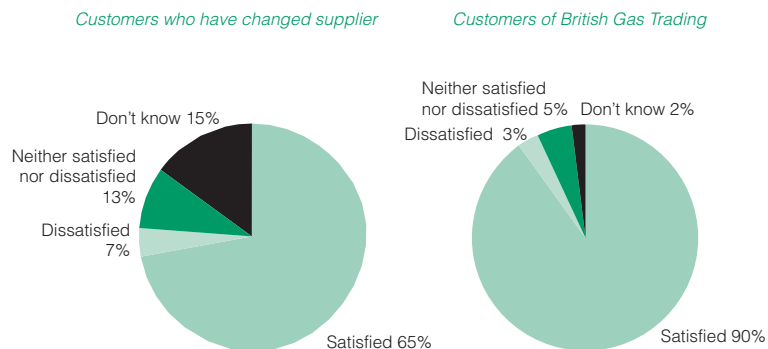
4.4 One of the potential benefits of competition is improvement in the quality of service that customers receive from their gas supplier. Although price is likely to remain a major incentive (84 per cent of customers in our survey said that price was the main factor influencing them to change supplier), quality of service is also important for customers. It may also become a greater consideration if the difference in prices offered by the companies reduces.

4.5 Our customer survey found that 65 per cent of those who had changed supplier were satisfied with the service they were receiving and 7 per cent were dissatisfied. For those who remained with British Gas Trading, 90 per cent were satisfied and only 3 per cent were dissatisfied. A further 16 per cent of those who had changed supplier, compared to 2 per cent of those who had not, had yet to form an opinion – possibly because they had been with their new supplier for only a short time (Figure 26).

Customers' satisfaction
with the service they are
receiving

Figure 26

This figure shows that many customers are content with the service they are receiving.



Source: National Audit Office /
OFGAS survey of customers
(by MORI)

4.6 Among customers who remained with British Gas Trading, 15 per cent said that the service was better than it had been two years earlier (Figure 27), compared to 4 per cent who said it was worse. Of those customers who had changed their gas supplier, 12 per cent considered that they were now getting a better service, but 6 per cent thought it was worse. But 31 per cent of this group

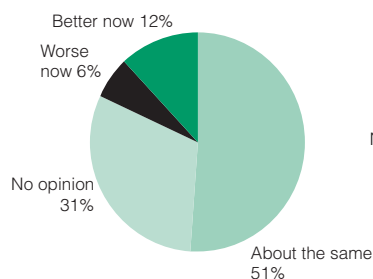
(compared to only 9 per cent of those who had stayed with British Gas Trading) had yet to reach an opinion, again possibly because they had been with their new supplier for only a short time.

**Whether customers
feel service
has improved**

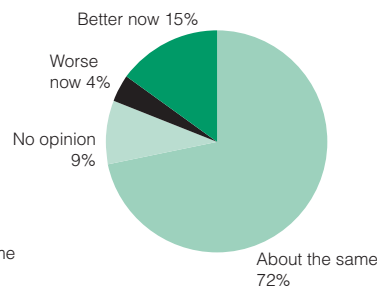
Figure 27

This figure shows that although most customers feel service is about the same, more feel it has got better rather than worsened.

*Customers who have changed supplier
Service received compared with previous
supplier*



*Customers of British Gas Trading
Current service relative to two years ago*



Source: National Audit Office/
OFGAS survey of customers
(by MORI)

OFGAS set minimum standards of service

4.7 OFGAS seek to influence the quality of the service that gas companies provide in two ways:

- By defining the standards of service which British Gas Trading should meet. Currently there are 27 such standards, for example when refunds are due to customers they should be dispatched within three days.
- By ensuring compliance with the licence conditions of each gas company that require companies to provide certain specific services and to meet certain social obligations to customers with special needs – the elderly, disabled, and the chronically sick (Figure 28). We found, however, that OFGAS carried out very limited monitoring of the new gas companies' compliance with their licence conditions. OFGAS explained that they had given priority to rolling out competition and that now that this was achieved they would give more attention to monitoring companies' compliance with their licence conditions. The Director General of OFGAS

has indicated that he is committed to increasing the attention that gas suppliers give to their social obligations and to improve OFGAS's monitoring of their performance in this area.

