Promoting choice and value
for all gas and electricity customers

The Retail Market Review – Impact Assessment for the final non-domestic proposals

Supplementary appendix

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Overview:

This document contains Ofgem's Impact Assessment of our final proposals for the non-domestic Retail Market Review (RMR). We are proposing new rules to help businesses, particularly smaller businesses, get their best deal from the market with the minimum of hassle.

This document assesses the potential impact of these proposals on consumers, competition, sustainable development, and health and safety. It also considers the risks and unintended consequences and the alternative options.

Our proposed changes involve:

- amending existing rules to bring more, slightly larger, businesses under our micro business protections;
- new rules to make processes clearer and simpler for smaller businesses; and
- new sanctions on energy suppliers who do not deal with their smaller business customers fairly, when they communicate contractual information, when customers want to switch, when they have a deemed contract, or when they bill customers.

We are also increasing our monitoring of supplier actions when switching any size of business, and continue to progress work to help all business customers engage confidently with third party intermediaries.

Context

The Retail Market Review (RMR) aims to make the market better at serving the interests of consumers and enable individual consumers to get a better deal from energy companies.

This document presents our Impact Assessment (IA) of the RMR non-domestic proposals, which should be read in conjunction with our final proposals document. The non-domestic RMR has links with the roll out of smart and advanced meters, our Smarter Markets Strategy, our wider work on third party intermediaries, Liquidity and initiatives on voluntary back-billing codes. We are working to ensure our RMR proposals work in a complementary manner to these initiatives.

IAs are a vital part of our policy-making process and provide a valuable framework for assessing the impact of important policy proposals. Ofgem has a statutory duty to undertake and publish IAs where the matter is 'important' – essentially defined as involving a major change or having a significant impact on regulated businesses or consumers.

Associated documents

All documents are available at www.ofgem.gov.uk

- The Retail Market Review – Final non-domestic proposals, Reference 38/13.
- The Retail Market Review – Updated proposals for businesses, Reference 134/12.
- The Retail Market Review – Updated domestic proposals, Reference 135/12.
- The Retail Market Review: Domestic Proposals, December 2011, Reference, 116/11.
- The Retail Market Review: Draft Impact Assessments for Domestic Proposals, Supplementary Appendices, December 2011, Reference: 116a/11.
- The Retail Market Review – Findings and Initial Proposals, March 2011, Reference: 34/11.
- Energy Supply Probe - Proposed Retail Market Remedies, August 2009, Reference: 99/09.
- Energy Supply Probe - Initial Findings Report, October 2008, Reference: 140/08.

Contents

1. Introduction

Chapter Summary

We describe the purpose of this document, outline the key barriers in the non-domestic market, and summarise our proposed package of measures, designed to alleviate these problems. Finally, we describe the approach we follow in assessing the impact of our proposals, and provide an outline of the structure of this document.

1.1. This Impact Assessment (IA) supports our accompanying final proposals document. These proposals aim to improve the information provided to business consumers and help them engage more effectively in the energy market.[1]

1.2. The purpose of this IA is to explain the potential impacts of our final proposals for non-domestic consumers: extending protections to more micro businesses; clearer and simpler processes for smaller business; introducing enforceable Standards of Conduct (SOC); and encouraging improvements to the objections process.

1.3. We intend to consult on the wider framework for Third Party Intermediaries (TPIs) later in 2013 and are progressing work to establish a common Code of Practice for TPIs in the business market and we are also consulting on gaining certain powers of the Business Protection from Misleading Marketing Regulations 2008 (BPMMRs).[2] Our TPI work will continue as a project discrete from RMR, so this IA does not explicitly consider the impact these may have in the non-domestic market.

1.4. Our quantitative and qualitative analysis indicates that our proposed package of measures is likely to provide a net benefit to non-domestic consumers.

Barriers in the non-domestic market

1.5. In our Retail Market Review (RMR) consultations since 2011 we have set out our concerns in relation to a number of specific problems faced by non-domestic consumers, particularly smaller businesses.

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[1] In this document we use the terms "market" and "markets" as shorthand for referring to different segments of the energy sector. For the avoidance of doubt these terms are not intended to describe or otherwise suggest the approach that may be taken by Ofgem for the purposes of market definition in competition law investigations.

[2] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=328&refer=Markets/RetMkts/rmr

1.6. Through our research, and consultation process, we have identified a number of key barriers to the effective engagement of non-domestic consumers. The key barriers that we have identified are:

- **Lack of clear contract information**: Smaller businesses often do not know when their contract ends or when they can switch supplier. This means they may be rolled over onto more expensive contracts or out of contract rates, missing out on opportunities to transfer to a better deal.
- **Billing issues**: Business consumers have reported issues with the clarity and accuracy of their bills. This can make it difficult for them to assess their energy consumption and spend. Inaccurate back-bills can cause businesses significant difficulties if a large bill is received unexpectedly.
- **Problems with transfers**: Poor behaviour from suppliers during the switching process means that businesses can be frustrated in their attempts to switch. Business consumers find that the switching process can be long and drawn out.

Our proposal

1.7. In October 2012, we consulted on a range of updated proposals that sought to help business consumers get the best energy deal without unnecessary difficulties. These measures were developed from concerns we had identified in specific areas of the business market. They proposed to widen protections for small businesses, investigate problems with businesses facing objections to transfer, improve confidence in TPIs and introduce binding Standards of Conduct (SOC) for small businesses, covering billing, the communication of contractual information, customer transfers and matters relating to deemed contracts.

1.8. Respondents welcomed many of the changes to the proposals developed since our initial consultation in November 2011. Many suppliers and consumer groups supported our new proposals to include the contract end date on bills. There remained mixed reactions to our proposal to introduce binding SOC for suppliers to small businesses, although responses in general were more positive than our previous consultation.

1.9. We have made minor changes and clarified some areas in the past months in light of responses and additional stakeholder engagement. Our final proposals include the following elements:

- **Protecting more businesses**: The scope of SLC 7A protections for micro businesses will be expanded, with larger electricity and gas consumption thresholds.
- **Simpler processes for micro businesses**: Termination notices will be allowed to be given at any time during a contract, and contract end dates and termination notice dates will be on bills.

- **Fairer treatment for micro businesses:** We will require suppliers to meet enforceable Standards of Conduct in their dealings with micro businesses. These cover billing, the communication of contractual information, customer transfers and matters relating to deemed contracts.
- **Reducing barriers to switching**: Increased monitoring and encouraging industry to resolve other issues with the objections process.
- **Third Party Intermediaries**: We are continuing to develop options for a Code of Practice for TPIs working in the non-domestic market. We are also reviewing the wider regulatory framework for TPIs later this year.

Objectives for the RMR proposal for non-domestic consumers

1.10. Our objective for the non-domestic part of the RMR project is different to the domestic RMR. There is more new entrant competition in this area of the market and more consumer engagement, with widespread use of fixed term contracts. Nonetheless, we have evidence that businesses, and particularly smaller businesses, face a number of specific problems in engaging effectively (see Chapter 2). Our objective with the RMR for business consumers is to address these specific barriers.

1.11. Our proposals will improve the information given to businesses, where issues have been identified through analysis of contacts data, consumer research and information from suppliers. Our package of measures will therefore be successful if we see a reduction in the unnecessary problems some business consumers, in particular smaller businesses, face when engaging in the energy market.

1.12. While we consider that these proposals will have significant benefits to business consumers in their own right, we do not consider that we will be able to meet our objectives in full unless we also tackle the issues around TPI behaviour in the market. We will issue a further consultation on our TPI proposals later in 2013.

Approach to the IA

1.13. In this section we set out our approach to conducting this IA. We also outline the balance between qualitative and quantitative assessments of the impacts.

1.14. The purpose of this IA is to assess the impacts of our proposals, and in particular to assess the net impact on consumers. We do this by assessing how likely our proposal is to achieve the objectives that we set out above. We start by analysing how our proposed package of measures is likely to address the barriers identified. We also assess the distributional effects of our proposals, and how it may impact on competition, sustainable development, and health and safety.

1.15. Our analysis is based on the assessment of our proposal against the counterfactual scenario. This represents the alternate situation that would exist if our proposals were not implemented.[3] While we have considered different options for each measure, our analysis considers exclusively the impacts that our proposed package of measures (formed by the preferred option for each measure) will have in relation to the counterfactual.[4]

1.16. In defining each one of the measures we have considered a number of options. We have analysed each option to decide the optimal measures to include in the package, and/or the optimal design for any specific measure. Chapter 6 sets out the assessment of the different options we have considered for each of our proposals.

Approach to the quantitative assessment

1.17. We expect the RMR proposals to produce changes in the behaviour of consumers and suppliers. In order to better understand the main drivers of this process, as well as the obstacles that may undermine it, we carry out an ex-ante cost-benefit analysis.

1.18. Our approach builds on Ofgem's overall objectives to promote consumers' choice and value, as we assess the impact of RMR proposals primarily on consumers' welfare. Nevertheless, this takes a long-term perspective, by considering the objective to maximise consumers' net benefits while allowing suppliers to earn a reasonable return (constrained by competitive pressure and the scope for efficiencies) in order to ensure quality of supply over the long run.

1.19. Within this framework, in Chapter 2 we carry out a quantitative assessment of the impact of the overall non-domestic RMR package on consumers against a counterfactual scenario, where RMR proposals would not be implemented. In particular, we focus on measuring the following effects:

- Engagement effect – The provision of contract end dates and termination notice on bills will encourage more consumer engagement when contracts come up for renewal, implying a higher number of consumers moving to better deals. These consumers could see a reduction in their bills relative to the counterfactual scenario.

[3] The counterfactual is a hypothetical alternative situation that reflects the best judgment as to what would have occurred in the absence of the RMR proposals. This includes, for example, the impacts of policies that have been implemented, but have a delivery date in the future (e.g. the smart metering rollout.)
[4] We do not assess the impacts of multiple alternate options to our proposal.

- Effect on prices - Some consumers could pay more as a result of suppliers' reaction to reduce price differentials between contract types, and face an increase in their bills relative to the counterfactual scenario.
- Pass-through of RMR proposal implementation costs – Suppliers may be able, and decide to, pass some of these costs on to consumers, depending on the level of competition and the scope for efficiency in the industry.

1.20. The quantitative assessment inevitably faces some limitations. These stem primarily from the uncertainty surrounding the future behaviour of consumers and suppliers in response to the RMR proposals. Moreover, there is an objective difficulty in quantifying all of the costs and benefits of these proposals in monetary terms, such as capturing all of the benefits from better service and fairer treatment under the implementation of the SOC.

1.21. In order to deal with this complexity, we adopt a stylised scenario approach and other related simplifying assumptions. Nonetheless, the analysis builds on a robust framework. Scenarios and assumptions are based on data we have gathered on consumer behaviour and average bills and have been designed to be representative.

1.22. This is a comparative static exercise, by which the possible post RMR scenarios are compared with the counterfactual scenario. This uses mainly historic consumption information and data from a TPI on the average rates paid by micro business consumers, along with the implementation cost estimates provided by suppliers (see Chapter 3).

1.23. We have focused our analysis on two main scenarios:

- Under a first "low impact" scenario, there is a small positive engagement effect generated by our proposals which is sufficiently strong to dominate any other negative effect from the pass-through of suppliers' implementation costs. As a result, consumers overall will be see a marginal net benefit from the RMR proposals.
- Under a second "high impact" scenario, the engagement effect will be stronger, but there will be price convergence. Some consumers will be worse off than before, but overall there will be a larger net benefit than the low impact scenario.

1.24. As a general caveat, we must stress that the whole quantitative assessment is aimed to better understand and highlight the main drivers of RMR impacts on consumers and competition. To serve this purpose, we make use of stylised assumptions and scenarios which inevitably drive the resulting figures. Therefore, these should not be taken as precise measures of the RMR effects.

