ANNEX 1

RETAIL MARKET REVIEW – DOMESTIC PROPOSALS: SCOTTISHPOWER RESPONSE

Executive Summary

i. Ofgem's Retail Market Review presents an ideal opportunity for stakeholders and industry to work together to ensure that the energy retail market works effectively for all consumers. The problems of the retail energy market in recent years and the consequent general lack of trust are widely acknowledged; we believe that suppliers and Ofgem need to work together to address these problems by improving the domestic energy market.

ii. We continue to believe that competition is the most effective way to meet the needs of consumers, drive innovation into the market and secure the returns needed for efficient investment. The remedies Ofgem has proposed include many which we can support and which will help consumers. However, the RMR core tariff proposal amounts to one of the most radical interventions in the operation of the retail market yet to be considered. It is therefore essential that it is thoroughly analysed and tested.

iii. We accept that there is evidence that individual outcomes for some consumers have been poor, especially prior to the full implementation of the probe remedies, and agree that steps should continue to be taken to address this. However, we do not agree with Ofgem's core diagnosis of the problem. At a macro level the evidence points to an efficient and competitive market which has delivered sustained benefits for consumers, low retail margins and some of the cheapest energy prices in Europe. We see no evidence for Ofgem's claim that the current level of consumer engagement in the retail energy market provides an ineffective constraint on suppliers. Indeed, this statement seems at variance with the findings of Ofgem's 2008 Energy Supply Probe. We also believe Ofgem has not demonstrated a strong causal link between poor tariff comparability and lack of consumer engagement. Key elements of the case are based on inaccurate and incomplete analysis of statistics.

<u>Proposal 1 - Improving tariff comparability</u>

iv. Ofgem's proposals to improve tariff comparability fall into two broad categories: 'information measures', notably a price comparison guide and a standardised Tariff Information Label; and 'core tariff proposals', notably various restrictions on the types of enduring and fixed term tariffs that suppliers are allowed to offer.

v. We fully support the proposed information measures, which we believe will have an unambiguously positive impact on tariff comparability, consumer engagement and overall consumer welfare. We believe these should form the core of Ofgem's measures to simplify consumer engagement, complemented where possible by other pro-competitive measures, such as steps to align language across the industry and better educate customers on tariffs, switching services and the energy market.

vi. We cannot support the core tariff proposals. These proposals, in particular the tariff restrictions, will have a range of adverse impacts on competition and consumer choice which seem to us likely to outweigh any benefits from improved tariff comparability. On the demand side these adverse impacts include reduced switching as a result of tariff convergence and behavioural biases, and reduced incentives for consumers to transact in a way that reduces suppliers' costs. On the supply side they include weakened intensity of competition resulting from removal of discounted products, promoting the conditions necessary for tacit collusion, increased supplier costs and reduced incentives for innovation and market entry. Aside from the obvious detrimental impact on consumers, this will constrain the ability of smaller suppliers such as ScottishPower to grow their market share. We are also concerned that the proposals may rapidly be seen as failing, leading to calls to re-regulate the industry.

vii. We are not opposing change that is necessary for the benefit of consumers, nor are we suggesting that Ofgem is wrong to consider a radical approach. However, we do consider that the current tariff proposals will not achieve their objectives and are likely to pose severe risks to the competitive market. We do not think that the survey and testing work undertaken by Ofgem supports the conclusions drawn, or that it is necessary for consumers to compare raw tariff rates (though this information should be available) in order to make accurate switching decisions based on quotations. Approaches such as providing further information would however be likely to improve outcomes and we support them. We therefore urge Ofgem to conduct a thorough impact assessment of the risks to competition from the core tariff proposals, and a more rigorous analysis of the mechanisms by which improved tariff comparability may translate to substantive welfare benefits.

<u>Proposal 2 – Strengthen probe remedies – domestic</u>

viii. We support steps to standardise the look and feel of the Annual Statement, and are comfortable with Ofgem standardising certain aspects of bills - though we would wish to retain our ability to differentiate our brand and content. We fully support plans to grow consumer trust in switching sites. Our main concern is the scale of IT change needed to introduce changes to bills and annual statements, and the interaction of these changes with our current project to implement a new billing system. We hope Ofgem will allow sufficient flexibility in implementation timescales that additional programme risk can be minimised at a proportionate cost. We believe these initiatives should be accompanied by a comprehensive review of the information that suppliers are now obliged to provide to consumers, with a view to striking the optimum balance between empowerment and information overload. We look forward to working with Ofgem to take these measures forward.

ix. We support proposals to strengthen SLC23 to improve the quality of information provided to customers at price change, and note that our own efforts to provide personalised forecasts have been recognised as best practice by Consumer Focus. We feel the proposal to require suppliers to advise customers to consider switching supplier is disproportionate and unhelpful in restoring consumer trust. It could also be bad advice if, as is often the case, the price change is a response to changes affecting the whole industry. We are also concerned that an overall ban on marketing materials would be counter-productive: price increases and product maturities are times when it is entirely appropriate to encourage customers to engage with their product options.

x. We do not consider there is any need to extend the 'right to cancel' window from 15 to 30 days and do not support the proposed changes to the existing process.

Proposal 3 – Standards of conduct

xi. We support the intention behind the proposed new Standards of Conduct and agree that these are standards that all customers should expect to receive when dealing with their energy supplier. However, their simplicity and breadth risks difficult questions of interpretation on enforcement.

xii. On that basis, we support their inclusion in new supply licence conditions using a two-stage enforcement process. This would allow for a reasonable dialogue between Ofgem and suppliers, especially to resolve differing views on interpretation, before moving to formal enforcement action. This would make such a broad ranging Licence Condition workable and fair to all parties.

Introduction

1. Ofgem's Retail Market Review presents an ideal opportunity for stakeholders and industry to work together to ensure that the energy retail market works effectively for all consumers. The problems of the retail energy market in recent years and the consequent general lack of trust are widely acknowledged; we believe that suppliers and Ofgem need to work together to address these problems by improving the domestic energy market.

2. We continue to believe that competition is the most effective way to meet the needs of consumers, drive innovation into the market and secure the appropriate returns needed for efficient investment. That investment is much needed throughout the GB energy chain – whether in smart meters and the green deal at the retail end; new renewable and other low carbon generation upstream; or in the networks needed to enable the market to function. In this context, it is crucial that the Review should build investor confidence in the market by establishing a stable platform for the future.

3. The remedies Ofgem has proposed include many that we can support and which will help consumers. However, the RMR core tariff proposal amounts to one of the most radical interventions in the operation of the retail market yet to be considered. It is therefore essential that it is thoroughly analysed and tested. We have structured our response as follows:

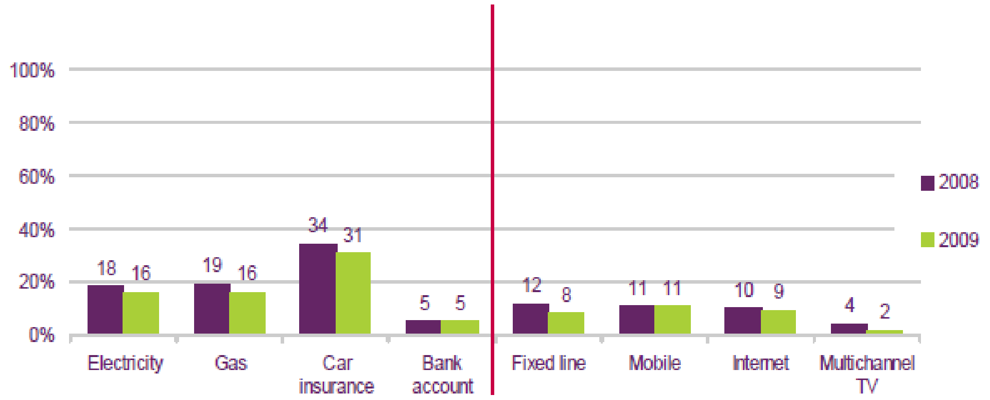
   - Ofgem's diagnosis of the problem and the extent to which the evidence indicates the presence of ineffective competition
   - Proposal 1 - Improving tariff comparability
   - Proposal 2 – Strengthen probe remedies – domestic
   - Proposal 3 – Standards of conduct
   - Annex 2: Impact of fixed standing charge on propensity to switch
   - Annex 3: Response to consultation questions

Features of a competitive market – Ofgem's diagnosis of the problem

<u>Indicators of effective competition</u>

4. Looking at the overall operation of the market, Britain has an impressive story to tell. There is a high level of competitive activity with around 100,000 customers switching energy supplier every week. This has driven considerable efficiency and innovation, with benefits to customers in terms of lower prices - relative to many EU countries - and significant product and service innovation such as fixed and capped price offers, green energy, social tariffs, energy service offerings, online billing and remote energy monitoring and control devices. Smart metering will result in a step change in the amount of information available to consumers and their suppliers on electricity and gas usage and will enable the development of new products and services which should be embraced by consumers and enhanced by the pressure of competition.

Figure 9: Proportion of consumers who have switched communications and utilities providers in the last 12 months



Base: All adults with fixed line (2008, 941) (2009, 781) mobile (2008, 1270) (2009, 1231) internet (2008, 460) (2009, 388) multichannel TV (2008, 896) (2009, 837), electricity (2008, 1309) (2009, 1226), gas (2008, 1125) (2009, 1069), car insurance (2008, 1107) (2009, 1019), bank account (2008, 1418) (2009, 1350)
Source: Ofcom Consumer Experience Report 2009

Source: Ofcom (2010)[1]

5. However, while the results of competition at a macro level have been remarkable, we agree that there is evidence that individual outcomes for some consumers have not always been as effective. Some consumers, especially prior to the full implementation of the Probe remedies around better price comparisons, may have switched to higher priced deals or not fully understood the products on offer. While it is not possible in a competitive market to entirely eliminate the possibility of consumers making bad choices, we agree that there is more that can and should be done to clarify the options available and reduce confusion.