Figure 28

Main types of service provided by gas suppliers

This figure illustrates the range of services offered by the gas supply companies.

For all customers



A supply of gas to those who request it (providing this is within the geographical area covered by the licence)



Notification of the gas used and charged for



Publication of prices



A range of payment methods



Advice and assistance to customers who find it difficult to pay a bill



Information, such as the name and address of the Gas Consumers Council, the company supplying the customer and the national freephone emergency telephone number

*Customers with special needs
(such as the elderly and partially sighted)*



Special controls and adaptors for gas appliances



Larger type



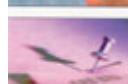
Priority treatment



Free gas safety check



Password identification scheme



Copy bills to nominated third parties

Source: National Audit Office and the gas supply companies

- In addition, in June 1998, in a response to a request by the Government, OFGAS and the electricity regulator, OFFER, published "The Social Dimension: Action Plan" the objective of which was to ensure that all customers benefit from competition, including those on low incomes. The plan's objectives for OFGAS were to reduce costs and improve efficiency of all meters, increase the choice of tariffs and payment methods for disadvantaged customers, help customers manage debt, and publish procedures for supply interruptions to prepayment meter customers.

Services provided by suppliers

4.8 From our customer survey we identified those services which customers most expected suppliers to provide, and through our survey of companies (Appendix 5) we identified the services suppliers were currently offering. Key findings were:

- **Affinity deals.** Suppliers offer a range of incentives to attract and retain customers. Customers are able to make additional savings on other goods and services by receiving loyalty points when they pay their bills. A number of charities have benefited from partnerships with suppliers by receiving a donation from the supplier when a customer transfers to them – see examples.

Supplier	Service and benefit
Amerada	Air Miles loyalty points
Eastern Natural Gas	Automatic monthly billing to the customer's Barclaycard account. Paying for gas in this way provides the customer with one point on Barclaycard's Profile scheme, which can be used to receive a range of goods and services. Eastern Natural Gas pay Wood Green Animal Shelters an initial £10, followed by a further £2.50 a year, for each supporter signing with them.

- **A choice of payment methods.** Some customers find prepayment meters helpful, for example as an aid to budgeting or an alternative to disconnection for debt. Suppliers are only required to offer such meters to those who build up debt or who fail a credit assessment. Customers who do not want a prepayment meter but still wish to make small but frequent payments can pay weekly – a facility offered by many suppliers – or fortnightly, a less common option. A report for the Gas Consumers Council by the Personal Finance Research Centre of the University of Bristol in September 1998 concluded, however, that gas suppliers varied in their commitment to making frequent payment methods available to customers.
- **Customers without bank accounts can avoid paying additional charges.** Many of the companies who responded to our questionnaire allow their customers to pay at the Post Office, in most cases free of charge. In some cases customers can pay free of charge at any branch of

the supplier's bank or at designated premises of their supplier. Customers of some suppliers have a choice of more than 19,000 outlets, including the Post Office, at which to pay their bill. Some suppliers also support PayPoint, a bill payment network that allows the customers of utility and service companies to pay their bills free of charge at over 7,300 retail locations nationwide. The outlets selected are typically those with extended opening hours and convenient locations close to customers' homes and main shopping centres.

■ **Additional services for special needs customers.** Companies' licences require them to offer a range of additional and free services to customers with special needs, such as the elderly, disabled and partially sighted (Figure 28). In approving companies' applications for licences to supply gas, OFGAS scrutinised each company's proposed services for such customers, and companies report to OFGAS the take up of these services by customers. Our analysis of companies' marketing material indicated that customers with special needs are being offered the additional services required of companies. Our customer survey showed, however, that only 9 per cent nationally, and 17 per cent in Scotland, of customers who are elderly or disabled are registered to receive these services. This may be due to pensioners not needing them or not wishing to be seen needing them. Another factor may be that suppliers require their elderly and disabled customers to opt in for these additional services and some give the services low prominence in their publicity material.

4.9 OFGAS have yet to establish the precise reasons for the low take up, or to consider the action that might be taken to encourage further take up of these services, but told us that the proportion of customers registering to receive these services has not changed significantly since competition was introduced. The National Right to Fuel Campaign concluded in research in December 1997 that OFGAS could do more to ensure that suppliers make customers with special needs aware of the services that are available to them. And consumer groups told us that companies should be required to highlight specifically in their literature the additional services that are available for customers with special needs.