1.25. Finally, the quantitative analysis is conceived to be strictly related and complementary to the detailed qualitative assessment, which is carried out in the remainder of Chapters 2 and 3.

Structure of the document

1.26. This document is structured as follows:

- Chapter 2 assesses the impacts on consumers.
- Chapter 3 assesses the impacts on competition.
- Chapter 4 assesses the impacts on sustainable development.
- Chapter 5 assesses the impacts on health and safety.
- Chapter 6 sets out the different options assessed in each of the measures in our proposed package.
- Chapter 7 considers any risks and unintended consequences.

2. Impacts on consumers

Chapter Summary

We identify the key barriers to consumer engagement in the non-domestic market, and assess the likely impacts of our proposals on consumers in terms of how they may mitigate or remove these barriers. We also provide a quantitative assessment of the costs and benefits of the RMR proposals.

2.1. In October 2012, we consulted on a range of measures that sought to help business consumers get the best energy deal without unnecessary difficulties. These proposals were developed from concerns we had identified in specific areas of the business market.

2.2. The qualitative assessment section of the chapter sets out the evidence for three main areas of concern in the business market based on our consumer research, and issues that small businesses have risen to organisations such as the Ombudsman and Consumer Direct.[5] We describe the evidence for these issues and potential impact of our proposals on each:

- Lack of clear contract information
- Billing issues
- Problems with transferring supplier

2.3. We have also attempted to quantify the impact of our proposals for two stylised scenarios. This analysis indicates that only relatively small benefits for business consumers will be required to offset any ongoing costs of implementing the RMR package.

Quantitative assessment

Framework

2.4. In this section we set out the quantitative assessment of the impact of the non-domestic RMR package on consumers. There are some challenges in quantifying these impacts with the data limitations that exist in the non-domestic market. Mindful of these issues, we outline below the key assumptions we have made to create a framework for analysis.

[5] In April 2012 Citizens Advice became responsible for the consumer advice service previously run by Consumer Direct.

2.5. In order to quantify the net impact of the RMR package we consider both the benefits and costs. On the costs side, we assess the responses we received to our information request to suppliers in November 2012, regarding the costs they were likely to face by implementing our RMR package. This is covered in detail in Chapter 3.

2.6. For the benefits side we make assumptions about the types of contract micro businesses are currently on, and attribute bill values to each contract. We discuss the logic behind this approach below, but the overarching theme is that we consider it likely that more engaged consumers that switch or negotiate with their current suppliers have lower bill values. Our benefit scenarios are built on the assumption that the proportion of consumers on each type of contract changes as a result of the RMR proposals.

2.7. We then combine the costs and benefits scenarios to develop what we consider are plausible net impacts of the RMR proposals. As we calculate an annual net impact, our benefits are calculated for a point in time at which RMR has been fully implemented. Cost figures used are the ongoing costs only, and exclude the one-off implementation costs identified by suppliers. This is because we have taken a long term assessment, and in the longer term consumers will only be faced with the ongoing costs.

2.8. Below we set out the specific assumptions we have made before describing each scenario.

Number of consumers

2.9. The micro business definition has three qualifying criteria based on electricity consumption, gas consumption, or employees and turnover.[6] Some suppliers apply the obligations of SLC 7A to businesses larger than the definition. Therefore it is difficult to assess exactly how many business consumers will be affected by our proposals.

2.10. Data from ELEXON indicates there are 2.06 million non-domestic electricity meters with lower annual consumption than the proposed threshold of 100,000 kWh. As described below in 2.52, a proportion of these meter points will be part of a group contracts outside of the micro business definition and using this figure is likely to be an overestimate. Therefore, the basis for the number of electricity customers is the

[6] Our proposal on a revised micro business definition is:
- consumption ≤ 100,000 kWh electricity per year, <u>or</u>
- consumption ≤ 293,000 kWh gas per year, <u>or</u>
- Employ fewer than 10 employees (or their FTE equivalent) <u>and</u> their turnover or balance sheet is no greater than €2 million.

total number of businesses with less than 10 employees. In October 2012, the Office of National Statistics estimates this at 1.85 million.[7]

2.11. Around a third of businesses in GB are supplied with gas. As of March 2013, Xoserve estimate there are 730,000 non-domestic gas meter points and 628,500 of these consume up to the proposed micro business threshold of 293,000 kWh per year.[8] We use this as an estimate for micro business gas customers.

Market segmentation

2.12. We do not have specific information on the proportion of consumers on different types of contract. However, we know that there are a significant proportion of business consumers that are engaged and actively look for a better deal on a fixed term contract. But there are also many consumers who are rolled over onto new contracts, or pay more expensive out of contract or deemed rates.

2.13. Switching data from electricity network companies, and consumer surveys by Cornwall Energy[9] and Datamonitor,[10] all estimate that 21-22 per cent of small businesses change suppliers each year. There are also a significant proportion of businesses that do not switch, but will arrange a new contract with their current supplier. Cornwall Energy's survey of 500 micro businesses showed that 26 per cent intended to 'organise a new contract with one or more existing energy suppliers in the next six to twelve months'. This survey also showed that 17 per cent of respondents with electricity contracts were on 28 day rolling supply contracts. It is possible many of these customers will on be out-of-contract rates. When consumers are not in a fixed term contract they will typically pay these rates.

2.14. A minority of customers will be on a deemed contract. A previous information request to suppliers indicated this was around 5 per cent.

2.15. In our quantitative research, 31 per cent of micro businesses and 27 per cent of SMEs, (using electricity and gas respectively), responded that 'we have always taken our electricity from the same supplier and have never considered switching'.[11]

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[7] Office for National Statistics. UK business: activity, size and location – 2012. http://www.statistics.gov.uk
[8] 293,000 kWh is the threshold for a gas meter to be read every month.
[9] Consumer Focus/Cornwall Energy, 2012, Under the microscope - reviewing the micro-business energy market, September 2012. http://www.consumerfocus.org.uk/files/2012/09/Under-the-microscope.pdf
[10] Datamonitor, 2012, Best Practice Customer Retention in the British Energy Market, July 2012.
[11] Accent, 2012, Quantitative Research into Non Domestic Customer Engagement and Experience of the Energy Market, June 2012.

Datamonitor[12] also estimate that the last contract for 30-40% of SMEs was a rollover of an existing contract.

2.16. Drawing across this research we have estimated a segmentation of micro businesses in Table 2.1, based on different types of contract.

Table 2.1: Estimated segmentation of micro businesses by contract type

Deemed	Out of contract	Rollover	New contract with same supplier	New contract with new supplier
5%	15%	33%	26%	21%

Source: Ofgem, 2013.

Non-domestic prices

2.17. Non-domestic energy prices are not freely available, although DECC publish the quarterly average prices paid by businesses within consumption bands (see 2.51). However, to conduct meaningful analysis we require different prices for each type of contract to estimate the effect of more businesses switching onto cheaper contracts, or at least negotiating better rates with their current supplier.

2.18. Non-domestic energy prices can vary widely, depending on the length and type of contract and relative purchasing power of the business. Rates for new customers tend to be the lowest, whilst customers on deemed or out of contract rates tend to pay the most. Suppliers who have their contract automatically extended for a further fixed term (rollover) will generally pay somewhere between these extremes.

2.19. A business switching site has provided us with the typical prices paid by micro businesses in the past year, split by different types of contract (see Table 2.2). These prices are based on a hypothetical customer on a 12 month contract, with annual electricity consumption of 25,000 kWh in the Midlands region and annual gas consumption of 65,000 kWh in the London region.

[12] Datamonitor, B2B Energy Buyer Research H1 2012, September 2012.

Table 2.2: Typical micro business energy prices, by type of contract, March 2012-2013. Excludes VAT and other charges.

	Acquisition		Rollover		Deemed	
	Standing charge per day	Unit rate per kWh	Standing charge per day	Unit rate per kWh	Standing charge per day	Unit rate per kWh
Electricity	23p	9.6p	39p	14.5p	53p	20.8p
Gas	34p	3.9p	69p	4.9p	81p	5.2p

Source: makeitcheaper.com

2.20. For the purposes of this analysis we use these as the typical rates micro businesses pay for their energy. Note that actual supplier rates may differ significantly from these rates.

2.21. The prices set out above do not reflect all of the different customer segments as shown in Table 2.1. For the 15 per cent of customers classified as 'out of contract' we assume the same rates as deemed contracts. Businesses in the 'new contract with new supplier' are assumed to pay the acquisition rates set out above.

2.22. It is likely that customers entering into new contracts with the same supplier would be offered rates close to, but slightly higher, than acquisition prices. Customers may be willing to pay a small differential if they attach a cost to the switching process. We do not have any data on these specific rates, and therefore have chosen to make an assumption that both the standing charge and unit rate are 5 per cent higher than acquisition prices.

Micro business consumption

2.23. To reach an average bill value we must also estimate the energy consumption of a typical micro business. Micro businesses can range from small shops with consumption similar to domestic households, up to energy intensive manufacturing companies.

2.24. Based on the distribution of annual consumption across electricity meters up to 100,000 kWh from ELEXON, we have estimated this typical electricity consumption at 16,000 kWh per year. Similarly, data from Xoserve estimates the average annual consumption of gas meters up to the monthly read threshold (293,000 kWh) at 53,000 kWh. These consumption values are much lower than the energy thresholds of the micro business definition, reflecting a distribution of micro businesses skewed towards relatively low consumption.

2.25. These consumption levels compare to an average household consumption of 3,300 kWh for electricity and 16,500 kWh for gas.

Quantifying the benefits

2.26. We expect our proposals to improve engagement for micro businesses. For some customers currently on rollover rates, this may mean switching supplier or negotiating better rates with their current supplier.

2.27. The potential benefit to these consumers is calculated by estimating the decrease in their annual bill from moving to a contract with lower prices. Based on the typical electricity consumption, a micro business moving from a rollover contract to a new contract with a new supplier, would benefit from a reduction in their bill from £2,462 to £1,620.[13] The change in bill values are totalled across all businesses and then divided by the total number of micro businesses to reach an average benefit per customer.

Scenarios

2.28. This section brings together the above framework to provide two scenarios that attempt to quantify the benefits from the RMR and the implementation costs provided by suppliers (see Chapter 3 for more detail of the implementation costs). Although we could compare many different alternative scenarios we have chosen to focus on two main scenarios to illustrate the potential effects of our RMR proposals. The first low impact scenario assumes only a very small change from the status quo, whilst our high impact scenario considers a world of increased engagement, together with a change in supplier behaviour.

Low impact scenario

2.29. In a low impact scenario the RMR proposals only have a limited effect on micro business engagement. In principle, our proposals could equally lead to more contract renegotiations with the same supplier or to more switching to a new supplier. We make a very conservative assumption that 0.1 per cent of consumers for both gas and electricity move from a rollover contract to a new contract with their current supplier, and another 0.1 per cent move from a rollover contract to switch supplier. Based on the total customer numbers detailed in 2.10 and 2.11 this would be a total of 3,690 electricity, and 1,258 gas customers.

2.30. We assume the proportion of deemed and out of contract customers is unchanged, and suppliers do not react by changing prices across all types of contract. Half of the customers moving from rollover contracts switch supplier, whilst the other half negotiate a new contract with their current supplier. The changes to the type of contracts are illustrated in Table 2.3 below.

[13] This excludes VAT and any other charges.

Table 2.3: Change in contract type as a result of RMR proposals - low and high impact scenario

	Deemed	Out of contract	Rollover	New contract with same supplier	New contract with new supplier
Pre RMR	5%	15%	33%	26%	21%
Low Impact Post RMR	5%	15%	32.8%	26.1%	21.1%
High Impact Post RMR	5%	15%	32%	26.5%	21.5%

Source: Ofgem, 2013.