6. That aside, we see no evidence for Ofgem's claim that the current level of consumer engagement in the retail energy market provides an ineffective constraint on suppliers.[2] Indeed, this statement seems entirely at variance with the findings of Ofgem's Energy Supply Probe:

   > "It is now ten years since GB domestic gas and electricity markets were opened up to retail competition and six years since price controls were removed. Both sectors have since moved from pure monopolies to markets where there are now greater levels of competitive activity and consumer switching than almost every other energy market in the world and most other UK consumer services markets. The fundamental structures of a competitive market are in place, and the transition to effective competitive markets is well advanced and continuing."[3]

7. We do not see any significant changes in the market since 2008 that would change this assessment. Consumers are able to benefit from a wide range of choice in:

   - **Prices** – Despite the need for continued investment by energy suppliers, prices remain competitive, particularly compared to other markets. Figures presented by Ofgem in a recent factsheet on energy prices[4] indicate that electricity prices in GB are among the cheapest in Europe and gas prices are cheapest in Europe. While Ofgem is concerned that prices may rise faster

[1] 'Strategic review of consumer switching A consultation on switching processes in the UK communications sector', Ofcom, 10 September 2010, page 35
[2] Ofgem (2011), 'The Retail Market Review: Domestic Proposals', December, page 1
[3] Energy Supply Probe – Initial Findings Report, Ofgem, October 2008
[4] Why Are Energy Prices Rising, Ofgem factsheet, October 2011

than they fall (we think the evidence is inconclusive), there is evidence that this is a common feature of many, perhaps most, competitive markets, and does not mean that competition is not working for consumers.

- **Customer service** – Customer service levels are improving with suppliers actively competing to be recognised on levels of service. There is a robust complaints procedure and independent redress scheme in place for consumers who do find the service from their supplier less than satisfactory.

- **Choice of suppliers** – GB energy consumers enjoy wide choice of suppliers, including the 'Big 6' and several smaller new entrants.

- **Choice of products** – there has been real innovation for customers in the range of products, with customers able to choose from standard tariff products with no tie-ins, fixed price products that offer them certainty over their price for a period of time, and discounted products which offer customers a discounted price for a period of time, in line with their preferences.

8. The UK energy retail market has seen consistently high levels of customer switching compared to other competitive energy markets across Europe and the world. While lower than in some previous years, customer churn remains steady at around 15 – 20%. In January 2010, 87% of customers were aware that they were able to switch supplier. Ofgem's own research found that 77% of customers who had never switched said they were happy with their current supplier. In an OFT survey cited by Ofgem, only 13% of consumers said that they had encountered a complex price in the energy sector and found it difficult to choose a supplier.[5] This does not suggest that current tariff structures are a significant barrier to switching.

9. Overall, we can understand that many consumers are not satisfied. Energy is not an exciting or desirable product – nobody likes to pay for their energy supply and particularly not when prices seem to be rising unfettered. However, Ofgem itself has noted that price rises are due to multiple factors, not least the rising costs of oil and gas, the cost of maintaining a safe and secure energy supply and Government's own environmental and social schemes. Higher prices do not in themselves indicate that the competitive market is not working for customers.

Price differential between disengaged and engaged

10. A key concern behind Ofgem's proposals appears to be that consumers who do not switch are paying too much[6]. In fact, we believe the price differential between active and inactive customers is relatively low compared with other markets. As Professor Littlechild has pointed out:

> "Ofgem's various charts suggest that the best online price on offer in the market at any time ranges from about 2% to about 20% below the average offline price. Typically, the gap seems to be of the order of 10 to 15%. This is a quite remarkable achievement. Retail competition seems to be ensuring that even sticky customers who make no attempt to change supplier are receiving a price that is within 10 to 15%

[5] OFT (2010), 'Advertising of prices', OFT1291. Ofgem incorrectly states the percentage as 61%, which relates only to a small subsample. As a proportion of all responses, the correct figure is 13% (see Oxera (2012) for a detailed explanation)

[6] The Retail Market Review – Findings and Initial Proposals, Ofgem Condoc, March 2011, page 5, para 1.2, Ofgem Condoc, page 8, para 2.1

of the very best price in the market – a price that is sometimes alleged to be actually below cost."[7]

11. It is a feature of competitive markets that customers who are more likely to exercise their right to switch attract better deals. Indeed, this is an essential mechanism to reward the time and effort involved in shopping around (so-called "search costs"). If passive customers get exactly the same deal as active ones, there is no incentive to incur search costs and there is a risk that consumer engagement will fall, not rise. However, suppliers need to work to keep the spread of prices between active and non-active customers in balance, and promote other, service-based offerings at non-active customers. If dispersion becomes too great, or if there is poor service, non-active customers will wish to become active in order to obtain the better deals. However, absent these factors, many customers will be broadly content with their deal and choose not to incur the search costs. This is an appropriate response to their circumstances.

Good and bad switching

12. Ofgem says that 'quality of switching remains a concern as a large proportion of consumers are not sure if they saved money by switching'[8]. This concern appears to be a key driver behind the tariff comparability proposals, and to have influenced the design of the Ipsos MORI quantitative research. However, the fact that around 25% of consumers are unsure whether they have saved money could be explained by many factors, including:

   - uncertainty over future tariff movements;
   - uncertainty over future consumption;
   - a decision to change supplier for reasons other than price (as did 21% of consumers in a recent survey[9]);
   - a lack of motivation to follow up and review how a switching decision turned out; and
   - cynicism/lack of trust in savings amount quoted by new supplier.

13. Ofgem presents no evidence to suggest that these statistics are any worse than other comparable sectors. Furthermore, suppliers have made great strides over the last year in improving the accuracy of their quote and comparison processes, and this should reduce actual poor switching decisions. We support further information measures to aid this process further, though it may be difficult to eliminate doubt in people's perception of switching decisions. Even where consumers do make bad decisions, this would not weaken the competitive constraint on suppliers unless suppliers could rely on consumers making such bad decisions.

[7] 'Ofgem's Procrustean Bed: a response to Ofgem's Consultation on its Retail Market Domestic Proposals',Stephen Littlechild, 23 January 2012 http://www.eprg.group.cam.ac.uk/wp-content/uploads/2012/01/Ofgems-Procrustean-Bed-23-Jan-2012.pdf
[8] The Retail Market Review – Domestic Proposals, Ofgem Condoc, para 2.4
[9] Of those who had switched supplier, 21% said the main trigger was something other than price, 'Customer Engagement with the Energy market - Tracking Survey', Ipsos MORI, 28 January 2011, page 49

How would improved tariff comparability help the disengaged engage?

14. Although Ofgem blames lack of engagement on poor tariff comparability, there is little discussion of the mechanism by which improved tariff comparability will lead to increased (or better) switching. This is important to understand, as it has implications for the types of comparison that consumers need to be able to make, and the accuracy with which they need to make them.

15. Virtually all 'engaged' consumers now switch via a channel in which they receive a personalised quotation and comparison (tariff comparison service, supplier website, doorstep sales agent, telesales agent). Whether these quotations are given by a comparison service or a supplier, there are strict (and strictly enforced) rules to ensure that the quotation and comparison are accurate. In these circumstances the price comparison is perfectly straightforward, and surveys confirm that consumers have no problem in this respect.[10]

16. The availability of bespoke comparisons, once consumers commit to their search, suggests that a more relevant role for improved tariff comparability may be as a prompt or nudge. For example, if price comparison tables were published in newspapers or magazines, this could alert consumers to the potential magnitude of the saving opportunity, prompting them to commit to searching when they would not otherwise have done so. In this context it is striking that most online switchers use a price comparison service whereas virtually all phone switchers go direct to the supplier[11]. A relevant factor inhibiting switching may therefore be the lack of (or lack of awareness of) suitable telephone-based price comparison services. This suggests that part of the 'nudge' message could usefully include numbers for telephone-based price comparison services.

17. If the main purpose served by the comparison table is to nudge the consumer into obtaining an accurate personalised quotation, this calls into doubt the relevance of the taxing arithmetical challenge given to respondents in the Ipsos MORI quantitative survey[12] - an exercise that would be inconceivable in other markets such as telecoms[13]. For the nudge effect to work there is no need to interpolate, since consumers cannot be expected to have accurate consumption data to hand, and nor is it essential for them to identify the very best deal.

18. This is borne out by the YouGov research, in which only 6% of respondents disagreed with the proposition "*If a trustworthy price comparison guide is available, I would rely on that instead of comparing standing charges and unit rates*"[14]. It is therefore questionable how much weight should be attached to the

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[10]In research carried out in 2010, 85% of switchers found the process of their last switch very or fairly easy (46% judging it "very" easy); just 4% rated it as very or fairly difficult. Ipsos MORI Tracking Survey, 28 January 2011,page 33

[11] Ipsos MORI Tracking Survey, 28 January 2011, page 55. For those who had switched online, the ratio of using price comparison sites to going direct to the supplier was 16:5; for consumers switching by telephone it was 2:28. Ipsos MORI note that some of those switching by phone may first have researched online (28% of switchers with internet access phoned the supplier), so the contrast may not be quite as extreme as implied by these ratios.

[12] Respondents were required to interpolate between three columns (low/medium/high) to identify the best tariff, which in one case differed by only 65p from the next cheapest (Option D, 2,500kWh pa consumption: Supplier 4 £435.99 versus Supplier 1 £436.64). Unsurprisingly success rates were not particularly high. See Ipsos MORI 'Consumer reactions to varying tariff comparability, Quantitative research conducted for Ofgem, 18 October 2011.

[13] To conduct a similar exercise for tariffs in the fixed line telecoms market, consumers would need to assess pence per minute rates and consumption figures at different times of day (day, evening and weekend) different call types (geographic numbers, 0845, premium rate numbers, mobiles and international), and different combinations of pay as you go and inclusive minutes tariffs.

[14] YouGov (2012) page 16.

Ipsos MORI results, and in particular, there is no reason to suppose that a tariff comparison table alone would be any less effective than a tariff comparison table plus regulated standing charge.