Giving Customers a Choice - The Introduction of Competition into the Domestic Gas Market

Part 5: Safety

5.1 This part examines:

- i) the arrangements to secure the safe delivery of gas to customers;
- ii) customer awareness of what to do if they have concerns about gas safety;
- iii) the security of gas supply should a company go out of business.

i) The arrangements to secure the safe delivery of gas to customers

5.2 The use of gas as a domestic fuel depends on public confidence in its safety. And unless customers believe that a uniform standard of safety exists across the industry, they may be deterred from changing their gas supplier. We examined, therefore, the regulatory regime that seeks to ensure that gas is safe, comparing the regime that operated before and after competition was introduced.

Responsibilities

5.3 Primary responsibility for regulating the safety of gas transported through pipes rests with the Health and Safety Commission and the Health and Safety Executive. Their task is to introduce and enforce appropriate regulations in the gas industry, for example requiring Transco to operate a 24 hour telephone service to handle calls from the public about gas escapes. OFGAS have complementary duties to consult the Executive and to exercise their functions so as to protect the public from dangers arising from gas.

Safety regime before competition

5.4 Prior to the introduction of competition into the domestic gas market, British Gas operated a fully integrated gas supply system and assumed many responsibilities associated with the supply and safety of gas (Figure 29).

Main supply and safety responsibilities of the former British Gas Corporation:

Figure 29

This figure shows the main supply and safety responsibilities of British Gas before competition was introduced

1. Ensuring that sufficient gas was brought onshore to meet the needs of all consumers.
2. Setting the requirements for the composition of gas so that all gas delivered to the consumer was safe at the point of use.
3. Odourising gas so that it can be detected by smell.
4. The daily balancing of supply and demand.
5. Seeking to ensure that in abnormal situations (e.g. a reduction in pressure from a pipe break) the flow of gas to domestic customers was maintained.
6. Providing sufficient storage facilities for dealing with daily load balancing and peak usage.
7. Providing a 24 hour emergency service to deal promptly with reported gas leaks and other dangerous circumstances.
8. Promoting regular maintenance of gas appliances, especially targeting the elderly, and providing the first half hour of labour free when leaks inside the home have been reported.
9. Developing research and development capabilities which provide an input into gas safety standards.

Source: Health and Safety Executive

Safety regime since competition

5.5 Following a detailed review to ensure there would be no reduction in gas safety standards in a competitive market, the Health and Safety Commission introduced the Gas Safety (Management) Regulations 1996. The Regulations deal with the management of the safe flow of gas in the national transmission and distribution system, including:

- **National emergency telephone number.** A key safety improvement has been the establishment of a single national freephone emergency telephone number, 0800 111 999, operated by Transco, which replaced numerous local numbers. Under service standards agreed with OFGAS, Transco's national emergency service must answer calls within 30 seconds and once they have received the report attend the site within either:
 - a) one hour for an uncontrolled escape (an escape that cannot be isolated by turning off the gas at the meter valve); or
 - b) two hours for an escape where the person reporting the escape has turned the gas off and confirmed that the smell of gas has disappeared.

- **Dealing with an emergency.** Under the conditions of Transco's licence, a Transco service engineer attending an emergency call in a customer's home will work for up to 30 minutes and if they find a cause for concern provide parts up to the value of £4 to repair equipment. If an appliance or pipework remains unsafe they will turn off the gas supply either at the appliance or the meter and provide the customer with information about a 24 hour telephone helpline which has details of local registered engineers. If gas equipment is disconnected arrangements also exist for Transco service engineers to provide temporary heating and cooking facilities for customers with special needs such as the elderly, disabled and chronically sick. Customers with special needs can only obtain this additional service if they have registered with their gas supplier (paragraph 4.8). OFGAS have received very few complaints from customers about Transco's emergency service.
- **Gas transportation.** Each company proposing to transport gas must obtain a licence from OFGAS and submit a safety case to the Health and Safety Executive which must be accepted before they can start transporting gas. While each safety case should cover all parts of the transportation system, the main focus is on the management of the safe flow of gas and the provision of an emergency system. All other transporters have sub-contracted their emergency service responsibilities to Transco.
- **Co-ordination.** Where more than one transporter is conveying gas in a network, a Network Emergency Co-ordinator must be appointed and a separate safety case submitted and accepted. Transco have accepted the rôle of Co-ordinator for the gas transmission and distribution system in Great Britain. They co-ordinate, control and monitor gas flows across the network in certain prescribed emergency conditions. The Regulations require gas transporters to co-operate with each other and with the Co-ordinator to ensure compliance with the Regulations which the Health and Safety Executive monitor. All gas suppliers must provide a report to the Executive when a gas incident results in hospitalisation or death.
- **Communications.** Although not specifically required to by the Regulations, the industry established VIGIL in April 1998 to promote good communications among all organisations in the domestic gas market. VIGIL provides a forum for discussing gas safety issues and is a source of information on gas safety. Its work is co-ordinated by a secondee from the Gas Consumers Council.