2.31. Consumers switching to a new supplier from a rollover contract could benefit from an annual saving of up to £842 for electricity and £658 for gas, shown in Table 2.4 below. Totalling the benefits across all customers and dividing by the total estimated number of micro businesses (1.85 million electricity, 628,000 gas) results in a benefit of £1.50 per customer. Given the ongoing implementation costs as estimated in of £1.25 per customer (see Table 3.2), this scenario suggests that only a small change in engagement and switching behaviour, of less than 0.2% of micro businesses, is required to provide an overall net benefit.

High impact scenario

2.32. Since only a small change in switching is required to generate a net benefit to consumers there is merit in considering a second scenario where the impact on engagement and switching is larger, but suppliers react and alter prices due to an increase in competitive pressure.

2.33. As per the low impact scenario, the proportion of deemed and out of contract customers is unchanged but we assume that 1 per cent of consumers move onto more competitively priced contracts. As in the low impact scenario, we assume they are split equally between new contracts with the same supplier, and to switching supplier. In responses to our information request (see 3.22) on the implementation costs, many suppliers expected an increase in queries and customer churn as a result of our proposals and this assumption appears reasonable in that context.

2.34. An increase in the level of switching to this extent may lead to a change in pricing behaviour by suppliers, in an attempt to maintain margins. Under a conservative, low risk strategy, suppliers will tend to decrease rollover prices, to try and retain their current customer base, while making acquisition rates slightly less attractive.

2.35. Assuming a 2 per cent decrease in rollover rates, and a similar increase in acquisition rates, the savings per customer would be lower than in the low impact scenario (see Table 2.4). But this effect would be outweighed by the higher volume of customers in the market moving to lower rates.

2.36. Customers who do not change from their current contract type will also be affected. The 32 per cent remaining on rollover contracts would see a benefit from lower rates whereas the 21 per cent already switching pre RMR would lose out slightly because of an increase in rates (see Table 2.3). Nevertheless, in such a scenario the overall benefit per customer is approximately £6.50, and a significant net benefit of more than £5 once ongoing costs are accounted for. We note that a larger net benefit could be obtained for consumers if we assumed that suppliers reacted with a riskier pricing strategy, by reducing acquisition prices and increasing prices for rollover contracts.

2.37. As we discuss in Chapter 3, there may also be scope for suppliers to become more efficient in order to preserve margins, which could leave prices otherwise unchanged. Although we do not explore this further, in this scenario the benefits to consumers could potentially be greater than our high impact scenario.

Table 2.4: Potential annual saving and net benefit per customer– low and high impact scenario

	Change in contract from rollover	Low impact scenario		High impact scenario	
		Annual Saving	Number of customers	Annual Saving	Number of customers
Electricity	Switch with new supplier	£842	1845	£793	9225
	New contract with same supplier	£761	1845	£712	9225
Gas	Switch with new supplier	£658	629	£601	3143
	New contract with same supplier	£548	629	£498	3143
Average benefit per customer		£1.50		£6.50	
Net benefit per customer *(average benefit – ongoing costs)*		**£0.25**		**£5.35**	

Source: Ofgem, 2013.

Conclusions

2.38. Any quantitative assessment is inevitably sensitive to the assumptions made in each scenario and there is objective difficulty in trying to measure the more intangible benefits of proposals, such as the SOC. The estimates above should therefore not be interpreted as precise estimates of the benefits of the RMR package.

2.39. What this analysis does suggest, is that the shift in consumer engagement required from our RMR proposals to provide an overall net benefit to micro businesses is relatively small. Even a change of less than 1% of all micro businesses could provide significant net benefits given the existing price differences between contracts.

Lack of clear contract information

Evidence

2.40. A review of suppliers' compliance with SLC 7A showed us that all suppliers have taken steps to comply with the licence condition, first introduced in January 2010.[14] This review has since been closed and suppliers have made improvements. However, there were a number of deficiencies with some supplier materials, mainly focused on two key issues:

- Suppliers were not providing either full or accurate information to micro businesses in their principal terms and statement of renewal terms about the duration of a contract.

- Principal terms and conditions were not always written in plain and intelligible language.

2.41. Consumer research has indicated that some businesses are subject to poor information about rollovers and termination of contracts. Evidence from business representative groups also demonstrated issues with energy contracts.

- Contracts were the biggest issue for smaller business respondents in our SOC research.[15] Many businesses had negative experiences of signing up to a contract they did not fully understand. In some cases, this can lead to consumers being tied into unaffordable contracts. Consumers also identified problems with complex tariff information, poor communication around contract rollovers, and unsuitable or inconsistent notice periods.

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[14] http://www.ofgem.gov.uk/business-consumers/Pages/protection-for-businesses.aspx
[15] Insight Exchange, 2012, Research into the proposed Standards of Conduct: Non-Domestic Consumers, December 2012, page 4.

- Qualitative evidence from our research in 2011 and 2012 showed widespread uncertainty and confusion over contracts and their terms.[16] [17]

- The Federation of Small Business (FSB) indicated that overall a fifth of their survey panel members experienced difficulties when attempting to switch energy suppliers. Of these, around two thirds (67 per cent) said the difficulties were due to notice periods for termination not being clearly stated, 55 per cent cited complicated terms and conditions, and 35 per cent attributed their difficulties to a lack of clarity over what paperwork needed to be submitted.[18]

2.42. Consumers currently covered by SLC 7A have said that they do not always receive communications relating to their contracts:

- In our qualitative research, there was a perception that suppliers failed to deliver renewal notifications.[19]

- A sizeable minority of business respondents in our quantitative research were dissatisfied with the clarity of contracts.[20] For example, 13 per cent of SMEs who said they had an electricity contract were dissatisfied with its clarity. Small and medium sized enterprises (SMEs) were more likely to express dissatisfaction in comparison to large businesses.[21]

- Over a quarter (26 per cent) of FSB survey panel members surveyed in 2011 said they had been rolled over without their knowledge.[22]

2.43. Research from the Forum of Private Business (FPB) indicated that 35 per cent of their survey panel members who responded did not know when their contract ended.[23] Cornwall Energy's review of the micro business energy market for Consumer Focus indicated a number of businesses were unaware of the end of their

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[16]Harris Interactive, 2011, Small and Medium Business Consumers' Experience of the Energy Market and their Use of Energy, report to Ofgem. March 2011, page 26.
[17] Opinion Leader, 2012, Research Findings on the Experiences of Non-domestic Customers, December 2012.
[18]Federation of Small Businesses, 2012, 'Voice of Small Business' survey online panel, April 2012. 3063 participants of which 3013 responded to this question. http://www.fsb.org.uk/fsb-survey-panel
[19] Opinion Leader, 2012, page 20, 21, 29.
[20]Accent, 2012, Quantitative Research into Non Domestic Customer Engagement and Experience of the Energy Market, November 2012, page 49.
[21] Electricity: SME 13 per cent and 9 per cent large businesses. Gas: 12 per cent SMEs and 5 per cent large businesses.
Base: respondents that knew they had a contract (83 per cent for each fuel).
[22]Federation of Small Businesses, 2012.
[23] Forum of Private Business, 2010, Utilities Report, December 2010, page 2.

fixed term contract. Less than three quarters (70 per cent) of respondents to their survey of micro businesses were aware of the end date of their fixed term contract.[24]

2.44. FPB research showed that 69 per cent of those small businesses surveyed felt it was difficult to keep up to date with contract anniversaries and notification periods. The research also indicated that businesses protected under SLC 7A were less dissatisfied than other small businesses not protected by the licence obligations.[25]

2.45. As part of the response to our November 2011 consultation we received 323 submissions from business consumers driven by two campaigns from two third party intermediaries (TPIs).[26] The first called for contract end dates and termination procedures to be highlighted on bills and for renewal letters to be sent by recorded delivery. In addition, the second campaign called for the standardisation of termination procedures and for suppliers to offer their best price first. These responses show some dissatisfaction with the current level of information provided to business consumers.

2.46. We have less evidence of significant detriment in the large business sector. This is partly because contacts data from the Ombudsman or Consumer Direct does not include large businesses. While large businesses can still find the energy industry complex, issues tend to be more pronounced at the smaller end of the market. Our recent research[27] suggests that large business consumers often have better relationships with energy suppliers than smaller businesses.

Causes

2.47. Energy is a low priority cost for many businesses. The evidence from our quantitative research[28] highlights that, of respondents who were aware of the proportion of their energy costs in relation to their total costs, 69 per cent of micro business respondents spend less than five per cent of their total costs on electricity. For small business respondents the equivalent figure is 74 per cent.[29] Nevertheless, we recognise that energy prices are a key pressure in the current economic climate, making it all the more important to help engagement.

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[24] Consumer Focus/Cornwall Energy, 2012, Under the microscope - reviewing the micro-business energy market, September 2012, page 51. http://www.consumerfocus.org.uk/files/2012/09/Under-the-microscope.pdf
[25] Forum of Private Business, 2010, page 2.
[26] RMR non-domestic informal responses http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=70&refer=Markets/RetMkts/rm
[27] Insight Exchange, 2012.
[28] Accent, 2012, page 30.
[29] Business size is defined by employee numbers. Micro businesses have less than 10 employees, and small businesses, 10-49 employees.

2.48. Information from our qualitative research showed that time can be a significant barrier to a business's engagement with their energy contract.[30] Some businesses had negative experiences with regard to contract rollovers and errors in the charges on their bills. They believed these could have been avoided if there had been greater transparency and clarity in the information provided by their supplier. Business consumers also felt that remedying issues could be both time consuming and costly to their business.

2.49. Suppliers take different approaches to the notice period they require for a customer to terminate. Some allow termination notice to be given at any time from the start of the contract, subject to a notice period typically between 30 and 90 days. Other suppliers only allow customers to give termination notice during a specified window, such as 60 to 90 days before a fixed term contract ends.

Impact of the proposals

2.50. The expansion of SLC 7A will increase the number of business consumers protected when they enter and come to the end of their energy contract. Our proposal extends the protections by almost doubling the electricity threshold from 55,000 kWh to 100,000 kWh and increasing the gas threshold by half from 200,000 kWh to 293,000 kWh;[31] in line with an approximate annual spend of between £10,000 and £11,000 per fuel before VAT.

2.51. Table 2.5 below shows the estimated annual spends at the proposed consumption thresholds, based on the average non-domestic prices paid by very small and small businesses.[32] The consumption ranges used by DECC do not align with these thresholds, and therefore the annual spends that are closest to these are highlighted for each fuel.

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[30] Opinion Leader, 2012.
[31] Gas meters consuming more than 293,000 kWh should be read monthly.
[32] Consumption ranges used by DECC for very small and small non-domestic consumers respectively are 0-20 MWh and 20-499 MWh (electricity), <278 MWh and 278-2777 MWh (gas). Prices include the Climate Change Levy (CCL), a tax on the use of energy in industry, commerce and the public sector, but exclude VAT. Supplier under 4,397 kWh of gas per month and 1,000 kWh of electricity per month pay the reduced 5% VAT as per domestic consumers. See http://hmrc.gov.uk for more details.

Table 2.5: Estimated annual spend for proposed micro business consumption thresholds, excluding VAT.

	Size of consumer and average unit rate	
	Very Small	Small
Electricity consumption threshold	12.36p per kWh	10.65p per kWh
100,000 kWh per year	£12,360	£10,646
Gas consumption threshold	3.87p per kWh	2.95p per kWh
293,000 kWh per year	£11,331	£8,647

Source: Ofgem analysis, DECC Quarterly Prices (Q2 2012)

2.52. There are 1.93 million non-domestic electricity meter points that consume up to 55,000 kWh (the current electricity consumption threshold of a micro business). As described in 2.10, there are an additional 130,000 meter points up to our proposed threshold of 100,000 kWh per year.[33]

2.53. Xoserve estimate there are 628,500 non-domestic gas meters (86 per cent of all non-domestic gas meter points) that consume less than 293,000 kWh per year.