19. In summary, we accept that there are problems with consumer understanding and engagement that are being addressed and where further improvements can and should be made, but we do not accept Ofgem's claim that there is insufficient competitive constraint on suppliers. We believe Ofgem has focussed too heavily on the narrow issue of direct comparability of tariff rates, to the exclusion of other more relevant factors.

Proposal 1 – Improving Tariff Comparability

20. Ofgem's proposals to improve tariff comparability fall into two broad categories:

    a) 'information measures', comprising a price comparison guide and a standardised Tariff Information Label;

    b) 'core tariff proposals', comprising various restrictions on the type of enduring and fixed term tariffs that suppliers are allowed to offer (plus some rules on contract rollover and no-exit fee switching windows for fixed term products).

21. We are fully supportive of the information measures, which we believe will have an unambiguously positive impact on tariff comparability, consumer engagement and overall consumer welfare. We believe these should form the core of Ofgem's measures to simplify consumer engagement, complemented where possible by other pro-competitive measures. We return to this in paragraphs 59 to 65 below.

22. We cannot support the core tariff proposals. These proposals, in particular the tariff restrictions, will have a range of adverse impacts on competition and consumer choice which seem to us likely to outweigh any benefits from improved comparability. We urge Ofgem to conduct a thorough impact assessment of the risks to competition from these proposals, and a more rigorous analysis of the mechanisms by which improved tariff comparability may translate to substantive welfare benefits.

23. To inform our response, we commissioned an independent economic appraisal of these proposals from Oxera. Oxera's report[15], which we are submitting separately, supports our concerns in these areas and provides a thorough review of the likely adverse impacts. We also commissioned independent research by YouGov[16] into consumer attitudes towards the proposals and are also submitting that report.

24. We explain below why we believe that Ofgem has not made a proper case for the benefits of tariff restrictions, and the various adverse effects which also need to be taken into account. We conclude this section by setting out our alternative proposals as to how Ofgem might better address this important issue.

<u>Benefits of tariff simplification are overstated</u>

25. Although we fully support Ofgem's proposed information measures, and believe they are an important ingredient for improving engagement and trust, we are

[15] 'Economic appraisal of Ofgem's domestic tariff proposals - An appropriate intervention to increase consumer engagement?, Report prepared for ScottishPower', Oxera, March 2012
[16] 'Ofgem Proposals Omnibus Research, Report for ScottishPower Energy Retail', YouGov, February 2012

concerned that Ofgem has failed properly to analyse the behavioural and economic context and may therefore have over-estimated the benefits that will accrue. This is important because it suggests that the incremental benefits of tariff restrictions (which we oppose) may also be much smaller than assumed by Ofgem.

26. Oxera's report concludes that Ofgem's analysis of the behavioural aspect of consumer engagement is flawed and falls short of the standard that would normally be expected for an intervention of this significance:

> "Ofgem's analysis focuses on the factors that affect consumers' decision-making, and draws on three sources of evidence: qualitative survey evidence; a quantitative assessment of tariff comparability; and insights from the behavioral economics literature. This analysis is, however, incomplete and in places inaccurate. Ofgem's approach is based on the OFT's decision-making framework ('access, assess, act'), which describes the *ability* and *incentives* necessary for consumer engagement. However, Ofgem focuses its analysis on only one relevant factor within the 'assess' stage: consumer capacity for engagement; it does not present an analysis of the *incentives* for consumers to access and act on information. As other evidence available to Ofgem shows, these incentives will be affected by factors including the price differentials between tariffs, framing effects, and the preferences of active customers for a number of existing tariff features.
>
> A fundamental concern with Ofgem's analysis is that it does not establish a clear link between consumers' limited capacity to understand the current tariffs on offer, and the level of engagement. In addition, the evidence that Ofgem does present is misleading. For example, while Ofgem suggests that 61% of consumers found it difficult to choose suppliers in the energy market, this statistic has been taken from the survey responses to a question asked to only a sub-group of all respondents. Adjusting for this sub-group effect, this figure could be around 13%.
>
> Even though Ofgem's focus is on the limitations of consumers' capacity to assess complex information, its qualitative analysis does not explicitly test whether this limited capacity is a causal factor driving consumer engagement, relative to other factors. Indeed, the causal factors of disengagement are not examined in detail. Establishing such a link is a central prerequisite to Ofgem's premise that restricting tariff structures will increase engagement."[17]

27. Oxera is also critical of the quantitative research, on which Ofgem relies to support its impact assessment. For example:

- Owing to the construction of the quantitative survey, it is not possible to compare the effects of the different components of the potential remedies or determine the likely impact of alternative interventions on the level of switching.

- Ofgem incorrectly interprets its quantitative evidence on customers' likelihood of switching under each proposed remedy: it asks only those consumers who select a particular remedy as their preferred option whether they would be more likely to switch in response to information presented in that manner. Correcting for these sub-sample issues significantly changes the interpretation of the results.

- The survey design itself is imperfect due to a lack of incentives for participants to engage in complicated calculations, and the possibility of fatigue bias.

[17] Oxera (2012) page ii

- Oxera concludes that “close inspection of Ofgem’s analysis reveals that the actual evidence is not sufficient to support a finding that consumer welfare overall is best served by introducing the tariff restrictions preferred by Ofgem”.

28. A significant weaknesses in Ofgem’s behavioural analysis is its failure to take account of consumers’ price-sensitivity and their declared willingness to switch as a function of potential saving. We show below (paragraph 34) that when this is taken into account, the net effect of the fixed standing charge may well be to reduce customer switching.

29. Although our YouGov research confirmed that customer perceptions of the market are generally poor, with almost ¾ of respondents feeling very or fairly cynical about the market, it also revealed relatively weak support for Ofgem’s proposals around tariff restriction. When presented with Ofgem’s core tariff proposals, 50% of respondents supported or strongly supported them as a whole (perhaps indicating an “endorsement bias”) but support for none of the specific proposals tested was more than 39%. The restrictions on discounts received a distinct thumbs down (less than 20% support) and the proposals on bundles and standing charge restrictions were met with neutrality.[18]

30. Both the Oxera and YouGov reports support our view that Ofgem has not fully considered the impacts of its proposals, nor has it sufficiently considered less intrusive alternatives which could build consumer trust and engagement without requiring such dramatic structural changes. The reports are consistent with our view that the issue is not that there are too many products in the market; rather, there is a need to improve customers’ understanding of them and help to develop incentives for customers to engage in the market.

<u>RMR Core tariff Proposal – DO NOT SUPPORT</u>

31. We do not agree with Ofgem’s ‘core tariff proposal.’ In particular, we are strongly opposed to:

    - standardising the fixed element of evergreen tariffs, which we believe carries significant risks to competition;
    - the prohibition of ‘behavioural’ discounts in evergreen tariffs, which will lead to inefficiencies and higher costs for consumers;
    - the prohibition of discounted and capped fixed term products, which significantly limits customer choice (and the scope to incentivise switching) for no obvious benefit.

32. We believe the likely benefits in terms of increased engagement have been over-estimated compared to pure information measures, and we believe there are significant risks and adverse impact which have not been properly assessed (see Table 1).

[18] YouGov (2012) pages 11-13

Table 1 - Potential risks and adverse impacts of tariff restrictions

Tariff restriction	Potential risk or adverse impact
'Evergreen' tariffs	
Regulated standing charge	• Leads to tariff convergence at lower consumption levels, reducing propensity to switch • Increased risks of tacit collusion, with potential to lessen competition*
Prohibition on discounts	• Prevents suppliers incentivising efficient behaviours (prompt payment, paperless billing etc), leading to higher overall prices
Prohibition on bundling	• Restricts innovation and consumer choice • Discourages market entry by brand extenders • Prevents charity affinity deals to the detriment of competition and charities alike
Fixed term products	
No discounted products	• Limits scope for suppliers to mount 'raids' on their rivals' customers;
No capped products	• Denies a significant number of consumers their preferred choice of product

* This risk applies to the whole package of tariff restrictions

<u>Regulated standing charge</u>

33. We do not support a regulated standing charge for standard tariffs. As explained above we believe the benefits in terms of increased engagement have been over-estimated, and adverse impacts have not been properly assessed. In particular:

    a) convergence of prices at lower consumption levels will reduce consumers' propensity to switch;

    b) increased transparency will facilitate tacit collusion and potentially lessen competition.

    c) various behavioural biases resulting from a regulated standing charge (endorsement, prominence) may lessen consumer incentives to search.

34. Imposition of a fixed standing charge will reduce the variation between different tariffs at lower consumption levels. There is plenty of evidence from consumer surveys to indicate that propensity to switch is strongly influenced by expected saving from switching. Combining this propensity to switch data with the probability distribution of consumption for gas and electricity, it is possible to estimate the impact on switching propensity of the change in tariff structures. This has been done for two scenarios (see Annex 2 for an explanation of the methodology):

    - a 'maximum saving' scenario in which switching propensity is based on the price difference between the most expensive and cheapest tariff at the relevant consumption level; this would correspond to a situation where switching decisions were triggered by generic advice on potential savings;

- an 'actual saving' scenario in which switching propensity is based on the price difference between the customer's actual tariff and the cheapest tariff; this would correspond to a situation where switching decisions were triggered by more tailored information (such as might be available from published tariff comparison tables).

35. The results are summarised in Table 2 for two sets of consumption data, actual data for 2007 and extrapolated data for 2012. With 2007 data, propensity to switch in the first scenario reduces by 10 percentage points (12% of status quo value) and in the second by 5 percentage points (11% of status quo value). The reduction is even greater with 2012 data, as consumption shifts towards lower levels where price convergence is greatest.