5.6 The Health and Safety Executive believe that the new gas safety regime put in place to support the introduction of competition in the domestic gas market is generally working well and has achieved its aim of maintaining safety standards. At the request of the Health and Safety Commission, the Executive are, however, reviewing the safety regime for the use of gas once it has been supplied to customers, for example with regard to the installation and maintenance of gas appliances. Among other issues, the review is considering the ability of the new competitive market to fund safety related publicity campaigns and research. The Executive plan to complete the review by the end of 1999.

ii) Customer awareness of what to do if they have concerns about gas safety

5.7 Gas can be a hazard in certain circumstances. It can be explosive, an asphyxiant, or when there is incomplete combustion it can give rise to carbon monoxide which is toxic. The public have an important rôle to play in minimising the risk of harm when a gas incident arises and we examined the extent of customers' awareness of what to do should an incident occur.

5.8 The Health and Safety Executive organise publicity campaigns to promote awareness of gas safety issues. OFGAS have supplemented these by producing free factsheets on gas safety and free booklets for landlords on their obligation to arrange annual safety checks of tenants' appliances. All the publicity material promotes Transco's national emergency number.

5.9 All operating licences require that the companies regularly inform their customers that gas escapes should be reported immediately. Our survey of gas companies found that all publicise Transco's national emergency telephone number as a matter of course in their bills and welcome packs along with other information on what to do if there is a gas leak. Transco also publicise the emergency number on all their service vehicles. Our customer survey found that 91 per cent of customers were aware of Transco's freephone number. OFGAS considered that this was a satisfactory level of awareness at the time, given the relatively short period that the national number had existed.

iii) The security of gas supply should a supplier go out of business

5.10 A further potential concern of customers, which can influence their decision to change suppliers, is whether their gas supply is guaranteed if their supplier goes out of business. Several companies commented to us, however, that if a gas supplier went out of business, it could probably sell its portfolio of customers

to another supplier because this would provide an opportunity to acquire new customers without the expense of a marketing campaign. In addition, if OFGAS find it necessary to revoke or suspend a domestic supplier's licence, as would be the case, for example, if a supplier ceased to trade, OFGAS can direct another supplier to take on the customers concerned.

Appendix 1: Study methodology

- 1** The main aspects of our methodology were:
 - We collected and evaluated information from OFGAS relating to the implementation of competition in the domestic gas market, and their monitoring of gas companies' compliance with their licence conditions.
 - We appointed London Economics, specialist economics consultants, to (i) assess the effect of competition in the gas supply market on gas purchase costs and (ii) assess whether effective competition has been secured.
 - Jointly with OFGAS we commissioned MORI to carry out a survey of a representative sample of gas customers in Great Britain to ascertain their views on the introduction of competition. More details are provided in Appendix 2.
 - Before undertaking the survey MORI ran four focus groups (two in Scotland and two in Staffordshire) in June 1998 to seek the opinions of gas customers. This helped in understanding how competition is affecting individual customers and the results of the discussions assisted in designing the MORI survey.
 - We sent a questionnaire to the 25 companies who, in July 1998, were supplying gas to domestic customers. The questionnaire asked their views on the way competition had been introduced and collected information on the gas prices and the types of service that gas companies are offering to customers.
 - We met four suppliers – British Gas Trading, Scottish Power, Calortex and Amerada Hess Gas.
 - We also met two potential suppliers to discuss with them why they had decided not to enter the market, for example whether they considered there were any significant barriers to entry.