2.54. In practice, many suppliers choose to apply the requirements of SLC 7A to a group of customers that are larger than micro businesses and some meter points will be part of larger group contracts that would not be classified as micro businesses. Although the number of extra businesses covered by the expansion of SLC 7A could be as high as 150,000-160,000 it is likely to be substantially less.

2.55. The addition of the end date of the contract and the last date a termination notice can be provided (termination information) on bills is a key part of our proposal to improve information to micro business consumers. Our quantitative research indicates many (83 per cent) businesses are aware that they have an energy contract. Around one in ten of those with a contract are unsure of its duration.[34] Our qualitative research indicated that micro and small businesses were not always sure or aware that they had a contract with their energy supplier. Although some consumers would like more information, for many the bill was the main contact with their supplier.[35]

[33] Source: ELEXON.
[34]Accent, 2012, page 50.
[35] Some consumers with low engagement wanted clearer, simpler information on their bill rather than more information in other forms. They often did not look at additional leaflets.

2.56. The expansion of SLC 7A alongside the contract end date and the termination information will alert businesses to engage with their supplier as their contract reaches renewal. If for any reason they did not receive or read a renewal letter (a current requirement of SLC 7A), or were not aware of receiving it, the reminder of the end date throughout the duration of the contract should mean they are more aware when they need to review their supply. This should lead to fewer consumers being automatically rolled over, onto significantly higher rates.[36]

2.57. Overall, our SLC 7A proposals will increase the number of business consumers getting clear and intelligible information about their contract. Contract end dates and termination information on bills will give consumers more clarity about their fixed term contracts, helping engagement and reducing the chance of them being inadvertently rolled over.

Unclear billing information

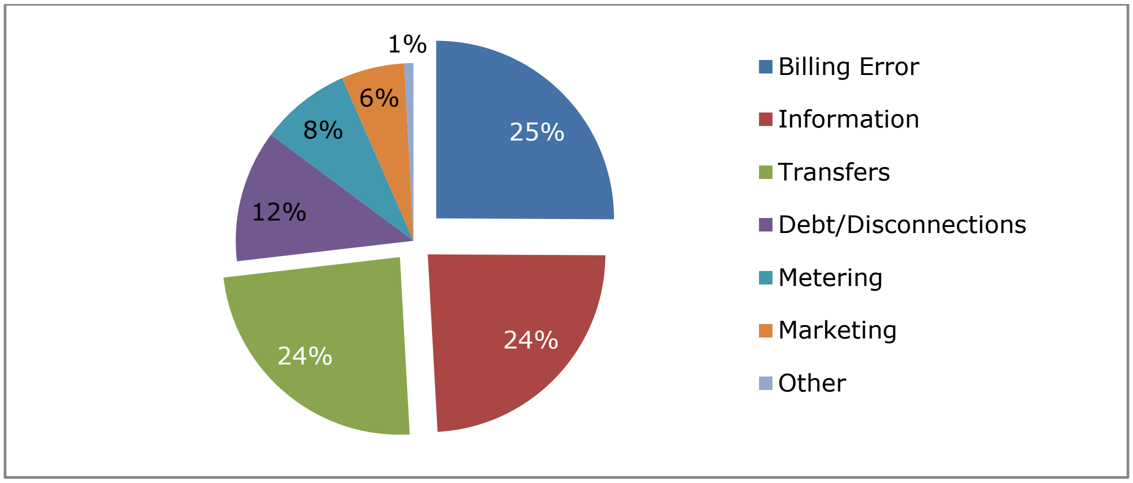
Evidence

2.58. Billing is a key area of dissatisfaction for non-domestic consumers. A quarter of non-domestic contacts to Consumer Direct/OFT (Office of Fair Trading) in Q1 2012 were due to billing, see Figure 2.1. The largest sub-categories were back-bills, errors in bills, inaccurate meter reads, estimated bills and bill clarity.

(Opinion Leader, 2012)

[36] In 'Under the microscope', Cornwall Energy cite a premium for rollover prices from a third party intermediary of 40 per cent for electricity prices and 53 per cent for gas prices in January 2012.

Figure 2.1: Primary contact reasons from non-domestic consumers to Consumer Direct/OFT Q1 2012



Source: Consumer Direct/OFT, Ofgem analysis.

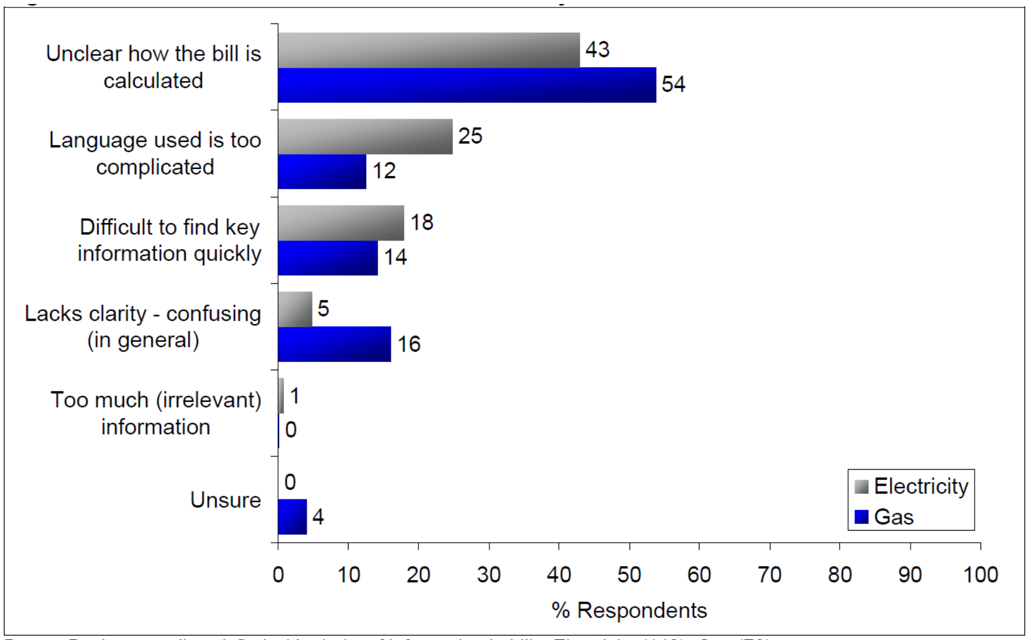
2.59. Our qualitative research highlights this issue, with business consumers reporting a perception that bills are not transparent and may be deliberately opaque.[37] Overall, businesses reported low levels of understanding of their energy bills and tariffs, and consequently did not scrutinise their bills very closely. Confusion stemmed from unfamiliar terminology, charges that were not understood, and the number of unexplained rates. We have also received a number of direct complaints from consumers and business representatives in relation to the level and transparency of deemed contract rates.

2.60. This research also highlighted that many businesses, and not only small businesses, felt that suppliers didn't recognise their needs and that information provided by suppliers was considered to be insufficient, difficult to understand or inaccurate.

2.61. Quantitative research reaffirms this perception.[38] A sixth (16 per cent) of electricity respondents and just over a fifth (21 per cent) of gas respondents were dissatisfied with the clarity of information on their bills and statements. Figure 2.2 below shows that of those business consumers dissatisfied with bill clarity, the major reason was due to it not being evident how the bill was calculated. Other reasons cited for dissatisfaction were complicated language and difficulties in finding key information.

[37] Opinion Leader, 2012, page 8.
[38] Accent, 2012.

Figure 2.2: Reasons for dissatisfaction with billing clarity



Bases: Businesses dissatisfied with clarity of information in bills: Electricity (142), Gas (76)

Source: Accent, 2012.

2.62. The majority of Consumer Direct/OFT contacts for billing were due to back-bills or catch-up bills. Although large back-bills are relatively infrequent they can cause small businesses difficulty.[39] Some businesses in our qualitative research felt they had probably been overcharged, but unless the sum had been considerable they often did not pursue it due to the time they thought this might entail.

2.63. We recently provided an update to our position on non-domestic back-billing.[40] An information request to suppliers showed that approximately 60 per cent of back-bills issued in 2011 (where the supplier was at fault) were less than £2,000, but nearly 10 per cent were over £10,000.

Causes

2.64. For many small businesses, energy is a low priority and therefore they do not scrutinise their bill too closely.[41] Our quantitative research[42] showed that over a third

[39] Opinion Leader, 2012, page 12.
[40] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Nondombackbillingpositionoct12.pdf&refer=Sustainability/Cp/Ewbc
[41] Opinion Leader, 2012.
[42] Accent, 2012, page 44.

(36 per cent) of electricity consumers accepted their bill, if it looked roughly correct. Smaller businesses in our qualitative research[43] simply checked bills to see if they looked about right in terms of monthly spend. They did not have the time to check and interrogate each bill, and many businesses did not challenge their supplier. This can result in problems not being resolved proactively, potentially leading to large back-bills.

2.65. Recent research[44] into the proposed SOC highlighted that smaller business often lacked a professional relationship with their supplier and sought the ability to have a discussion with someone who understood their business. Qualitative research[45] also suggested that some business consumers would value a dedicated account manager. The absence of any personal contact with suppliers to give sufficient context means that negative experiences can be accentuated.

Impact of the proposals

2.66. Enforceable SOC will provide an incentive for suppliers to improve behaviour and interactions with consumers or risk enforcement action.

2.67. Analysis of Ombudsman cases from micro businesses shows that in 2010/2011, 81 per cent covered billing issues. Of the 1,400 billing cases, over 1,200 would have the potential to be covered by the proposed SOC. These 1,200 cases cover such issues as back-billing, disputed charges, inaccurate invoices and renewal notices.

2.68. The SOC will be particularly helpful with regards to billing, where there are currently only limited licence conditions in place (e.g. requirements to incorporate a consumer's own reading into a bill). However, last year many non-domestic suppliers signed up to voluntary standards on back-billing for micro business consumers.[46] Many suppliers have since gone further than the code requirements to limit the back-bill period.[47]

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[43]Opinion Leader, 2012, page 15.
[44]Insight Exchange, 2012, page 3.
[45] Opinion Leader, 2012.
[46]http://www.energy-uk.org.uk/policy/microbusiness-.html
[47] 13 of 22 gas suppliers that supply micro businesses and 12 of 19 electricity suppliers that supply micro businesses have signed up to the code. Consumer Focus has published a list of signatories to the code and their current time limitation to back-bills where the supplier is at fault. http://www.consumerfocus.org.uk/policy-research/energy/non-domesticbusiness-energy

Problems with transfers

Evidence

2.69. Analysis of contacts to Consumer Direct/OFT shows that transfers are a greater concern for businesses than for domestic consumers.[48] They represent around a quarter of contacts from small businesses, and particularly focus on problems due to contracts and supplier objections.

2.70. This may partly be a function of the higher switching rates and greater prevalence of fixed term contracts in the non-domestic market.[49] But it also suggests that consumers may not be fully aware of their contract terms and when they are able to switch supplier.

2.71. Quantitative research indicates some dissatisfaction with the transfer process.[50] Of those that had switched or considered switching, 16 per cent of electricity micro businesses and 12 per cent of gas SME respondents were dissatisfied with the switching experience. As Figure 2.3 shows, over half of all respondents who expressed dissatisfaction attributed this to unclear/inaccurate information or it being a time-consuming and difficult process.