Table 2 - Propensity to switch – status quo v fixed standing charge

	2007 consumption		**"2012" consumption**	
% of consumers willing to switch based on:	**Status Quo**	**Fixed SC**	**Status Quo**	**Fixed SC**
Max saving (most expensive supplier versus cheapest supplier)	88%	78%	88%	73%
Actual saving (own supplier versus cheapest supplier)	50%	45%	49%	38%

36. These results are before the impact on potential savings of banning discounted products, and before the price convergence effects of greater transparency. These will compound the impact of the regulated standing charge and lead to a greater reduction in switching propensity.

37. In contrast, Ofgem's quantitative research suggests that for non-E7 consumers, restricting tariffs would increase the proportion of consumers who say they are somewhat or much more likely to switch by 7%.[19] Even if those respondents were on average 100% more likely to switch, these results suggest that the net impact on switching could be significantly negative.

38. The Oxera report assesses the core tariff proposals against OFT's criteria for determining when interventions may reduce competitive intensity and against the conditions arising from the *Airtours* case. Oxera conclude that Ofgem's proposals (notably fixed standing charge and removal of discounted products) create conditions that would be expected to foster tacit collusion[20]. This is a serious risk which could cause harm to all consumers, and deserves to be thoroughly investigated.

39. The Oxera report also cites various academic studies which demonstrate that regulatory intervention such as fixing the standing charge can lead to consumers being 'over protected'[21]. Because they believe the tariffs are in some sense 'endorsed' by the regulator, consumers' incentives to search more widely are

[19] Ipsos MORI (2011) 'Consumer reactions to varying tariff comparability', Figure3, Option B (74%) versus Option D (67%). These percentages reflect the views of different sub-samples, so are not directly comparable, and the split between 'somewhat' and 'much' is not disclosed, but this is the best data available.
[20] Oxera (2012), section 5.3
[21] Oxera (2012), section 4.3

reduced, potentially reducing engagement and switching. This effect has not been considered in Ofgem's assessment.

40. Finally, Ofgem must fully consider the distributional impacts of the fixed standing charge, in particular for vulnerable and fuel poor consumers. In general terms, the fixed standing charge will significantly increase prices for low and high consumers who do not wish to engage in the fixed term market (as they could otherwise shop around for a supplier whose tariff structure best suits their needs) and slightly reduce prices for average consumers. Vulnerable and fuel poor consumers can fall into both low and high use categories – for example high users may include pensioners who are at home all day using their heating, or people in low quality or electrically heated housing.

<u>Prohibition on discounts and bundling</u>

41. The prohibition on discounts for standard products will remove the ability of suppliers to incentivise efficient behaviours by their customers, and will increase costs. For example:

- without the Dual Fuel discount, the number of customers buying gas and electricity from different suppliers may increase, with additional billing, customer service and meter reading costs;

- without online discounts, the number of customers submitting meter readings online may reduce, with additional meter reading costs;

- without prompt payment discounts, the number of customers paying late may increase, with additional costs of reminder letters and working capital.

42. It is particularly important for new entrants to be able to differentiate themselves from the 'Big 6', and novel forms of discount or bundling are one way of achieving this – particularly where the new entrant is a 'brand extender', capitalising on a strong customer base in some other retail sector to cross-sell energy. Removing this opportunity may therefore discourage market entry.

43. Finally, the prohibitions on discounts and bundling of standard products may restrict innovation and market entry and are likely to be unpopular with consumers. Responses to the YouGov survey indicate that around 70% customers expect to receive retail discounts (and a similar percentage are specifically aware of dual fuel discounts)[22], and even if average prices are unaffected, these customers will lose out from their removal.

<u>No discounted or capped fixed term products</u>

44. We do not support the banning of discounted and capped fixed term products. Ofgem has not explained why it considers these measures are necessary. Although Ofgem makes reference to prohibiting 'adverse unilateral variations', there is no evidence that consumers are harmed by such 'adverse' variations. Under existing regulations, if a discounted tariff increases (because the standard tariff increases), consumers have the opportunity to switch to another product or supplier without penalty. They are therefore no worse off when the price goes up

[22] YouGov (2012) pages 7,8

than customers on evergreen standard tariff – and in fact better off to the extent of the discount.[23]

45. It appears Ofgem's main motivation may be to simplify tariff comparison: if discounted products were permitted, they would likely be included in tariff comparison tables and add complexity to arithmetical tariff comparison. We do not consider this is a strong argument since, as argued above (paragraph 17), the low/medium/high columns will normally suffice in place of arithmetical comparisons and almost all customers now receive a personalised quotation. If space in a comparison table is at a premium, discounted products could be omitted from the table and more sophisticated customers directed to a full list elsewhere (as would be necessary anyway in respect of fixed price products).

46. Whilst the case for banning discounted products is weak, there are significant adverse impacts which have not been properly assessed. In particular banning such products could:

    a) reduce the intensity of competition by limiting the scope for suppliers to mount 'raids' on their rivals' sticky customers;

    b) heighten risks of tacit collusion, with potential to lessen competition (see paragraph 38);

    c) deny a significant number of consumers their preferred choice of product.

47. Suppliers currently make use of discounted products as a way of raiding their rivals' sticky customers. Although the discounted tariffs *per se* are not discriminatory, their use to support targeted sales activity against rivals' customers has a similar positive effect. The literature on price discrimination is clear that this is one of the circumstances in which price discrimination can lead to lower prices for consumers and lower profits for suppliers:

> "denying a firm the right to meet the price of a competitor on a discriminatory basis provides the latter with some protection against price attacks. The effect is then to weaken competition, contrary to the belief of the proponents of naive application of legislation prohibiting price discrimination ..." [24]

> "... when a firm offers a deal to those customers who 'belong' (in some sense) to rival firms that differs from the deal it offers its "own" customers. In most cases we expect the firm to offer a better deal to rival firms' customers in order to build market share. A feature of such models is that, compared to the situation where deals are uniform, price discrimination can act to intensify competition, in the sense that all prices come down and equilibrium profits decrease. ... The basic reason why this kind of discrimination intensifies competition across the board is that it makes it cheaper for a firm to target its rivals; customers without damaging the profits it can extract from its own customer base; when all firms target each others' customers, though, all prices come down."[25]

> "Competitive price discrimination may intensify competition by giving firms more weapons with which to wage their war. Allowing firms to set market-specific prices through discrimination breaks the cross-market profit implications of aggressive price moves that may restrain price competition when firms are limited to uniform pricing.

[23] It is important to distinguish 'discounted tariffs' from 'variable discounted products'. The latter do have the potential to mislead consumers but we are not arguing for their retention.
[24] Thisse, J.-F., and X. Vives (1988), "On the Strategic Choice of Spatial Price Policy" American Economic Review, 78(1), 122-137, page 134
[25] Armstrong M. and J. Vickers J (2001), 'Competitive Price Discrimination' Rand Journal of Economics, 32(4), 579—605, page 584

Thus, firms may price more aggressively in some markets when permitted to discriminate; if firms differ in which markets they target for this aggressive pricing and competitive reactions are strong, prices in all markets may fall."[26]

48. Banning discounted products could therefore result in a significant lessening of competitive intensity, with obvious adverse consequences for consumers. It may also harm companies such as ScottishPower who have a smaller market share than many of the other large integrated suppliers and aspire to expand that share.

49. The retail market has responded to a growing consumer appetite for discounted, capped and fixed price products. Just over a third of ScottishPower's domestic customer base purchase the two product types that Ofgem is proposing to prohibit, capped or discounted. The YouGov research found that capped and discounted-type products were just as appealing to customers as fixed price products, indicating that they welcome the choice of product types. Only 6% of customers surveyed did not find any products shown appealing.[27] By restricting the types of non-standard products available in the market, Ofgem could frustrate customers who are currently active in the market, without necessarily stimulating the interest of inactive customers. Ofgem must be careful not to overly restrict consumer choice in the pursuit of an active market, as this may have the opposite effect.

Summary of economic considerations

50. To conclude this discussion of the economic case for Ofgem's proposals, Table 3 summarises the main pros and cons of the information measures and the tariff restrictions (viewed as an increment to the information measures), under three headings: overall consumer welfare as indicated by average prices, overall consumer welfare as indicated by market entry and innovation, and the interests of vulnerable consumers where distributional impacts are particularly relevant. Whilst the impact of information measures is uniformly positive, the tariff restrictions are largely negative in their impact.

Table 3 - Pros and cons of information measures and tariff restrictions

	Overall consumer welfare – average prices	**Overall consumer welfare – market entry and innovation**	**Vulnerable consumer interests - distributional impacts**
Information measures	More frequent and better switching increases competitive pressure and leads to reduction in average prices (though likely to be small given that supplier margins are already low)	Increased competitive pressure stimulates innovation	Some disengaged consumers (of which higher than average % are vulnerable) engage and benefit from cheaper tariffs

Table continues …

[26] Corts, K (1998), "Third-Degree Price Discrimination in Oligopoly: All-Out Competition and Strategic Commitment," Rand Journal of Economics, 29(2), 306-323, page 321
[27] ICM Omnibus, October 30th – November 1st 2009

	Overall consumer welfare – average prices	Overall consumer welfare – market entry and innovation	Vulnerable consumer interests - distributional impacts
Tariff restrictions (within core tariff proposal) (incremental impact relative to information measures)	Lessening of competitive pressure increases average prices: • greater risk of tacit collusion from increased transparency • reduced propensity to switch as a result of tariff convergence (offset by improved ease of comparison) • weakened scope for 'raiding' rivals' customers using discounted tariffs Higher industry costs increase average prices: • inefficient customer behaviour in absence of discounts • industry compliance costs	Reduced scope for bundling and product differentiation • reduces innovation • discourages market entry	Vulnerable groups may benefit disproportionately from any improved quality of switching decisions Less sophisticated consumers more likely to stick with evergreen tariffs rather than fixed term products due to behavioural biases (Ofgem endorsement, default and prominence effects) Fixed standing charge increases prices for low and high consuming customers relative to medium – unclear whether this is positive or negative overall for vulnerable customers

Key: positive impacts in blue, negative impacts in red, neutral/ambiguous in black

Operational Impacts

51. Ofgem must also consider the operational impacts of the Core Tariff proposals. The timing of such a significant change will be crucial, to ensure that consumers are treated in a fair and equitable way, while at the same time minimising the operational complexities on suppliers. There are two options that we can see: either a mass market move, meaning that the market changes as a whole on one specified date; or a phased implementation, with a 'complete by' date. The physical upheaval associated with the former will be significant, as we expect that all customers will need to be communicated with, and given appropriate notice of the change. However, this would be fairer on customers. A phased implementation would be more manageable for suppliers and allow a better level of customer service. It would also potentially give some suppliers a competitive advantage, if they were able to manage the change in a more efficient way. However, there would be potential inconsistencies for customers, since some customers would be forced on to the new arrangements ahead of others, and the impact on customers may well vary.