- We analysed the database of complaints received by the Gas Consumers Council to identify the types of issues and concerns which customers were raising with them. We also reviewed the action, where appropriate, which OFGAS were taking in response to these concerns.
- On gas safety issues we consulted the Health and Safety Executive.
- We consulted selected third parties who have an interest in the domestic gas market:
 - Transco
 - The Local Authorities Co-ordinating Body on Food and Trading Standards (LACOTS)
 - The Consumers' Association
 - The Gas Consumers Council
 - The Public Utilities Access Forum (including the National Right to Fuel Campaign, Age Concern, the National Association of Citizens Advice Bureaux and the National Consumers Council)
 - The Bristol University Personal Finance Research Centre
- We constituted an advisory panel to provide us with informed comment on the scope of our study; the audit methodology; our findings and their presentation in this report.

The National Audit Office panel

- Professor John Chesshire of the Science Policy Research Unit at the University of Sussex
 - Peter Vass, Director of the Centre for the Study of Regulated Industries at the University of Bath School of Management
 - Professor Catherine Waddams of the Centre for Management under Regulation at the University of Warwick
 - Jan Brady, Managing Director of Albermarle Connection, communication advisor
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Appendix 2: The MORI survey

1 The National Audit Office and OFGAS jointly commissioned MORI to carry out a survey of gas customers in Great Britain to ascertain their views on the introduction of competition. The survey consisted of qualitative and quantitative research.

Qualitative research

2 MORI ran four focus groups (two in Edinburgh and two in Staffordshire) in June 1998 to discuss customers' experiences of competition in the domestic gas market. The purpose of the groups was to help us understand how competition is affecting individual customers and to help us design the survey questionnaire for the quantitative research.

3 At each location one discussion involved gas customers from higher income groups (occupation groups ABC1) and the other involved customers from lower income groups (occupation groups C2DE). There were between eight and ten participants in each group, including between four and five customers who had changed supplier. There were at least two prepayment meter customers involved in discussions in each location.

4 The main areas of discussion in the focus groups were customers' awareness of, and attitude towards, competition; their sources of information about competition; their experiences of doorstep selling; their opinions of gas suppliers; their knowledge of the offers available from suppliers; and the method of payment they used.

Quantitative research

5 Between 11 July and 16 August 1998 MORI conducted 2,511 face to face interviews with domestic gas customers in their homes. To provide a large enough sample to allow separate analysis, the numbers of interviews with customers who had changed supplier and with customers in Scotland were boosted to 803 and 691 respectively. The proportion of lower income enumeration districts in the sample was also boosted to facilitate separate analysis. Final data were weighted to match the known profile of gas customers in Great Britain by work status, age, social group and changers and non-changers. The survey results for a sample of 2,500 have a sampling error up to + or – 2 per cent, with 95 per cent confidence.

MORI carried out research previously into gas competition in Stage 1 (South West England) in September and October 1996, in Stage 1 and Stage 2b in November and December 1997, and nationally in December 1997.

Key findings

Nearly all customers are aware of competition in the domestic gas market

6 In the survey, 95 per cent of customers said they were aware that competition has been introduced into the domestic gas market. But the proportion of customers who said they were very or fairly well informed about competition, 58 per cent, was significantly lower than in the previous MORI surveys. Lower income groups were the least well informed of the changes, while those that have changed were the best informed.

The majority of customers are not aware that new suppliers offer lower prices

7 Only 39 per cent of customers were aware that the prices offered by new suppliers are lower than those of British Gas Trading. Twenty seven per cent of customers found it difficult to compare the prices available from the new gas suppliers: the overriding difficulty appearing to be a lack of information on the pricing structures.

Why did you find it difficult to compare the different prices available from the various gas suppliers?

	Per cent
Lack of information	32
Nothing to compare figures to yet	13
Information is confusing/not clear	13
None of suppliers give you an exact price	12
Difficult to compare like with like	9
Suppliers always say their prices are lower	7
Other reason	14

Sample size: 637 customers who said that they found it fairly or very difficult to compare the different prices available from the various gas suppliers (Source MORI)

Many customers are not aware of the varying costs of different payment methods

8 Only 14 per cent of budget plan payers, 34 per cent of prepayment meter users, 23 per cent of cash payers and 35 per cent of cheque payers know that their method of payment is **not** the cheapest offered by their supplier. Monthly direct debit is the cheapest method.