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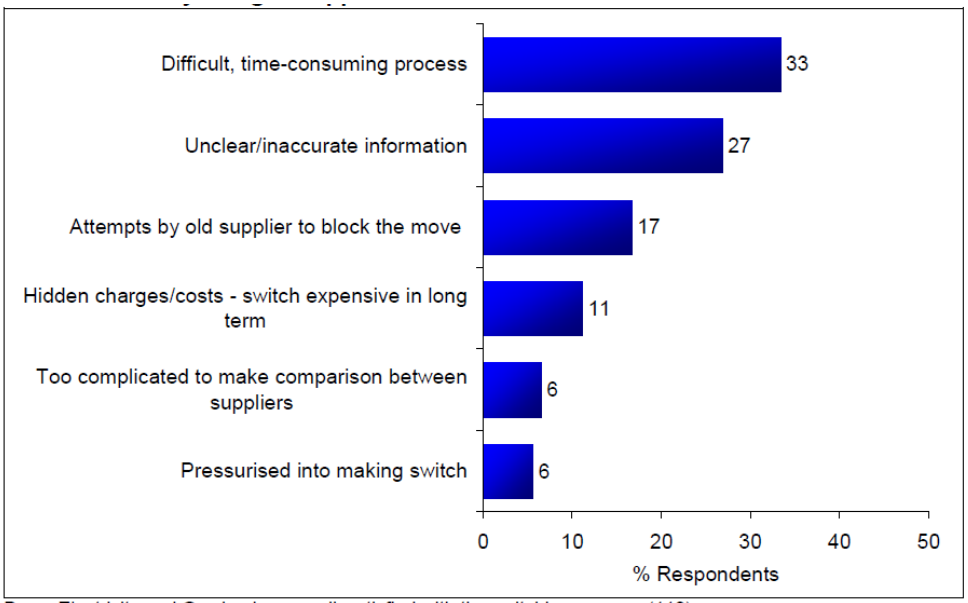
[48] See Figure 2.1. 24 per cent of business contacts are due to transfers, compared to 6 per cent for domestic consumers.
[49] Datamonitor estimates the churn rate for major energy users (spend >£50,000 per year) at 24 per cent for electricity and gas in 2011. For SMEs (spend <£50,000 per year) the churn rate is estimated at 23 per cent for electricity and 21.5 per cent for gas. Cornwall Energy estimates that for micro businesses, 76 per cent of electricity consumers and 73 per cent of gas consumers were supplied under a fixed term contract.
[50] Accent, 2012.

Figure 2.3: Reasons for dissatisfaction with the experience of switching or seeking to switch energy supplier



Base: Electricity and Gas businesses dissatisfied with the switching process (118)

Source: Accent, 2012.

2.72. Data we receive from suppliers shows that most object to approximately a quarter or less of attempted transfers. Objection rates for a number of suppliers also appear to have fallen over the past year.[51] However we remain concerned that some suppliers still object to close to 50 per cent of consumers wishing to leave. We recognise that this can be influenced by the practices of the gaining supplier, the proportion of their customers on fixed term contracts, and differences in contractual terms, but we consider that objections should be the exception, not the norm.[52] If consumers are consistently frustrated by the switching process, or face financial penalty, then they will be less likely to switch in the future, diminishing competitive pressure on suppliers. Of those SMEs who said they had never considered switching in our quantitative research, 25 per cent using electricity and 28 per cent using gas said they believe it is 'too much hassle'.[53]

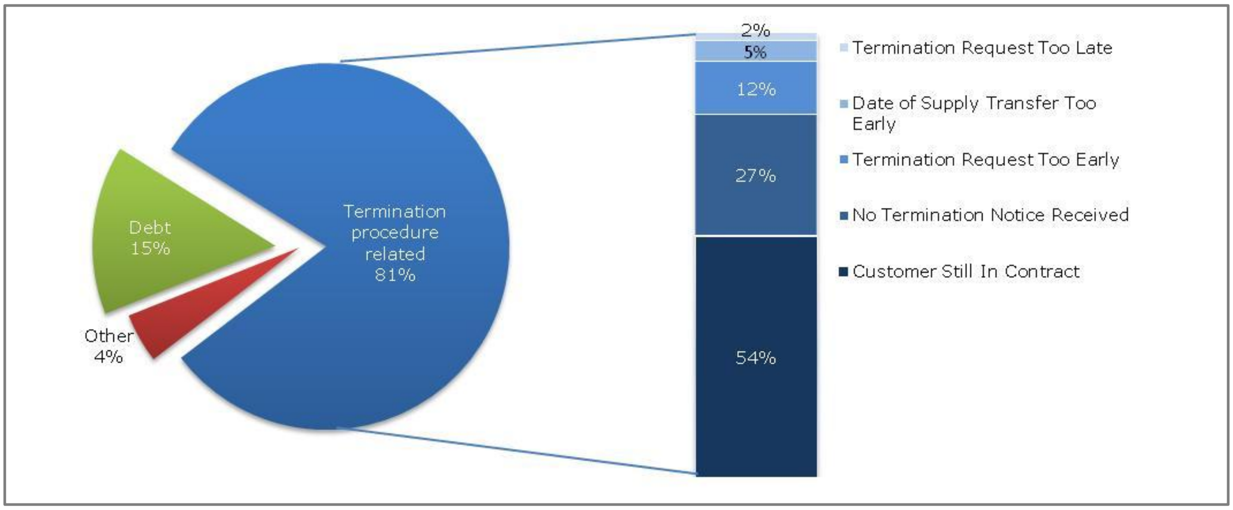
2.73. We have also received complaints directly from consumers and brokers describing the difficulties they have faced when trying to switch supplier.

[51] Based on voluntary data submissions provided to us by non-domestic suppliers.
[52] See Chapter 5 of the document, 'Final proposals for non-domestic customers'.
[53]Accent, 2012, page 8.

Causes

2.74. The RMR non-domestic consultation document in November 2011 included analysis of an information request to suppliers.[54] Figure 2.4 below shows that the majority of objections were related to the termination procedure. This suggests that many businesses do not have clear information about the process for termination and switching supplier.

Figure 2.4: Most objections are related to termination procedures



Source: Ofgem.

2.75. As mentioned in paragraph 2.49, this may be caused by the different renewal and termination procedures across suppliers that consumers may assume are the same across all suppliers. Our qualitative research[55] showed some businesses are uncertain about whether they can switch, or were surprised when they tried to switch and found that they were tied into a specific fixed term.

2.76. We also received copies of the notices suppliers sent to consumers when they objected to a transfer, a requirement of SLC 14.3. Although we saw examples of good practice, some letters did not sufficiently explain the reason for the objection, and what the consumer needed to do to resolve it. We published an open letter in the November 2011 consultation reminding suppliers of their obligations under SLC 14.3 and set out areas of good practice. We have seen some improvements to these letters.

[54]Chapter 3 of RMR non-domestic proposals, November 2011.
[55]Opinion Leader, 2012, page 21.

Impact of the proposals

2.77. As described in paragraph 2.56, the expansion of SLC 7A alongside the introduction of end dates and termination notice dates on contracts will alert more businesses to engage as their contracts reach the time for renewal. Several brokers in our SOC research[56] noted that the responsiveness of suppliers to queries, such as contract end dates, had decreased noticeably. If there are fewer attempts by consumers to switch when they are still in contract, a major source of objections (see Figure 2.4) would fall.

2.78. The clarification to SLC 7A to enable termination notice to be given at any time before the notice period should also reduce a proportion of objections. As Figure 2.4 shows, 12 per cent of objections in our sample related to termination procedures were due to the request for termination being too early.

2.79. We do not propose any specific licence changes to SLC 14, although the proposed SOC do cover transfers. Suppliers will be expected to act fairly when they are objecting to a transfer. In addition, we consider that some of the issues raised to us could be addressed by the industry[57] and we recently approved a modification to the Master Registration Agreement (MRA) regarding the change of tenancy indicator.[58]

2.80. If business consumers have more clarity about their contract, when it ends, and what they need to do to transfer, they will experience fewer problems when they try to change supplier.

[56] Insight Exchange, 2012.
[57] A number of respondents had concerns around change of tenancies, repeated registration requests and win-backs. See Chapter 4 of the October 2012 consultation document, 'Updated proposals for businesses'.
[58] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=127&refer=Licensing/ElecCodes/MRA

3. Impacts on competition

Chapter Summary

We describe the potential impacts on competition of the non-domestic RMR proposals. We identify the likely overall impacts across suppliers as well as differential impacts across suppliers.

3.1. In this section we assess the potential impacts of our proposals on competition. We evaluate how likely our proposals are to affect supplier competition in the market, barriers to entry and expansion, small suppliers and the ability of suppliers to innovate.

3.2. This section also presents an initial assessment of the costs of implementing the RMR proposals provided to us by suppliers.

Impacts in terms of competitive pressure

Overall impact across suppliers

3.3. The addition of contract end dates on bills will act as an additional reminder to micro businesses on fixed term contracts. For many businesses, the bill is the main interaction they have with their supplier.[59] The frequent reminder of this date should act as a trigger for businesses to proactively review their energy contract. The scenarios of the quantitative assessment in Chapter 2 are based upon this assumption.

3.4. If small businesses are more aware of their contract end date, we anticipate more consumers would search the market, increasing the pressure on suppliers to offer competitive rates at renewal. In response to our formal request for information (RFI) on the implementation costs of RMR, many suppliers anticipated an increase in queries and churn as a result of our proposals.

3.5. The expansion of SLC 7A will increase the number of business consumers receiving clear principal terms and notices of renewal terms. If this alongside the contract end date on bills, improves micro businesses' engagement then competitive pressure should increase across the market.

[59] Opinion Leader, 2012.

3.6. The principles-based approach to the SOC proposals will allow suppliers flexibility in the way they to treat consumers fairly, which can be both consistent with the SOC and suit a supplier's specific business model. We see the SOC as a catalyst to improve the relationship between suppliers and consumers and we expect it to help improve consumers' trust in the energy market. Alongside the specific proposals on SLC 7A, this could lead to greater levels of engagement by consumers, placing greater competitive pressures on suppliers. The SOC will ensure issues that business consumers face in the market are dealt with promptly, saving them time and money.

Differential impacts across suppliers

3.7. Many non-domestic suppliers operate across the whole non-domestic market, whilst some suppliers only serve large industrial consumers. Market indicators show the larger section of the non-domestic market is already more competitive and consumers usually proactively negotiate their energy contract with suppliers, or use a broker to do so on their behalf. Therefore we expect any increase in competitive pressure to be concentrated on suppliers with significant portfolios of smaller businesses.

3.8. Similarly, the SOC and other rules in SLC 7A will only apply to suppliers of micro businesses. For these suppliers, we do not consider there to be differential impacts on competitive pressures. A principles-based approach allows suppliers flexibility in how they address any issue. This offers equal opportunities and challenges to all suppliers, who can account for their own business model and circumstances.

Impact on barriers to entry and expansion and small suppliers

3.9. In their response to our previous consultations one supplier highlighted that enforceable SOC could impose a greater cost on smaller suppliers. It estimated that per customer costs would typically be ten times those of larger suppliers due to a lack of scale. This may make it more difficult for them to compete.

3.10. Our analysis of implementation costs (see following section) showed a large variation in costs per customer across all of our proposals. Although some of the higher costs per customer are for smaller suppliers, this is not consistent across respondents. Some suppliers, both large and small, were also unable to provide an estimate of the implementation costs of SOC.

3.11. Our proposed SOC have developed significantly since our original proposal in November 2011. Enforceable SOC only apply to suppliers of micro businesses for billing, transfers, the communication of contractual information and matters relating to deemed contracts. We have now set out in more detail the scope of these areas and also proposed to introduce a bespoke enforcement approach. We recognise that depending on the size of the organisation, the nature of the business or internal business practices, it may be appropriate for actions around the SOC to be documented and communicated in different ways. We also recognise that appropriate documentation and 'audit trails' may be different for different situations. Documentation produced may vary depending on the scope of the issue, what it relates to and the nature of internal and organisational processes.