52. Consideration would also have to be given to customers who have selected fixed term deals that are not due to end at the point of change. The most sensible option for these customers would be to allow the customers to remain on that offer until the previously agreed fixed term period had expired. We would assume that under the RMR core tariff proposal, these customers would then be required to default to a standard tariff, even if the terms of that deal stated otherwise.

53. We would assume that such a change would be required to be treated as a unilateral variation to all customer contracts and that customers would be required to be notified in accordance with Standard Licence Condition 23. Under this Licence Condition, a customer has the opportunity to reject the proposed new terms and switch supplier. It is not clear what process Ofgem would envisage being in place to manage the expectations of customers who wish to object to the change, but would not be able to.

54. Customer awareness and understanding of the impact, scale and rationale behind any such change would therefore be crucial. A significant number of customers will experience some immediate disadvantage (such as loss of a No Standing Charge tariff or a Dual Fuel discount) which they may resent. Ofgem acknowledges in the consultation that the customer experience will need to be very carefully managed, but does not appear to have a clear vision as to how this would be done. It will not be enough to rely on suppliers sending letters to customers informing them of the change – in the current climate of distrust in energy suppliers, we are concerned that this would only serve to further alienate consumers and potentially lead to more becoming disengaged.

55. Instead, as a minimum we would expect Ofgem to commence a high profile, sustained information and education campaign for consumers to ensure that they are aware of the change and understand the reasons underpinning it and potential impacts. We feel that this would be the most effective way to build trust and consumer awareness if such an impactful change were to go ahead.

56. In any case, even with such a campaign, we would anticipate an increased number of complaints and contacts from customers who will see a change in their tariff, which suppliers will need to be resourced to deal with. We estimate that managing these customers would require at least 120 additional FTE over a 12 week period, at a cost of around £650,000. These FTE would also all require training for at least 4 weeks, in order to ensure a suitable service level for customers.

57. There are practical impacts of the proposals which will affect customers on different metering types. For instance, the consultation proposes to make exceptions for customers with Economy 7 meters, but seems to overlook the impacts on multi-rate meter customers and prepayment customers.

58. We have a particular interest in the operational management of this due to our imminent move to a new customer billing system at the end of this year. We are currently working to ensure as smooth a transition to the new system for our customers as possible, with least wasted cost. Changes to tariff and market structures before this move will require changes to be made in parallel to both the existing and new billing systems – which would be inefficient and wasteful – and would increase the risk of problems on introduction of the new system.

<u>Alternative proposals</u>

59. We recognise that many consumers are dissatisfied with the market and we welcome Ofgem's intention to address this problem and improve levels of consumer engagement. The challenge is to build trust in the market, better equip customers to make informed switching decisions, highlight the potential savings from switching, and alert consumers to the existence of quick and easy switching routes that do not rely on internet access. We believe that all of these objectives can be achieved through remedies which avoid the potential adverse impacts on competition of Ofgem's proposals.

60. We start from the principle that Ofgem should not be banning particular transactions (provided that they are fair), but should be setting down standards of disclosure and clarity so that consumers can, to the greatest extent practicable, make informed choices. We want to work with Ofgem and stakeholders to promote a new, renewed transparency agenda across the marketplace. We think that there is a range of information remedies that will provide meaningful and effective support for customers in engaging with the market.

61. In considering remedies, it is important to understand how customers currently switch and will switch on an enduring basis. The vast majority of switches are completed, either proactively or reactively, on the doorstep, by phone or online.[28] Across all these routes, customers use information on their consumption or monthly or annual cost estimates to make switching decisions. Based on this, remedies to simplify the structure of tariffs are unlikely to materially influence the nature of the actual switching interaction. However, providing better information to customers both before a potential switch and at the point of switching, could well give consumers better confidence in making switching decisions.

62. Specifically, and as outlined in our response to the March 2011 proposals consultation, we consider that the transparency agenda would be best served by a package of information remedies that would include:

Common Language - Simple, consistent and consumer friendly language is essential to ensuring understanding. Existing energy terminology and nomenclature can be intimidating, misunderstood and mean different things to different stakeholders. An agreed common language for describing the tariffs, types of contract and other key characteristics of interest to consumers would be a valuable step forward in improving basic levels of comprehension in the energy market.

Energy Jargon-Buster – A glossary of customer friendly terms should be developed to define the agreed common language. This "Jargon-Buster" should be accepted, utilised and publicised by all key stakeholder including suppliers, Ofgem, Consumer Focus, price comparison sites and the media. While similar tools can already be found, there is a clear lack of consistency and clarity that could easily be eliminated if concerted industry action was taken on this matter.

Clear Tariff Label – We support measures to develop a clear, standardised format Tariff Label for every available tariff. This would include a clear disclosure of the key terms of each tariff, including details of available discounts, and the Standard Comparison figures, as outlined below.

Standard Comparison Figure – A simple comparison figure should be developed to enable consumers to easily compare different products on a like-for-like basis. We originally proposed this as a metric in 2 parts, based in part on the Annual Percentage Rate (APR) in financial services. We have further refined our thinking, based on the issues raised by Ofgem's proposals and research and now think that this figure needs to be composed of:

- a Standard Equivalent Rate, expressed in pence per unit, to include VAT, which would break the overall annual cost at industry average consumption to a single cost per unit, for easy comparison; and

[28] Customer Engagement with the Energy Market – Tracking Survey, Ipsos MORI, 28 January 2011

- a calculation of the total bill in pounds (either per day or per year) at low, medium and high consumption levels. Those consumption levels should be approved or set by Ofgem.

Consumer research should be used to fine tune this metric. If sufficiently consumer-friendly, it could be reflected in annual statements, displayed in all Tariff labels and used by customers in price comparisons, regardless of switching route. This would allow quicker, 'at a glance' comparisons, across a range of tariff structures, without the need to restrict or minimise tariff formats or innovation. As an example, we have included illustrative Standard Comparison Figures for three existing ScottishPower tariffs in the table below (please note, this is not intended to show the format of a proposed Tariff Information Label).

Table 4 - Illustrative Standard Comparison Figures

Tariff Name	Standard (Dual Fuel)	Fixed Price Energy January 2015 (Dual Fuel)	Help Beat Cancer – Discounted Energy January 2015 (Dual Fuel)
Payment Method	Direct Debit	Direct Debit	Direct Debit
Standard Equivalent Rate (PPU) (inc. VAT)	Gas - 4.209p Elec - 14.904p	Gas - 4.504p Elec - 15.268p	Gas – 4.082p Elec – 14.457p
Estimated Annual Bill (inc. VAT):			
Low User	£837.22	£885.64	£811.51
Medium User	£1169.49	£1230.12	£1133.77
High User	£1606.72	£1681.79	£1557.83

Up to date, prominent, product list – We would recommend that all suppliers should be required to publish an up to date, accurate product list, detailing all available tariffs at a particular point in time. This could be accompanied by relevant bill figures and could be made interactive on supplier websites, allowing customers to select information for their particular region and circumstances, where appropriate.

Standard format – To be used to the extent practicable for the presentation of the information described above.

63. Within this framework, suppliers would be expected to strive hard to achieve a step change in the transparency and clarity of presentation of tariffs, but there would not be restrictions on what is on offer. We believe that this package of measures could provide consumers with straightforward, clear and consistent information on tariffs that would enable easier and quicker comparisons across the board. We would encourage Ofgem to assess these proposals in full and on its merits before dismissing or overlooking these.

64. All the above must be accompanied by collective measures to re-build trust in the market. It is right that suppliers should be challenged when they get it wrong – but equally, in order to help build consumer faith in the industry, it should be recognised when they get it right. As the independent economic regulator, Ofgem has an important role to play. We believe there could be real value for consumers in Ofgem, perhaps in conjunction with consumer bodies, conducting a sustained and targeted switching awareness campaign. The campaign would be targeted particularly at customers who have yet to switch supplier or tariff and

would continue to build on the positive work from the Consumer Energy Summit to encourage consumers to 'Check, Insulate and Save'. This campaign could reassure customers that it is generally easy and 'hassle-free' to change supplier – and perhaps alert them to under-used telephone based switching and comparison services. In conjunction with this, suppliers are working on ways to accelerate the switching process and reduce the barriers.

65. Ofgem should also consider the ways in which customers switch supplier or have opportunities to do so. We welcome measures to bring the Confidence Code back within Ofgem's remit and think that that this will help to drive consumer confidence in switching sites.

Proposal 2 – Strengthen Probe Remedies – domestic

66. We think it is right that Ofgem continues to review the market and provide regular reviews on progress against the remedies that it introduced as part of the 2008 Energy Supply Probe ("the Probe"). We are committed to making our customer billing and other information as user-friendly as possible. We very much recognise the importance of core standards in this area though we would also note the importance of allowing for some flexibility to allow suppliers to innovate and compete in their customer service.

Proposals on Bills and Annual Statements – BROADLY SUPPORT

67. We fully support the objectives which underpin Ofgem's objectives in this area, namely greater clarity, consistency and value across the information given to customers. In the interests of Better Regulation, and assuming that all suppliers are supportive of these proposals, we would prefer to work towards these objectives in conjunction with Ofgem and consumer groups on a co-operative basis and without the need for additional regulation. Our preference is therefore Ofgem's 'option 1', to rely on existing SLC 31A. However, if Ofgem is concerned that not all suppliers would engage in this way, we can understand the need for further prescription through the Licence Condition.