Is your payment method the cheapest this supplier offers or not?

Method	Yes, cheapest (per cent)	No, not cheapest (per cent)	Don't know (per cent)
Direct debit/standing order	75	2	23
Quarterly cash	27	23	50
Quarterly cheque	21	35	44
Budget payment plan	48	14	38
Prepayment meter	30	34	36

Sample size: 2,487 customers (Source MORI)

9 Of those who were aware that they were not using the cheapest method, the main reasons for not using a cheaper method were the convenience of the current method (22 per cent of those not using monthly direct debit), a dislike of direct debit (18 per cent) and preferring to have control over payments (16 per cent). Prepayment meter customers also indicated that they prefer to pay for what they use, when they use it (22 per cent of prepayment meter customers).

Doorstep selling has been an effective way of communicating with customers

10 The greatest sources of information on gas competition for 65 per cent of changers were visits by gas suppliers. Visits by gas suppliers appear to have occurred more frequently among those on lower incomes, suggesting that gas suppliers are specifically targeting this group.

11 Fifty seven per cent of customers who were visited found the contact informative and 31 per cent found the visit uninformative. The main reasons given for dissatisfaction with doorstep salesmen were that they were too pushy, wanted customers to sign straight away or used hard sell techniques. This type of factor was mentioned by 47 per cent of those who were dissatisfied.

The majority of customers who change supplier do so to pay cheaper prices

12 The main reason spontaneously given by 84 per cent of changers for changing to their current supplier was cheaper prices. Of those customers who had changed, 40 per cent were from occupational groups ABC1 and 60 per cent were from occupational groups C2DE. The proportions of these groups in the general population are 43 per cent and 57 per cent respectively, showing that, so far, groups C2DE have been more likely than average to change. This reverses the trend observed in the previous MORI surveys.

13 Of those who were considering changing, but have not yet done so, the main reasons given for not changing were that they were waiting to see what happens (42 per cent) and that they did not know enough about other suppliers (41 per cent). Of those who had always been with British Gas and had not considered changing, the main reasons given for not changing were that they were happy with British Gas (74 per cent) and saw no reason to change (63 per cent).

Most customers found it easy to change supplier and service has improved

14 Eighty eight per cent of changers found it easy to leave their last gas company, with only 5 per cent finding it difficult. Eighty six per cent of gas customers were satisfied with the service they received from their current supplier. While 72 per cent of British Gas Trading's customers rated service as about the same as two years ago, 15 per cent rated it as better and only 4 per cent rated it as worse.

Appendix 3: Savings made by customers who have changed supplier

1 At the time of our examination just over 4 million customers had changed from British Gas Trading to a new supplier. We estimated the savings that have been made by those customers by estimating their total annual bill if they had stayed with British Gas Trading and comparing this amount with their estimated bill with the new suppliers.

How much would the customers be paying if they had not changed?

2 Based on British Gas Trading information in January 1999 we used the following customer profiles for the 4 million customers who have changed to a new supplier:

- monthly direct debit – 32 per cent (1,280,000 customers);
- payment methods under the quarterly direct debit tariff (which includes standard credit customers paying within 10 days of their billing date) - 36 per cent (1,440,000 customers);
- standard credit - 25 per cent (1,000,000 customers);
- prepayment – 7 per cent (280,000 customers).

3 We estimated the total reduction in annual bills for those customers who had changed supplier by comparing how much they would be paying with British Gas Trading with the average of each tariff available from the new suppliers in January 1999 and multiplying the difference by the number of customers using each payment method.

Payment method	Typical annual bill		Number of customers	Reduction in total annual bill
	from British Gas Trading	from a new supplier		
Monthly direct debit	£286	£264	1,280,000	£28 million
Payment methods under quarterly direct debit tariff	£303	£276	1,440,000	£39 million
Standard credit	£334	£283	1,000,000	£51 million
Prepayment	£234	£235	280,000	No reduction

4 The estimated total savings made by customers from changing supplier were therefore £118 million – an average of £30 each.

5 These customers would already have saved an average of £48 each if they had stayed with British Gas Trading. Their total saving compared to the April 1996 prices is therefore (£30+£48) x 4 million = **£312 million**.