3.12. Due to these changes, we consider the proposal does not add a significantly greater level of regulation to small suppliers or potential new entrants. Consumers' expectations are that any supplier should be complying with the SOC at a minimum.[60]

Impacts on innovation

Overall impact across suppliers

3.13. We consider that our proposals for SLC 7A proposal are proportionate, and will not significantly affect or constrain the range of products or services suppliers wish to offer their customers.

3.14. By using a principles-based approach, the SOC allow suppliers a degree of flexibility and freedom to comply with these Standards. This approach allows suppliers to be innovative and find solutions to challenges in the retail market in a way that is not possible under a directives-based approach. A more directive based approach to regulation would dictate how suppliers handled interactions with their consumers.

Differential impacts across suppliers

3.15. The SOC proposal will apply to all suppliers of micro businesses equally. Any differential impact will be a function of business strategy and individual decisions rather than a direct consequence of the SOC.

3.16. This will be an opportunity for the industry to consider a different mindset with regard to how they interact with consumers, and the degree to which they put these interactions at the heart of their business. We recognise that some suppliers are already considering this type of shift in their business culture, or do so already, so some suppliers may face a greater degree of change to comply with the SOC than others.

Implementation costs

3.17. This section sets out our indicative assessment of the implementation costs of the RMR package. Firstly, we set out the costs that suppliers have told us they will incur through implementing RMR and set out an approach for extrapolating these

[60]Insight Exchange, 2012.

costs to industry level. Secondly, we assess suppliers' rationale for the costs they submitted, focusing on high-cost outliers. Finally, we discuss whether there is any scope for efficiencies to be made on these costs.

October 2012 RMR

3.18. In the October 2012 RMR consultation document and accompanying draft IA, we posed a series of questions on the cost of implementing our proposals. We asked suppliers to identify where they may incur incremental costs as a result of implementation and the magnitude of these costs. We requested this information to allow us to estimate the impact of our proposed package of measures against the counterfactual.

3.19. We asked suppliers to provide estimates of one-off and ongoing costs according to the following definitions:

- **One-off costs**: hardware, system updates, process updates and other one off costs.
- **Ongoing costs**: responding to customer queries, auditing/monitoring, running new processes and other ongoing costs.

3.20. These costs were estimated against each of the main proposals: the expansion of protections for micro businesses, contract end dates on bills, termination notice dates on bills, simplification of termination rules and the SOC.

Request for information

3.21. This established a framework for our cost assessment. However, we recognised that suppliers may choose to focus their responses on the content and policy intent of the RMR proposals rather than implementation costs. There was therefore a risk that suppliers did not provide any cost estimates that could undermine the breadth and robustness of the quantitative assessment.

3.22. To ensure that suppliers provided the required information, we issued a RFI in November 2012 with a deadline of 18 January 2013. We considered that this would give suppliers additional time to develop their estimates outside of the consultation response period.

Analysis of suppliers' actual cost estimates

3.23. We have provided two sets of analysis in this section. The first is a summary of the actual cost information that we received. The second is an estimate of these costs extrapolated for the industry as a whole.

3.24. We have focused the analysis on ongoing costs. Although suppliers will incur one-off costs, these will be sunk costs and will have a reduced impact on RMR implementation costs in the future.

Table 3.1: Summary of cost information submitted by suppliers

Proposal	Total one-off costs	Total ongoing costs
SLC 7A - extension of protections	£1,096,186	£424,933
SLC 7A - contract end date on bills	£1,020,912	£7,601,454
SLC 7A - termination notice date on bills	£1,004,924	£442,391
SLC 7A -clarification of termination condition	£570,755	£58,391
SLC 7A - Total	**£3,692,777**	**£8,527,169**
Standards of Conduct	£1,836,848	£1,224,026
TOTAL	**£5,393,625**	**£9,751,195**

Source: Ofgem, 2013. Includes 19 supplier responses. 3 suppliers were unable to quantify the costs of the Standards of Conduct proposal.

Commentary on high level differences

3.25. The six former incumbent suppliers account for 83% of all one-off costs and 93% of all ongoing costs. This is broadly consistent with their market share.

3.26. Short term costs are largely attributed to systems upgrades, whilst ongoing costs were focused on increased queries, higher customer engagement and the cost of running new processes.

3.27. Some suppliers already treat all of their customers according to the rules of SLC 7A. This has resulted in significant variations in the cost estimates across suppliers.

Extrapolating costs for the industry

3.28. The costs we received provide valuable evidence of individual supplier views on RMR implementation. However, it is our view that the estimates are in many cases too incomplete to be fully reflective of anticipated industry costs.

3.29. Therefore we have sought to extrapolate the information to form a view of the industry as a whole. We received an extreme outlier for the ongoing costs of our proposals for contract end dates on bills. This has been removed from the dataset due to it being vastly different to the other estimates provided and we do not consider it is representative of an industry view (see 3.37).

3.30. For this extrapolation, we followed a three stage process:

1) Totalled the cost information that we received for each RMR proposal from each supplier (minus the extreme outlier).

2) Divided this by the total number of customers for the suppliers that submitted cost information has (minus the customer numbers for the extreme outlier supplier). This results in an average per customer cost.

3) Multiplied these average per-customer costs by the total estimate of gas and electricity micro business consumers in GB (see 2.10).

Table 3.2: Extrapolated costs per customer[61]

	Per customer		Industry Total	
Proposal	One-off costs	Ongoing costs	One-off costs	Ongoing costs
SLC 7A	£1.49	£0.49	£3,692,777	£1,222,492
SOC	£1.15	£0.75	£2,836,588	£1,857,983
TOTAL	**£2.64**	**£1.25**	**£6,529,365**	**£3,080,476**

Source: Ofgem, 2013.

3.31. The extrapolation approach allows us to form a more complete view of the ongoing costs suppliers may incur. The figures reflect the view that the SLC 7A proposals (taken collectively) will have higher upfront costs, but the SOC proposal will incur higher ongoing costs. The extrapolated industry costs for the SLC 7A proposals are much lower than the overall costs submitted by suppliers due to the removal of the large outlier. Both the one-off and ongoing costs for the SOC are higher as three suppliers were unable to provide an estimate.

Drivers of implementation costs

One off costs

3.32. The proposals for SLC 7A are estimated to cost £3.7million. This is split evenly across three proposals – the extension of protections, contract end dates on bills and termination notice dates on bills. The clarification of the termination notice condition contributes around £600,000 to the total.

[61] Totals may not sum due to rounding.

3.33. The SOC proposal has the highest cost of all the individual proposals at approximately £1.8 million. Three suppliers were unable to provide cost estimates for this, so the extrapolated figure for the industry is considerably higher at £2.8 million.

3.34. Updating and redesigning billing systems represent the highest cost overall, at 56% of the total costs. This is particularly true for the proposals related to bills and the expansion of SLC 7A, representing 75% of all one-off costs.

3.35. Reviewing and updating internal processes account for 28% of the one-off costs, but represent the greatest cost driver for the SOC proposal at £775,000 (this would be higher under the extrapolated scenario).

3.36. Other costs include design agency costs, staff training costs, costs of queries directly relating to the RMR proposals and the cost of mailing customers the updated terms and conditions.

Ongoing costs

3.37. The ongoing costs for SLC 7A are much higher than the SOC proposal at £8.5 million. This is due to the aforementioned outlier from one supplier, contributing £7.5 million to that total. Once this outlier is taken into account, the ongoing costs for SLC 7A fall to a lower level than that of the SOC.

3.38. The main costs associated with the SLC 7A proposals are an increase in customer queries due to more customer engagement and churn in the market. This is the justification behind the outlier figure - ongoing costs of shifting resource between sales activities to manage increased numbers of customers shopping around. Without this outlier, the cost of auditing/monitoring to ensure compliance with the proposals is more significant, particularly for clarification of the termination condition.

3.39. The SOC proposal is expected to cost £1.2million per year, with almost half of these costs attributed to one supplier. However, several suppliers have not been able to provide a cost estimate for this due to uncertainty at the time of the October 2012 consultation on the enforcement approach. Further details of our approach to enforcement are provided in the final proposals document.

3.40. For those suppliers able to provide an estimate, the main costs associated with the SOC proposal were auditing and monitoring to ensure compliance and more customer communications.

Commentary and critique of cost submissions

3.41. There are large variations in costs across all suppliers, even for those with similar portfolios of customers.

3.42. Several suppliers felt unable to quantify the impact of the SOC proposal. We have extrapolated figures for the rest of the industry to account for this.

3.43. The majority of the ongoing costs of the proposal for contract end date on bills are attributed to one supplier that provided an estimate of £3 million - £12 million. For ease of analysis we have used the midpoint of this range, at £7.5 million.

Could suppliers make efficiency savings?

3.44. We have seen that some suppliers submitted ongoing costs significantly higher than others. We recognise that suppliers may not be able to fully estimate costs, particularly ongoing costs, at this stage of RMR development. This may also be because suppliers have taken different approaches to compliance, leading to variations in their estimates. That said there is scope to suggest that the variation in cost per customer may be due to the potential for efficiency savings to be made by suppliers.

3.45. Attempting to define an 'efficient supplier' is not straightforward in the non-domestic market. To base this on the minimum cost estimate provided would result in an extremely small figure, as the lowest per customer estimates tend to be close to zero cost. Using the median cost estimate could provide a better indicator, although the distribution of cost estimates around the median is such that using it as an indicator would result in the similar level of aggregated industry costs calculated already in Table 3.2 above.

3.46. There are a number of reasons why we consider it is difficult to calculate a level of costs incurred for an 'efficient' non-domestic supplier:

- differences in supplier market shares;
- different customer portfolios for each supplier in the market. Some suppliers will have a large domestic base, whilst others may focus on large industrial users; and
- variation in the starting point for different suppliers - some suppliers may already have systems or processes in places. This is particularly true for the proposal of expanding SLC 7A protections, as some suppliers already treat all their customers as micro businesses.

3.47. Of course, this does not mean that there is no scope for efficiency savings. Any ongoing costs are likely to fall over time in a more competitive environment as suppliers become more efficient in delivering our proposals.

4. Impacts on sustainable development

4.1. We do not consider there are any significant impacts on sustainable development arising from our proposals.

5. Impacts on health and safety

5.1. We do not consider there are any significant impacts on health and safety arising from our proposals.

6. Risks and unintended consequences

Chapter Summary

This section sets out the potential risks and unintended consequences of the non-domestic proposals.

Risks surrounding the quantitative assessment

6.1. In Chapter 2 we set out a quantitative assessment of the impact of the RMR proposals. Inevitably, there are some caveats that must be included surrounding the sensitivity of the results. There are also some broader risks surrounding the assumptions we have made, which are considered below.

Assumptions used in quantitative assessment

6.2. As part of our cost benefit analysis, we make a number of core assumptions that underlie our results. These are set out, alongside our justification for making these assumptions, in Chapter 2. However, as with any assumptions made, there remains a risk that they are inaccurate.

Higher engagement

6.3. Our core assumption is that the RMR proposals will lead to more engaged consumers. Our hypothesis is that when consumers become more engaged, they may realise that they are not on the best deal for them and look for a cheaper contract. As a simplification, we have assumed that businesses can be broadly segmented by type of contract, which will be related to the amount of savings they could make.

6.4. We consider these to be simple and robust assumptions. However, alternative impacts of the RMR are possible. For example, the impact of the SOC could be that the customer service improves, and to protect their existing customer base, suppliers reduce prices for these consumers. This means that even more engaged consumers may feel that the improvements in service and price they receive are sufficient that they do not need change their contract.

Consumption and energy prices for micro businesses

6.5. We have used information available to us to attribute the average consumption and typical rates a micro business would pay for their energy. Assumptions on consumption levels will have a particularly large impact on the expected benefits and therefore there is a risk that the consumption levels we have used are not representative of a typical micro business.