68. We are supportive of steps to standardise the look and feel of the Annual Statement, including universal wording and the presentation of key information in an agreed format. Prescription of key wording, such as contract terms or the switching reminder, would improve the consistency and comparability of the information given to customers and eliminate issues of interpretation. This would also assist to build a strong base for consistent wording for products or tariffs. There will be a delicate balance in developing a consistent language, to ensure that information is legally correct, in relation to suppliers' contract terms, but clear for customers to understand. For example, a Fixed Term period end date is not necessarily the same as a Contract End date, as a customer may continue in contract with a supplier on standard terms at the end of a fixed term period. We would be happy to work with Ofgem in developing this terminology.

69. In addition, and subject to any system constraints, we think that the Annual Statement in particular should aim to have a standard format and possibly even a standard heading or logo, so that consumers can easily identify what it is and what it is used for. We would like suppliers to be able to continue using their own colours or branding around this standardisation, but would like to work with Ofgem to understand how this would be possible.

70. In terms of the level of information to be provided to consumers, we think that there would be value in a review of the overall impacts of the proposed changes,

to ensure that the information sent to customers is pitched at the optimum level to engage customers and to avoid the unintended effects of 'information overload.' For example, we note the proposal to include a standardised 'Tariff Information Label' in addition to the Principal Terms of the customer's relevant Domestic Supply Contract. However, we envisage that some of this information may be duplicated in both the Principal Terms and Tariff Information Label, such as details of cancellation charges and any fixed term period end date. In order to ensure that the information is as effective for customers as possible, we would recommend presenting the information in as simple and straightforward a format as can be achieved, avoiding such duplication.

71. Our biggest concern with this proposal is the potential scale of IT change needed to introduce these remedies, and the costs associated with these. We are keen to work with Ofgem to introduce these changes as quickly and efficiently as possible but we would request some recognition of the fact that we will shortly be commencing a move to a new customer service and billing system, which will ultimately make our existing (legacy) billing system redundant. We wish to avoid making changes in two billing systems at the same time, in order to minimise risks to the programme and the chances of error or poor customer service. We would also naturally wish to avoid any risks of disproportionate cost. We understand the need to make these changes to help customers, and we recognise that much of this (such as formatting and static language) can be implemented sooner. However, where personalised information needs to be provided to customers, such as a personal saving or annual spend amount, this will require intervention with the billing system. In that case it would be helpful if changes could be phased in a way that would mitigate clashes with our system migration, recognising that more straightforward changes can be made sooner.

72. We understand the rationale behind Ofgem's proposal that bills and Annual Statements should be sent separately, to increase the impact of the Annual Statement and draw customers' attention to it. However, this will have an impact on costs to customers as there will be a natural increase in printing and postage costs and in the resource to support customer calls triggered by these separate communications. We estimate that this cost will be £0.35 per customer. While this is probably manageable for our customers, we would like the opportunity to ensure cost efficiencies wherever possible, through sending information to customers at the same time. If Ofgem wishes a separate mailing for the annual Statement, we think it could usefully be combined with other similar information. For example, the current Standards of Service leaflet is sent with bills, but would fit nicely with the Annual Statement, providing customers with a single information point each year, while minimising costs in a practicable way.

73. There is less scope to standardise bills because of the need to reflect the characteristics of the product in question, and because of the role played by bills in innovation and supplier differentiation. However, we recognise that Ofgem may wish to standardise the presentation of the information around previous consumption and future illustration of spend, in line with the Annual Statement requirements. We are comfortable with this, although would be reluctant to otherwise lose the ability to differentiate our brand in our bill format, which has been developed based on feedback from our customers on their preferred bill 'look and feel.'

74. One remaining point of concern around the proposed modifications to SLC 31A is the requirement to ensure that all information is presented in a format that is 'clear and easy to understand, does not mislead the customer and is fair in terms

of content and presentation'. To be clear, we do not have a concern with this requirement in principle. However, this requirement does by its nature contain a level of subjectivity in its interpretation. Some information on the bill will be less easily understood by its very nature, such as the gas conversion calculation. Other information will have been developed in a format which aims to make it as clear as possible, and which has been tested with customers, but which Ofgem may not think is the best format. We would be interested to understand how this requirement would be enforced in practice. Our preference would be for Ofgem to adopt a two stage process to support any 'principles' within the Licence that require some level of subjective interpretation. This would allow Ofgem to raise concerns and suppliers to answer or address these in a fair and efficient way, without placing an unfair burden on suppliers in terms of potential enforcement action. We also think that this would work better for consumers, allowing identified areas of harm to be addressed as quickly as possible. We explore this concept further in relation to Proposal 3 – Standards of Conduct.

<u>Changes to language and format of price increase notifications – BROADLY SUPPORT</u>

75. Our own customer research indicates that many customers only engage with the market when they need to, and price increase notifications are an important trigger for this. We agree that customers deserve the right level of information to prompt them to take action and at an appropriate time. In response to concerns over the quality of information provided to customers at such times, we have actively sought to improve our price change notifications to customers. We are pleased that this effort, particularly our efforts to provide individual customers with a personalised illustration of their forecast costs on the new prices, was recognised as best practice by Consumer Focus in its recent open letter to Ofgem.[29]

76. We are therefore sympathetic to the proposals to strengthen SLC 23 to improve the quality of information provided to customers at a price change. We support Ofgem's proposals to provide additional personalised price and tariff information to customers at the point of a price change.

77. While we would prefer to retain the right to format price change notifications in accordance with the 'look and feel' of our existing customer communications, we can accept the premise that customers would respond better to a standardised notification format, and that this will help customers better understand the impacts of the change. The draft formats presented by Ofgem in the consultation document look straightforward and we would be happy to work with Ofgem to develop these as appropriate. We would like suppliers to be able to continue using their own colours or branding around this standardisation, but would like to work with Ofgem to understand how this would be possible.

78. We are comfortable with providing an annual estimate of the cost of the change, as an illustrative '£ per year' figure. We are concerned that credit customers may make misleading comparisons between the "£ per month" figure from the price comparison, which is an annual average, and their monthly billed amount, which varies seasonally. We think that a '£ per year' figure will be more easily comparable with actual bills, and will result in larger savings (in absolute terms) in tariff comparison tables, which is more likely to motivate customers to switch.

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[29] Letter to Ofgem on Energy Tariffs, Consumer Focus, November 2011

79. We agree that key price change messages should not be obscured behind a mass of marketing copy but we are concerned that an overall ban on marketing materials would not be in the interests of consumers. In particular, price increases or product maturities are active switching prompts and present a key opportunity for suppliers to encourage customers to engage with their product options. Such a restriction would run contrary to overall aims of the RMR.

80. We are also concerned about the proposed amendment to require suppliers to include 'a statement to consider switching supplier'[30], in addition to a reminder that they can change supplier. This is counter-intuitive and at a time when trust in the industry is low, and sends a poor message to customers, implying that "you are not valuable to us." We cannot think of any industry where such a step would be considered necessary or appropriate. It could also constitute bad advice to the consumer if, as if often the case, the price increase is as a result of changes in world markets or regulation which affect all suppliers, or if the adverse change was of minor or even insignificant impact. (In this context, we wonder whether it is proportionate to remove the word "significant" from the condition, meaning that this notification procedure, with the associated cost, is needed for insignificant matters.)

<u>Changes to 'Right to Cancel' process – DO NOT SUPPORT</u>

81. Ofgem is proposing changes to the existing 'right to cancel' process, including extending the current window in which another supplier can apply to take the customer's supply, from 15 working days to 30 working days. Ofgem's view is that this will allow the new supplier enough time after the cooling off period to apply to take the supply. We are not aware of any current problems with this timescale, nor any evidence that Ofgem has presented that this is not working for customers under the present arrangements. Indeed, the new supplier currently has a strong incentive to apply to take that supply as quickly as possible after the cooling off period, not just due to the importance of gaining a new customer, but due to the new 3rd Package Licence Conditions requiring a switch to be completed within 21 calendar days after the cooling off period. On that basis, we do not see that this is a necessary change.

82. In addition to this, Ofgem has proposed a modification to the Condition that would allow a customer to avoid the increase if they move to a different tariff or product with their existing supplier. We can understand that this proposal is designed to encourage customers to engage with products and we can support this intention. However, we are concerned that the consequence of this proposal, particularly as currently drafted, will effectively require a supplier to ensure that all alternative tariffs available are not impacted by the price change. In practice, fixed price offers are likely to be re-priced at a similar time to a change in standard pricing. If, in the light of the concerns we have expressed on the core tariff proposal, suppliers were allowed more than one variable product, then this element might need revision. We suggest that the drafting of this element is re-thought once the major points of principle are settled.

83. We consider that the cancellation right should not apply in relation to changes in the Ofgem-determined standing charge, if implemented.

[30] Condoc Figure 5, page 47

Enhanced monitoring

84. We note the Ofgem is seeking views on enhancing its monitoring of suppliers' Licence compliance. As before, we think it is right that Ofgem continues to monitor the effectiveness of its remedies in protecting consumers and supporting competition. We are interested in the detail of this monitoring and would be pleased to take part in the debate on information currently collected and its usefulness, and additionally, any useful or more appropriate information that is currently not collected.

Proposal 3 – Standards of Conduct

85. Consumer trust will play a vital role in building better engagement within the energy market and in fact we would suggest that it is one of the biggest contributors to extended consumer disengagement in the current economic climate[31]. Continued lack of trust in suppliers and the ongoing perception that energy suppliers are underhand and misleading customers will remain a significant barrier to encouraging consumers to making better and more informed switching decisions. Ofgem, industry and stakeholders will need to work together to re-build trust in the industry, if we are to successfully encourage customers that there is value for them in engaging with their energy supply.