Appendix 4: Potential savings if customers changed their payment method

1 Our survey of customers showed that 53 per cent of customers paid for their gas on a standard credit tariff. Because gas companies charge lower prices to customers who pay by direct debit, there is scope for customers to save money if they change to this method of payment. To estimate the amount that customers could save in this way we:

- used the findings of our survey to estimate the number of customers in the survey who were not aware that direct debit is the cheapest payment method offered by their gas supplier;
- estimated the number of these customers who had a bank account and who therefore could pay by direct debit if they wished; we then extrapolated this result to estimate the total number of customers in Great Britain who pay by standard credit, who are not aware that direct debit is cheaper, and who had a bank account and could change to direct debit if they wished;
- estimated the amount each such customer could save by changing from standard credit to direct debit;
- multiplied this amount by the number of customers who (a) are not aware that direct debit is the cheapest payment method offered by their gas supplier and (b) could change to direct debit if they wished.

How many standard credit customers are not aware that direct debit is the cheapest payment method offered by their gas supplier?

2 Our survey of customers showed that of the 2,511 customers in the survey:

- 1,165 customers paid for their gas by cheque, cash or budget plan (i.e. they paid the standard credit tariff).
- Of these 1,165 customers, 346 (30 per cent) believed (mistakenly) that the methods they were using were the cheapest offered by their gas supplier.

- Of the 1,165 customers, another 518 (44 per cent) did not know the cheapest method offered by their gas supplier.

3 We concluded, therefore, that $346 + 518 = 864$ of the 1,165 customers (74 per cent) who paid by cheque, cash or budget plan were not aware of the cheapest payment method offered by their gas supplier.

How many of these 864 standard credit customers had a bank account and therefore would be able to pay by direct debit if they wished?

4 Additional analysis by MORI showed that 660 of the 864 customers had a bank account and therefore would be able to pay by direct debit if they wished. This represents 57 per cent of the 1,165 customers who paid for their gas by cheque, cash or budget plan. We estimated from the survey that there are 9.3 million customers who pay using these methods, so 57 per cent x 9.3 million = **5.3 million** customers would be able to pay by direct debit but are not aware that it is the cheapest payment method offered by their gas supplier.

How much would each customer save by changing to direct debit?

5 The average of all the standard credit tariffs available in January 1999 (for the consumption of 19,050 kWh a year, the average amount used by standard credit customers) is £285. The average of all the monthly direct debit tariffs available in January 1999 for the same amount of gas is £265- **£20 less**.

What is the total saving available to customers from changing their payment method?

6 If the 5.3 million customers identified above changed their supplier and saved an average of £20 each, the total saving would be $£20 \times 5.3 \text{ million} =$ **£106 million**.

Appendix 5: Gas company survey

Survey objectives and methodology

1 In July 1998 we asked 25 companies supplying gas to domestic customers to complete a short questionnaire. This sought their views on the way competition had been introduced and collected information on prices and services. Respondents were promised anonymity. Nineteen replies were received, a response rate of 76 per cent.

Marketing

2 A range of marketing methods have been used, but doorstep selling and leaflets have dominated. Direct mailing has also featured prominently. Where suppliers have used doorstep selling it has been their main marketing method. Nearly all the respondents observed that marketing proposals had been discussed with OFGAS during the initial licence application. Some questioned the validity of price comparisons made by other suppliers.

If another supplier ceases to trade

3 Respondents did not find this a problem area since it would provide an opportunity for them to extend their customer portfolios. One respondent felt it unlikely that the relevant licence condition would ever be used by OFGAS, as a failing supplier would be more likely to sell their customer portfolio while it still had a value. Some respondents said they had given their views on a consultative paper issued by OFGAS in August 1997 but had heard nothing since.

Customer information about gas leaks

4 Customers of the respondents are made aware of the national emergency telephone number (0800 111 999) on numerous occasions, most notably on or with bills and in welcome packs. Some respondents have also advised their customers of what to do when they have a gas leak and two have provided their customers with the Department of Trade and Industry leaflet on the risks of carbon monoxide poisoning.

Customer service

5 Respondents expressed a wide range of views on the transfer of customers between suppliers, ranging from not satisfactory to working well. But most respondents felt that adequate procedures are now in place, although for them to work smoothly it is necessary for suppliers to meet their commitments on meter readings and for Transco's record of meter numbers to be improved.