6.6. The typical consumption levels we have used are based on industry data and therefore we consider them to be as representative as possible. They will reflect the fact that the majority of micro businesses will be skewed towards relatively low consumption, but higher than a typical domestic household.

Segmentation of customers by contract type

6.7. We have drawn across the current research available to estimate a segmentation of the market based on the different types of contract for micro businesses. This is a necessary simplification due to the limitations on detailed pricing and contractual information. Although we consider our assumption to be sensible, in reality the distinction between contracts may be more blurred.

Construction of the analysis

6.8. The model we developed for the cost benefit analysis is very stylised, reflecting limits to the information available as well as the non-quantifiable benefits we expect to arise from the RMR (for example, such as the benefits from the SOC). While this approach is relatively simple it does entail some risk.

Timing

6.9. Our cost benefit analysis relies on a comparative static comparison i.e. we are comparing a pre and post RMR world. This does not take into account the timing of any changes, such as how long it will take for policies to be implemented. There is a risk that, depending on the level of costs passed through, consumers will bear the costs of RMR policies before they see any the benefits.

6.10. This is a concern, but it is unlikely to significantly change the overall balance between costs and benefits. Some of the proposals, such as the SOC, will come into force immediately from the proposed date of RMR implementation. In addition, the benefits required to outweigh the implementation costs are relatively small. Even if these are delayed and discounted, we would still expect consumers to benefit overall.

Costs

6.11. The cost estimates we received from suppliers showed significant variation (see Chapter 3) and though we use our 'best guess' estimate for the industry as a whole, there is a risk that this underestimates the actual cost of the proposals. However, given the cautious assumptions made in our scenarios, costs would need to rise significantly to outweigh the potential benefits. Also, this does not take into account the additional benefits that are difficult to quantify.

Counterfactual

6.12. In the scenarios considered, our counterfactual is that without the RMR, the current status quo will prevail and there would be no changes that will significantly impact on the levels of consumer engagement. It is possible that initiatives such as the contract end date on bills would be implemented by suppliers without the RMR proposal. Two suppliers had already added contract end dates to their micro business bills at the time of our October 2012 consultation. If we were to use this scenario as the counterfactual, then the benefits of the RMR would be reduced.

Protecting more businesses

Expansion of SLC 7A protections

Access to Redress

6.13. We recognise that by changing the current micro business definition of SLC 7A, we may be introducing confusion in relation to business consumer complaints. The current micro business definition is used operationally by the Ombudsman and has been adopted by consumer organisations and suppliers in relation to the complaints handling regulations. If we expand our SLC 7A protections while access to redress remained the same, some business consumers may not be getting consistent support from consumer advice services and redress schemes.

6.14. To mitigate the risk in the short term, we will be seeking to secure voluntary agreement with suppliers and consumer redress bodies. This is an interim measure to ensure that all micro businesses, including those newly in scope as a result of our proposals, are able to access complaints redress via the same route as currently protected micro businesses.

6.15. The longer term solution is for a change in legislation to match the Redress Scheme Order[62] with our revised consumption criteria, we will continue to engage with the appropriate government bodies to try to secure this change.

Higher consumption thresholds

6.16. We have proposed to extend SLC 7A protections significantly, almost doubling the electricity threshold and increasing the gas threshold by half. However, some smaller businesses do not regularly check their energy consumption, as our quantitative research indicated (see Figure 6.1). Smaller businesses, in qualitative

[62]The Gas and Electricity Regulated Providers (Redress Scheme Order) 2008 http://www.legislation.gov.uk/uksi/2008/2268/pdfs/uksi_20082268_en.pdf

research,[63] also admitted that monitoring energy usage is not a priority. Nevertheless, consumption information should be readily available to suppliers and many business consumers will be familiar with their monthly spend. This should improve over time as more businesses have smart and advanced meters installed.

Table 6.1: Proportion of businesses that never checked energy consumption

	Micro Businesses	Small Businesses	Medium Sized Businesses	Large Businesses
Electricity	24%	16%	12%	7%
Gas	23%	21%	19%	10%

Bases:
Electricity: micro businesses (294), small businesses (270), medium sized businesses (108), large businesses (138)
Gas: micro businesses (112), small businesses (132), medium sized businesses (94), large businesses (62)

Source: Accent, 2012.

Clearer and simpler processes for micro businesses

Contract end date and termination notice date on bills

6.17. Although the contract end date and the information regarding notice of termination and the last date a termination notice can be provided (termination information) will be mandated through the proposed licence condition amendments, there will be some flexibility as to where and how suppliers provide this information. Our proposed licence condition is clear that this should be in a prominent position and in plain and intelligible language. This should help to minimise any risk that suppliers do not show this information clearly, such as on the back of the bill.

6.18. The reminder of the end date and termination information on fixed term contracts may encourage more consumers to terminate their contracts. If they do not find an alternative supplier, they may be charged out-of-contract rates or deemed rates. Table 2.2 shows that these can be more than double the typical rates offered to new customers. However, we consider that this risk is outweighed by the improvements in engagement we anticipate from our proposal (see paragraph 2.56) and fewer consumers being unexpectedly rolled over.

[63] Opinion Leader, 2012.

Allowing termination notice at any time

6.19. A small number of consultation respondents have highlighted the risk consumers may give notice very early in their contract, but then fail to take further action before it ends. This may result in them moving onto out of contract rates.

6.20. We are only aware of two suppliers that will be substantially affected by this change. We consider that the benefits of consistency across the market outweigh this risk, and will be mitigated by the extra information consumers will be provided on bills.

Fairer treatment for micro businesses

Standards of Conduct

6.21. Respondents to our November 2011 and October 2012 consultations raised concerns about the potential for regulatory risk posed by the SOC proposal. This was based on our previous proposal that covered all interactions between suppliers and consumers. We have since proposed to limit the scope of the SOC to billing, contracts and transfers and to only cover micro businesses.

6.22. Our new policy proposals still cover a significant number of interactions between consumers and suppliers. Given the wide scope of this licence condition, concerns were raised that suppliers could be exposed to risks if our expectations in relation to the SOC were unclear. This would lead to overly cautious behaviour by suppliers, and ultimately the cost of the service increasing to business consumers.

6.23. To address these concerns and help clarify our intent we have:

- limited the scope of the SOC to interactions in billing, contracts and transfers;
- clarified which interactions under billing, communications about contractual information and transfers are covered by SOC;
- introduced a fairness provision;
- as an annex to the consultation document, provided clarification around some of the terminology in the licence drafting, based on existing legal definitions, clarifying what we expect from the SOC; and
- proposed a bespoke approach to enforcement for the SOC which includes a reasonable person test.

6.24. The addition of an overarching fairness objective will help focus supplier activity in relation to the SOC in a way that is consistent with our underlying policy intent and will minimise the potential of regulatory risk.

6.25. The consultation document includes an annex with clarification of some of the terminology used in the SOC to ensure that suppliers and consumers are aware of how we interpret these terms. This clarity should also help to reduce regulatory risk as suppliers and consumers are clear on our aim and requirements with reference to the SOC.

6.26. Stakeholders noted that our proposed approach to enforcement would have an impact on how they worked in practice. This outlines that we will use a reasonable person test. An assessment of the seriousness of a breach will be made on the basis of whether a reasonable person, intent on complying with the SOC, would have acted in the way a supplier did in its interactions with business consumers. Further detail on our approach to enforcement is included in the consultation document. We expect that this approach should help to mitigate unintended consequences. Where supplier actions are not in line with our policy intent we may take enforcement action.

6.27. Ofgem is separately conducting a wider review of its approach to Enforcement. Our initial proposals will be published in March 2013.[64] Amongst other things, we will be setting out our thinking on who takes the final decisions on whether there are breaches of the licence and if there are what, if any, penalty should be imposed. We believe that our proposals will address comments raised by stakeholders in the context of SOC about how enforcement decisions are made, having a consistent approach to assessing compliance with the SOC, and whether Ofgem will adopt a subjective assessment about compliance with the SOC.

6.28. We will take a proportionate approach to enforcement and therefore see a role for the Ombudsman in regard to individual cases. There may be a risk, based on experiences in other markets, that the Ombudsman's determinations will develop precedent over time. We do not feel this is the case and is reflected in their terms of reference which state they will not be bound their by their past decisions. Based on our proposal it does not appear that the Ombudsman's actions will be inconsistent with our policy intent. However, if this measure comes into force we would look to work with the Ombudsman to help foster a shared understanding of our objectives and expectations relating to the SOC. This sharing agreement is part of the Memorandum of Understanding between the Authority and the Ombudsman.

[64] http://www.ofgem.gov.uk/About%20us/enforcement/Pages/Enforcement.aspx

Reducing barriers to switching

Objections

6.29. There is a risk that industry resolutions, such as a recent modfication to the MRA regarding the change of tenancy indicator,[65] are not successful in resolving the issues[66] highlighted in response to our previous consultations. If this is the case, we will consider if further regulatory intervention is necessary. Our current enforcement investigation should encourage all suppliers to review their objection practices.

[65] The Ofgem decision letter which gives consent to this modification can be found at: http://www.ofgem.gov.uk/Licensing/ElecCodes/MRA/Documents1/MCP198_200_D.pdf
[66]See Chapter 4 of the consultation document, 'Updated proposals for businesses'.

7. Assessment of alternative options

Chapter Summary

This final chapter assesses the alternative options we have considered for each proposal and the pros and cons of these options.

7.1. This chapter outlines the alternative options we have considered for each of our proposals. We consider each measure in turn:

- Protecting more businesses
- Clearer and simpler processes for smaller businesses
- Fairer treatment for smaller businesses
- Reducing barriers to switching

7.2. As outlined in Chapter 1, our proposal for a single Code of Practice for non-domestic TPIs is being progressed via an industry working group and we will consult further on the wider regulatory framework for TPIs later this year.

7.3. The pros and cons of each option are listed, alongside our preferred policy option. The final proposals document and preceding chapters of this IA describe our preferred options in more detail.

Protecting more businesses

Developments since November 2011 and October 2012 proposals

7.4. We initially considered alternative options for the expansion of SLC 7A based on meter types and employee numbers/turnover. Supplier responses to our November 2011 consultation often mentioned that information on employees or turnover can be difficult to verify. Our research has also indicated that employee numbers are not always a good indicator of the relative importance of energy to the business. Therefore we did not propose to increase the threshold on employee numbers and turnover to the EU small business definition as we originally proposed in our November 2011 consultation.[67]

7.5. Following our October 2012 consultation, suppliers and consumer groups were generally supportive of our revised micro business definition that substantially increased the consumption thresholds. A number of suppliers considered the definition would be simpler to apply in practice if any reference to employees and

[67]Fewer than 50 employees and ≤€10 million turnover or balance sheet.

turnover was removed. Whilst such a definition would be easier for suppliers, there is a risk that current micro businesses could be excluded. Table 7.1 sets out the options we have considered and the respective pros and cons.

Table 7.1: Policy options for the expansion of SLC 7A protections

Policy option	Pros	Cons
Option 1: Definition including all non-domestic consumers with nHH (non half hourly) meters	- Relatively easy for businesses to identify. - Only excludes the largest businesses with HH (half hourly) metering.[68]	- Large businesses may inadvertently be covered. - May be difficult to communicate to consumers. - In future with smart/advanced meters all non-domestic sites will have half hourly capable meters. - .
Option 2: Include EU small business definition (< 50 employees and ≤ €10 million turnover)	- Definition widely recognised already. - Businesses may be more familiar with this information. - Micro business definition of employees and turnover is already used for the redress scheme and complaints handling standards.[69]	- Bill payer may not know this information. - Difficult for suppliers to verify. - Not a consistent link between business size and energy consumption. - Very large consumers may be included if they have relatively few employees
Option 3: Increased consumption thresholds. Retain micro business definition of employees and turnover.	- Consumption can be linked to approximate spend per year. - Information that suppliers readily hold. - Does not exclude any businesses already covered by SLC 7A. - Should not inadvertently include larger businesses.	- Not all small businesses are familiar with their energy consumption (mitigated by retaining employees/turnover of current micro business definition).
Option 4: Definition based on energy consumption only. Remove reference to employees/turnover	- Simpler definition for suppliers to apply.	- Not all small businesses are familiar with their energy consumption.