86. We therefore believe that there is merit in reviewing the current operation of the Standards of Conduct and how these work for consumers. We understand Ofgem's concern that, as there are no direct enforcement powers supporting the Standards, they tend to be overlooked in relation to the more specific Licence Conditions.

87. The Standards of Conduct are standards that we believe all suppliers would want to meet in servicing their customers and, in that respect, they should form a key component of the enduring retail market. We therefore support proposals to enshrine the Standards of Conduct in a suitable over-arching Licence Condition.

88. Such 'principles-based' regulation is a recognised approach, used by other sectoral regulators such as the Financial Services Authority. However it must be recognised that it represents a significant departure from the rules-based licence conditions traditionally used in the energy sector. While we are happy to develop this new approach in conjunction with Ofgem and industry, it will be important that it is accompanied by an appropriate enforcement regime.

89. The current Licence Condition modification and enforcement regime is designed for enforcing specific, rules-based regulation, as it assumes a clear understanding by suppliers of the extent of the application of that Licence Condition and allows Ofgem a direct and immediate power of enforcement action. We believe a two-stage enforcement approach will be more appropriate for principles-based regulation.

90. The key feature of a two stage enforcement regime is that licensees are given a reasonable opportunity to remedy any breach before they become liable for a penalty or enforcement order. For example, a useful precedent is the bespoke

[31] Almost three-quarters of respondents to the YouGov survey were "very" or "fairly" cynical about the market. YouGov report for Scottish Power, February 2012, page 6

enforcement regime that Ofgem introduced for Condition 25A (Prohibition of undue discrimination in supply), which normally has three stages[32]:

Stage 1: Ofgem writes to the Supplier, giving it an opportunity to respond and provide objective justification for a suspected breach.

Stage 2: If Ofgem is not satisfied with the response, it writes to the Supplier explaining why it is not satisfied and allowing the Supplier a reasonable time to respond; if, at this stage, the Supplier revises its pricing, Ofgem is unlikely to take further action, unless there is evidence of a persistent failure to comply.

Stage 3: If the Supplier does not revise its pricing, Ofgem will make the case for a licence breach and continue enforcement in line with existing Enforcement Guidelines, potentially leading to a financial penalty and/ or an enforcement order.

91. In exceptional circumstances Ofgem reserves the right to proceed directly to enforcement action. This maintains deterrence in the most serious cases.

92. Similar approaches are also employed by other regulators. For example, the Communications Act 2003 sets out a two stage enforcement process which Ofcom must follow in enforcing telecommunications regulations:

Stage 1: Following an investigation, Ofcom issues a 'Section 94' notification explaining why it considers there has been a contravention and giving a deadline (normally one month) to remedy any ongoing contravention.

Stage 2: If the company does not comply with the Section 94 notification, Ofgem may issue a 'Section 95' enforcement notification and may also impose a financial penalty under Section 96.

93. We consider that it would be necessary for Ofgem to adopt a similar enforcement approach for the Standards of Conduct as it has for Condition 25A. This would mitigate any unintentional differences in interpretation of the high level principles between Ofgem and suppliers.

94. It will also be important to consider how principles-based regulation will work in the wider context of the European market, since we have seen a continued preference at EU level for rules-based regulation, for example the detailed requirements that have been driven through the Third Package Directives.[33] Given that the ultimate aim of the EU will be a single market with a consistent level of regulation, this may prove a challenge to principles-based regulatory framework that will need to be carefully managed.

95. We also think that the SOCs should not apply to relationships between a supplier and larger industrial and commercial customers. This is not because we would not aim to apply those standards in our interactions, but because such customers will have their own purchasing departments and may be legally represented in negotiations with suppliers. It is not necessary for such discussions to be subject to regulatory supervision.

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[32] 'Guidelines on Cost Reflectivity between Payment Methods and the Prohibition of Undue Discrimination in Domestic Gas and Electricity Supply Contracts', Ofgem, 7 August 2009, p19.

[33] Directive 2009/73/EC (Gas Directive) and Directive 2009/72/EC (Electricity Directive)

Annex 2

Impact of fixed standing charge on propensity to switch

Consumers will generally be willing to switch only if the anticipated cost saving is sufficient to justify the anticipated effort and time expenditure in switching and the anticipated risks (eg making a bad decision or experiencing subsequent hassle).

Ofgem's analysis considers the effect of its tariff simplification measures on the effort and risk side of the equation, but ignores the effect on the cost saving. This is reasonable in case of information measures which do not affect the available savings. However, the modelling presented in this annex shows that imposition of a fixed standing charge will directly affect the achievable cost saving and may actually reduce the amount of switching, if the impact on cost savings outweighs the impact on effort and risk.

The imposition of a fixed standing charge has the effect of converging prices at low consumption levels, reducing the incentive to switch for such customers. The impact on switching has been modelled for two scenarios (using the methodology described below):

a) a 'maximum saving' scenario in which switching propensity is based on the price difference between the most expensive and cheapest tariff at the relevant consumption level; this would correspond to a situation where switching decisions were triggered by generic advice on potential savings;

b) an 'actual saving' scenario in which switching propensity is based on the price difference between the customer's actual tariff and the cheapest tariff; this would correspond to a situation where switching decisions were triggered by more tailored information (such as might be available from published tariff comparison tables).

The results of the modelling are shown in the following table.

Table 5 - Propensity to switch - Gas, Electricity and Average

	2007 consumption data					
Proportion of consumers who would be willing to switch based on:	**Gas**		**Electricity**		**Average**	
	Status Quo	**Fixed SC**	**Status Quo**	**Fixed SC**	**Status Quo**	**Fixed SC**
Maximum saving (most expensive supplier versus cheapest supplier)	88%	79%	88%	76%	88%	78%
Actual saving (own supplier versus cheapest supplier)	62%	59%	39%	31%	50%	45%

The reduction in switching propensity (averaged over gas and electricity) arising from a move to fixed standing charges ranges from 10 percentage points (based on maximum saving) to 5 percentage points (based on actual saving).

Methodology

The proportion of consumers who would be willing to switch for a given tariff structure is calculated as follows:

$$S_{max} = \int_0^{\infty} \rho(c)\, s(\Delta p_{max}(c))\, dc$$

$$S_{actual} = \sum_i m_i \int_0^{\infty} \rho(c)\, s(\Delta p_i(c))\, dc$$

Where:

S_{max} is the proportion willing to switch based on the maximum saving (most expensive supplier versus cheapest supplier).

S_{actual} is the proportion willing to switch based on the actual saving (own supplier versus cheapest supplier)

ρ(c) is the probability density function of consumption *c*

$s(\Delta p)$ is the proportion of customers willing to switch for an annual saving of Δp

$\Delta p_{max}(c)$ is the maximum saving at consumption *c* (most expensive tariff versus cheapest)

m_i is the market share of Supplier *i*

$\Delta p_i(c)$ is the saving for a customer of Supplier *i* at consumption *c* (actual tariff versus cheapest).

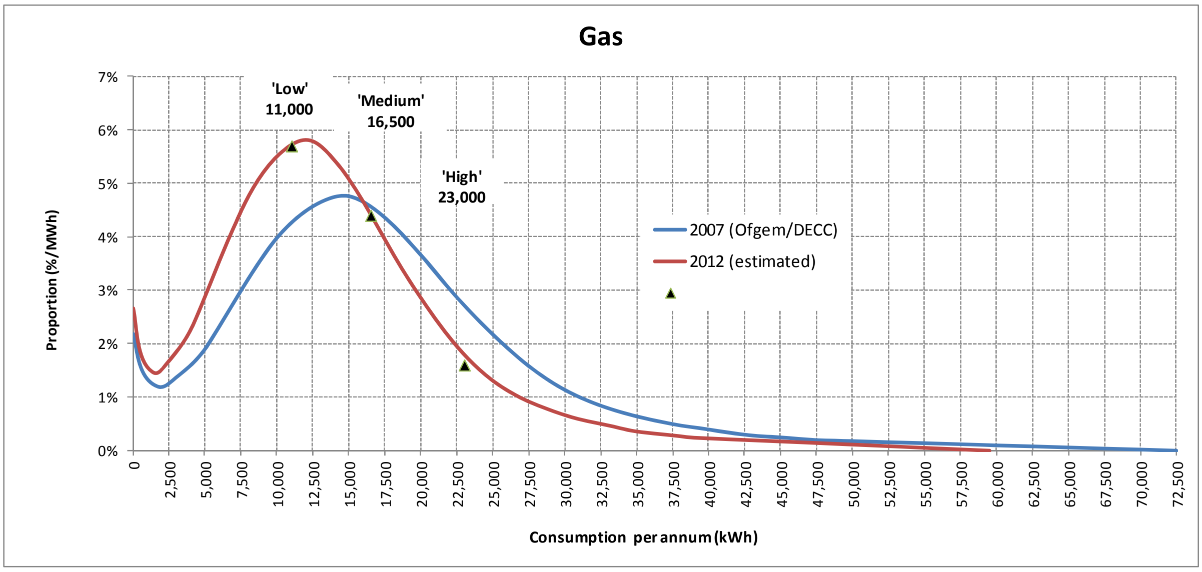
Distribution of consumption

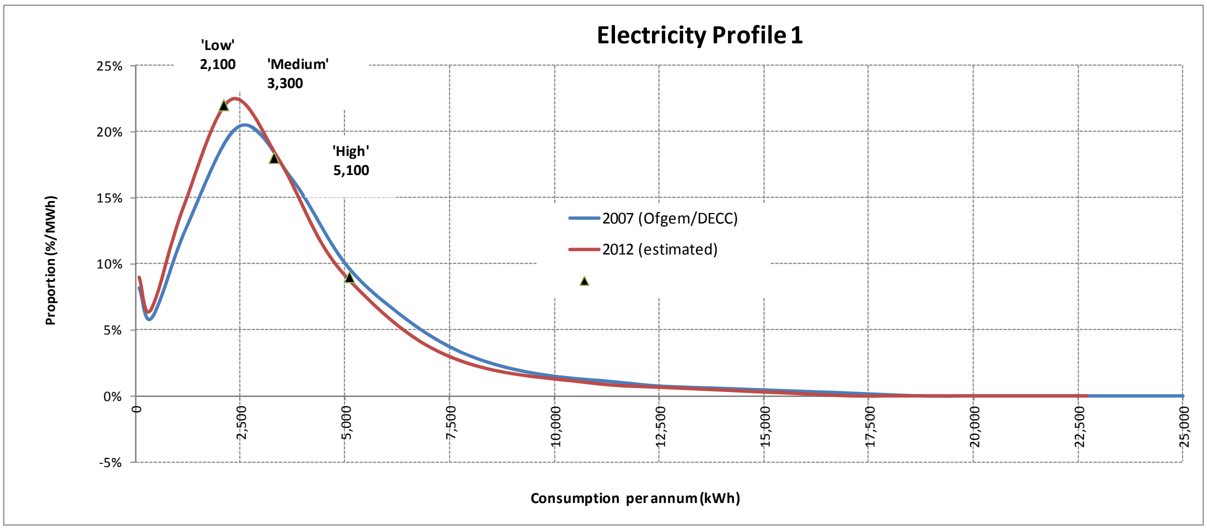
The distribution of customers by consumption, ρ(c), is based on distributions derived by Ofgem from DECC data[34]. These distributions related to 2007.