6 Five suppliers consult in varying degrees with caring agencies and draw on their experience to identify the needs of their elderly, chronically sick and disabled customers. The remainder say they focus on their licence commitments.

7 British Gas Trading have regular meetings with OFGAS to discuss issues affecting customer service. They are required to meet the service targets agreed with OFGAS as part of the price control regime. The remaining respondents have met with OFGAS on a varying number of occasions, but some said that they had not been approached by OFGAS since their initial licence application had been processed.

British Gas Trading

8 The principal complaints of the new suppliers against British Gas Trading were that the company were permitted to introduce their new lower tariff too early in the development of the competitive market and that the company's direct debit reductions were not cost reflective. One respondent noted that the company's size gave them an unfair advantage when advertising their services on television because the cost of this expensive, but potentially very effective, method of marketing could be spread over a much larger number of customers.

Payment methods

9 Respondents offer their customers a range of payment methods. For those customers wishing to make small but frequent payments, weekly payment facilities are offered in most cases. Some respondents offer fortnightly schemes, while British Gas Trading also offer payment by gas stamps. The majority of respondents allow their customers to pay free of charge at the Post Office and some customers can settle their bills free at any branch of their gas supplier's bank.

10 A few respondents have supported the development of PayPoint – a new bill payment network which allows customers of utility and service companies to pay their bills free of charge at over 7,300 retail locations nationwide. The outlets selected are typically those with extended opening hours and convenient locations close to customers’ homes and main shopping centres.

Level of competition

11 Most of the new suppliers that responded did not feel that the criteria for a competitive market had been achieved. They were concerned at British Gas Trading’s dominant position and alleged abuses of it, such as tariffs that are not cost reflective and premature advertising. But they also felt that the extension of competition had been frustrated by the over reaction of consumer groups to poor doorstep selling practices, customers’ lack of awareness and OFGAS’s over protective regulation and inadequate policing of licence compliance.

12 British Gas Trading believe their five main criteria for a competitive market had been achieved: customer awareness of choice, ease of changing between suppliers, suppliers’ commitment to customers, low or no barriers to entry and exit, and an acceptable degree of concentration in the market. But the company were critical of the additional obligations placed upon them, some aspects of the transfer process and the advantage gained by electricity companies due to delays in the opening up of that market to competition.

OFGAS performance

13 We asked respondents to score the performance of OFGAS on a five point scale ranging from +3 (very well) to –1 (badly), where +1 was an average performance and +2 meant that OFGAS had done well. OFGAS achieved 1.89. No respondent rated OFGAS at less than average.

14 Respondents were impressed by the positive approach adopted by OFGAS and their determination to get competition extended. Working relations were deemed good and they felt that OFGAS had been helpful and supportive. Areas where respondents felt OFGAS could have done better included the policing of British Gas Trading’s activities, the assessment of risks before the opening of each tranche, and the use of an interim computer system by Transco in Scotland and the North East of England.

Glossary of terms

Direct debit	A payment method by which the customer's bill is paid automatically from their bank account each month or each quarter.
kWh	Kilowatt hour: the total energy received when power is delivered at the rate of one thousand watts for one hour. 1 kWh = 0.0341 therms.
Network Code	A compendium of contractual terms governing the use by shippers of the gas transportation and storage pipeline system operated by Transco.
Prepayment meter	A meter into which a customer inserts coins, mechanical tokens or an electronic card in order to obtain gas.
Producers	The companies that explore for gas, drill the wells and flow the gas out of the ground. Almost all operate offshore. They send their gas along undersea pipes to gas processing facilities at terminals around the coast of Great Britain.
Public gas transporters	Operate the parts of the network which store gas and transport it from the coastal terminals to gas customers. Transco are by far the largest public gas transporter and serve around 99 per cent of households.
Shippers	Buy gas from producers and sell it to suppliers. They employ a public gas transporter to transport the gas to customers.
Standard credit	The tariff charged by suppliers to customers who pay their bills by cash, cheque, credit or debit card.
Supplier	A company which contracts with shippers to buy gas which they then sell to customers. A supplier may also be a shipper.
Tariffs	The published prices charged by gas suppliers.
Therm	A unit of energy in the imperial system of measures. 1 therm = 29.3071 kWh.