7.6. Our preferred option remains Option 3, which increases the annual consumption thresholds to 100,000 kWh for electricity and 293,000 kWh for gas,

[68] There are approximately 125,000 HH meters. Any supply must have a HH metering system where the average of the maximum demands in the three months of highest demand over a 12 month period is more than 100kW (Source: ELEXON).
[69]The Gas and Electricity Regulated Providers (Redress Scheme) Order 2008:http://www.legislation.gov.uk/uksi/2008/2268/contents/made
The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008 :http://www.legislation.gov.uk/uksi/2008/1898/contents/made

whilst retaining the micro business definition for employee numbers and turnover. Chapter 2 of our final proposals describes the rationale of this proposal in more detail.

Clearer and simpler processes for micro businesses

Developments since November 2011 and October 2012 proposals

7.7. Our proposals for end dates and termination information on bills and simplifying termination procedures for micro businesses were new proposals in our October 2012 consultation. Consumer groups and TPIs told us that small businesses would benefit from the end date of their contract being clearly placed on the bill. The majority of non-domestic suppliers have also expressed support for this proposal, although highlighting system costs and the time it would take to implement. A limited number of suppliers did not see any benefit from this proposal, arguing that bills are already saturated with information.

7.8. The vast majority of respondents also supported the simplification to termination rules. Many suppliers already allow termination at any time and would be unaffected. The only risk identified was that more businesses may give termination notice early in the contract and not contact the supplier at the time of renewal, potentially moving onto expensive out of contract rates.

Contract end dates and termination notice date on bills

7.9. The policy options that have been considered are summarised in Figure 7.2 below, with our preferred policy highlighted.

Table 7.2: Policy options for contracts end date and termination notice date on micro business bills

Policy option	Pros	Cons
Option 1: Voluntary agreement	- Some suppliers have already started introducing this. Others may follow.	- Some suppliers may not choose to do this, limiting any benefits to consumers.
Option 2: Mandate contact end date **only**	- Micro businesses will be more aware when their contract comes to an end	- Termination notice periods vary between supplier and consumers may not be fully aware when they have to provide notice.
Option 3: Mandate the termination notice date **only**	- Potentially of more use to customer than only the contract end date.	- Customer still needs the contract end date to inform new supplier when to transfer supply.
Option 4: Mandate contract end date and termination notice	- Gives consumers all the information required to give notice and transfer at the correct time.	- Additional cost to suppliers. - Potential clutter on bill.
Option 5: Mandate contract end date and termination notice for all non-domestic consumers	- Would create consistency across the market.	- No evidence that large businesses require this. - Larger companies more likely to deal with brokers or have dedicated account managers. The end date of a contract is unlikely to be overlooked.

7.10. Our preferred option remains Option 4, which mandates both the contract end date and last termination notice micro business bills. Chapter 3 of our final proposals document explains the proposal in more detail.

Simplification of termination rules

7.11. Currently there may be confusion around the termination and rollover procedures for consumers covered by SLC 7A. The majority of suppliers allow customers to give termination notice at any time before their notice period. However, other suppliers will require a separate termination notice even though the customer has already given notice that they do not want to rollover. We consider it is important that we clarify termination requirements so that micro businesses only have to provide a single notice.

7.12. We are proposing to amend SLC 7A to make it clear that any consumer that gives notice that they do not wish to rollover will not be required to give a separate termination notice.

Fairer treatment for micro businesses – Standards of Conduct

Developments since November 2011 and October 2012 proposals

7.13. In November 2011 we consulted on proposed new SOC, to try and tackle problems in the non-domestic market and improve supplier conduct. These SOC proposed to cover all businesses and all interactions. We received a considerable level of challenge, with respondents suggesting the market is already competitive. For example, in instances of detriment, business consumers are free to change supplier if they are unhappy with the service. Additional issues over regulatory risk and interpreting our intentions around the SOC were raised. There was some support from business representative groups. Consumer Focus supported SOC focussed on improving information.

7.14. Following that consultation, we commissioned research, reviewed market indicators and contacts data to respond to the challenges that we received. In October 2012 we amended our proposal so that SOC would apply only to small business consumers and cover the key interactions of billing, contracts and transfers.

7.15. We are not proposing any changes from our October 2012 proposals and believe that our proposals will help deliver a better functioning market. Following our last consultation, the majority of respondents agreed that if introduced, the SOC should be limited to smaller business consumers. As such we have proposed that the SOC continue to apply to micro business consumers.

7.16. The majority of respondents also agreed that most problems are centred on billing, the communication of contractual information and customer transfers. However, we did receive some challenge that SLC 7A and SLC 14 already offer consumer protections for contracting and transfers. Following this feedback we have reconsidered our evidence and policy objectives and concluded that our policy proposal is the most effective route to improving supplier behaviour and tackling these problems in the market.

7.17. We still consider that there is activity that causes problems for non-domestic consumers outside the scope of existing rules. The SOC will also improve the transfer process; ensuring that objections are fair (including the fairness of terms within contracts regarding transfers) and those problems are resolved promptly. The SOC will apply to the communication of contracts but not contract terms themselves (with the exception of when terms apply to billing, transfers or deemed contracts). This supplements SLC 7A covering the terms of contracts.

7.18. The policy options which have been considered are summarised in the table below.

Table 7.3: Policy options for the Standards of Conduct

Policy	Options Considered
Framing and scope of Standards of Conduct	**Option 1.** Legally binding SLC, covering billing. Using a directives-based approach to regulation.
	Option 2. Legally binding SOC, covering billing, using principles-based approach to regulation.
	Option 3. Legally binding SOC as in Option 2 covering billing using principles-based regulation. Also adds an overarching fairness provision above SLC 7A and SLC 14.
	Option 4. Legally binding SOC, covering micro business consumers and billing, the communication of contractual information, transfers and matters related to deemed contracts.
	Option 5. Legally binding SOC for all non-domestic consumers covering all interactions between suppliers and consumers.

Framing and scope of the SOC

Option 1 – Legally binding supply licence conditions for billing, using directives-based approach to regulation

7.19. This approach would outline a prescriptive set of rules that suppliers would need to meet in order to comply with the licence condition. The licence condition would only cover billing activity and be limited to suppliers of small non-domestic consumers. Our analysis indicates that problems in the market are centred on contracts, transfers, and significant issues around billing. Billing can be a particular issue for non-domestic consumers, covering a range of billing problems including (but not limited to) back-billing, billing accuracy and billing clarity.[70,71] Currently we only have limited protections for billing, whereas we have some specific licence conditions around contracts (SLC 7A) and objections (SLC 14).

7.20. This option would limit the coverage of the licence condition to suppliers of small businesses, as we do not have strong evidence showing a need for this regulation to cover larger businesses.[72]

[70] Accent, 2012, Opinion Leader, 2012 and Insight Exchange, 2012.
[71] Ombudsman Services: Energy http://www.ombudsman-services.org/energy.html
[72] Insight Exchange, 2012.

7.21. By using a directives-based approach we would dictate exactly what elements of billing suppliers must focus their attention and how they must comply. A directives-based approach could stifle innovation as suppliers would not have flexibility to meet challenges in the market. Suppliers could also find themselves in a difficult situation to overcome problems in the market. For example, billing clarity has been raised as an issue in our research. However, our qualitative research[73] of the market suggests that some market participants want more detail on bills whereas others want less. In this scenario, a directives-based approach does not easily allow the market to find solutions for all participants. A directives-based approach also dictates specific interactions that are covered by the licence. However, as noted earlier, problems in billing are more widespread than just two or three issues, and there would be a risk not all issues would be covered.

7.22. We are not proposing to use this option for several reasons. As a result of the lack of flexibility from a directives-based approach, we may limit innovation and harm the ability of suppliers to meet challenges. Additionally, the existing protections do not go far enough in two major problem areas in the market, contracts and transfers.

Option 2 – Legally binding SOC for billing, using a principles-based approach to regulation

7.23. This proposal would match the proposal in Option 1 but would use a principles-based approach to regulation. This approach would give suppliers flexibility to tackle billing issues and ensure the range of issues could be fully addressed.

7.24. This approach is favoured over Option 1 as it tackles many of the drawbacks of this approach to regulation. However, it would not cover the other problems identified with respect to contracts and transfers.

Option 3 – As Option 2 and add an overarching fairness provision to the existing licence conditions SLC 7A and SLC 14

7.25. This option would build on the increased protections around billing in Option 2 and add an overarching fairness provision above the existing licence conditions, SLC 7A and SLC 14.

7.26. Our evidence highlights that over two thirds of contacts to Consumer Direct/OFT in Q1 2012 were centred on billing, contracts and transfers. Therefore additional protections in these areas would help tackle the vast majority of problems in the market. This fairness provision would clarify to suppliers how the attitudes, behaviours and interactions with customers should take place.

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[73] Opinion Leader, 2012.

7.27. However, our analysis of contacts data highlights that there are issues outside of the existing licence conditions. For that reason, we do not propose to proceed with this option.

Option 4 – Legally binding Standards of Conduct, covering micro business consumers, using principles-based regulation

7.28. Our preferred option is to propose revised SOC in the non-domestic market. This option is largely unchanged from the October 2012 consultation. We would limit the scope of the SOC to suppliers of micro businesses, in line with our proposed expansion of SLC 7A. Limiting the SOC to cover small businesses is based on our research, which supports the need for intervention to help small business consumers.[74]

7.29. We are also proposing to focus the Standards to key areas of consumer detriment around billing, the communication of contractual information, transfers and matters related to deemed contracts.

7.30. Small businesses are currently covered by existing, non-binding SOC. Despite the introduction of the voluntary standards, there are still some significant issues for these consumers. Therefore, we consider that the existing voluntary SOC have not been effective, new Standards need to be backed by enforcement powers.

7.31. To mitigate issues around regulatory risk, we are proposing to include an overarching 'fairness' principle as part of the proposed licence drafting.[75] This approach also provides guidance to non-domestic suppliers about how they should approach their interactions with their customers. By acting fairly, we believe that suppliers will improve consumer interactions in the market. In our consultation document we have provided clarity regarding the definition of billing, the communication of contractual information and customer transfers.

Option 5 – Legally binding SOC, covering all non-domestic consumers

7.32. Our last option and original proposal in November 2011 was to introduce the SOC as a legally binding, overarching licence condition covering suppliers to business consumers of all sizes. This option would cover all interactions between suppliers, and their customers, including their representatives. Following our November 2011 consultation and analysis of our evidence, we are not proposing this option. There is limited evidence to introduce the SOC for large businesses.[76]

[74] Insight Exchange, 2012 and Opinion Leader, 2012.
[75] See Appendix 3 and 4 of the final non-domestic proposals.
[76] Insight Exchange, 2012, page 33.

Reducing barriers to switching - Objections

7.33. We are not considering any specific licence changes to SLC 14 on objections and we received few responses supportive of changes to the licence. Nevertheless, the proposed SOC would cover objections.

7.34. As part of our Better Regulation principles[77] we consider some of the specific issues raised to us around objections may be resolved through appropriate modifications to industry processes.

[77] http://www.ofgem.gov.uk/About%20us/BetterReg/Pages/BetterReg.aspx

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Appendix 2 – Feedback Questionnaire

Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Any further comments?

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