For the purpose of sensitivity analysis, the impact of falling average consumption resulting from energy efficiency measures has also been modelled. Consumption trends in the Ofgem report suggests that average gas consumption fell by an average of 3.7% pa over the period 2005 to 2009, and average Profile 1 electricity consumption fell by an average of 1.9% pa over the same period.[35] Gas and electricity distributions for a notional "2012" have been estimated by scaling the 2007 data by -18.0% and -9.2% respectively. Even if actual consumption levels in 2012 are higher than this, these lower consumption levels may be representative of future years when additional energy efficiency programmes have taken effect.

[34] 'Revision of typical domestic consumption values', Ofgem, 10 August 2010, page 8 http://www.ofgem.gov.uk/Markets/RetMkts/Compl/Consumption/Documents1/Review%20of%20typical%20domestic%20consumption%20values.pdf

[35] Ibid, page 11



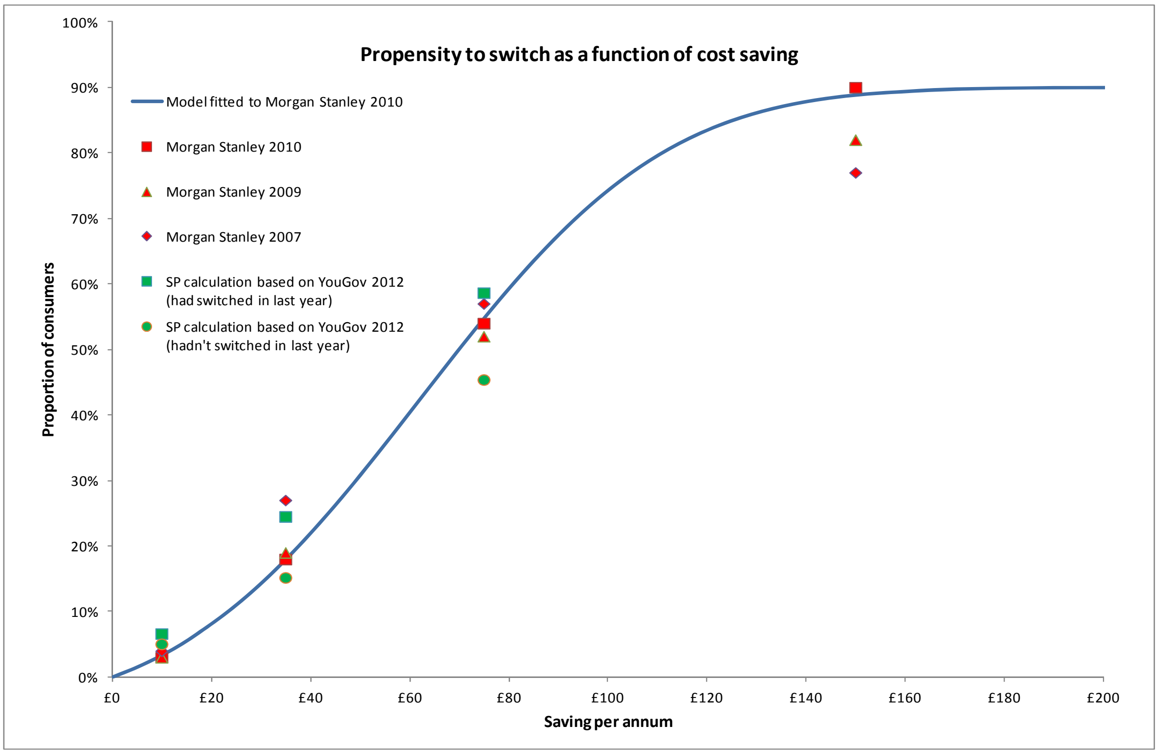


Proportion of customers willing to switch

The proportion of customers willing to switch for a given annual saving, *s(Δp),* is modelled using the curve shown in the chart below, chosen to fit the most recent data from the Morgan Stanley survey (2010).[36] These data points are shown, together with data from other sources for comparison.

The curve is a cumulative normal distribution with mean of £62 and standard deviation of £39, and is adjusted to go through the origin. The survey questions on which the data points are based were typically expressed as a range of savings (eg '£50 to £100' or 'Up to £50'). Data points have been plotted at the midpoints of these ranges, except that data points for the category 'Over £100' are plotted at £150. In most of the surveys a proportion of customers said no saving would be enough for them to switch. This was 10% in Morgan Stanley (2010), hence the curve flattens off at 90%.

[36] Morgan Stanley Energy Supply Survey, January 7, 2011, page 10



We assume that most switchers will be switching gas and electricity together (ie a dual fuel contract), so the relevant saving for the purpose of the propensity model is the combined electricity plus gas saving. We therefore calculate the propensity to switch based on twice the individual fuel saving, ie:

$$s_{gas} = s(2\Delta p_{gas}) \qquad s_{elec} = s(2\Delta p_{elec})$$

Tariff structures

The estimated savings under 'status quo' are based on recently announced tariffs for the Big 6, for credit customers paying by cash, excluding any prompt payment discount and dual fuel discount. Market shares are approximate, based on retail revenues in segmental accounts.[37]

Table 6 - Tariff assumptions (inc VAT) - Gas

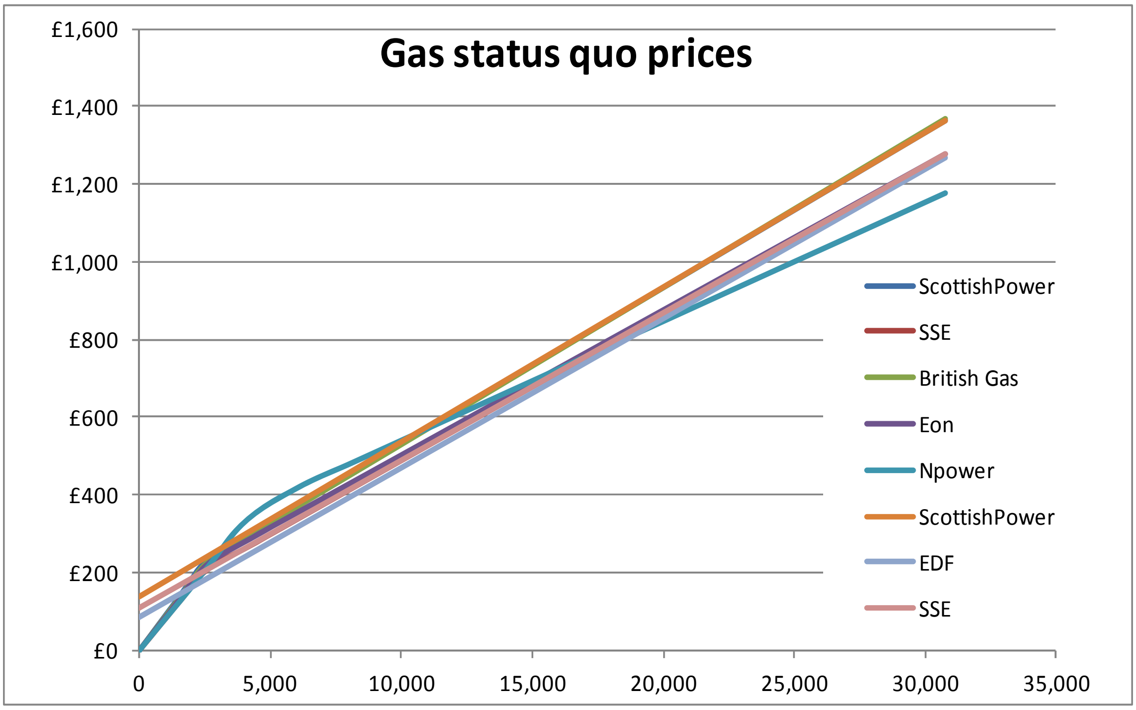
		Status quo - NSC			**Status quo - SC**		**Regulated SC**	
Supplier	Market share	Tier 1 (p/kWh)	Tier 2 (p/kWh)	Threshold (kWh pa)	SC (£ pa)	Unit rate (p/kWh)	SC (£ pa)	Unit rate (p/kWh)
ScottishPower	8%	9.0322	3.9939	2,680	£135.03	3.9939	£42.00	4.6048
SSE	15%	8.1767	3.7993	2,500	£109.58	3.7993	£42.00	4.2415
British Gas	43%	8.7491	4.0301	2,680			£42.00	4.5842
Eon	14%	8.5733	3.7296	2,680			£42.00	4.3059
Npower	13%	8.1903	3.0662	4,572			£42.00	4.3092
EDF	7%				£84.32	3.8483	£42.00	4.1357

[37] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/FIR_results_Final.pdf

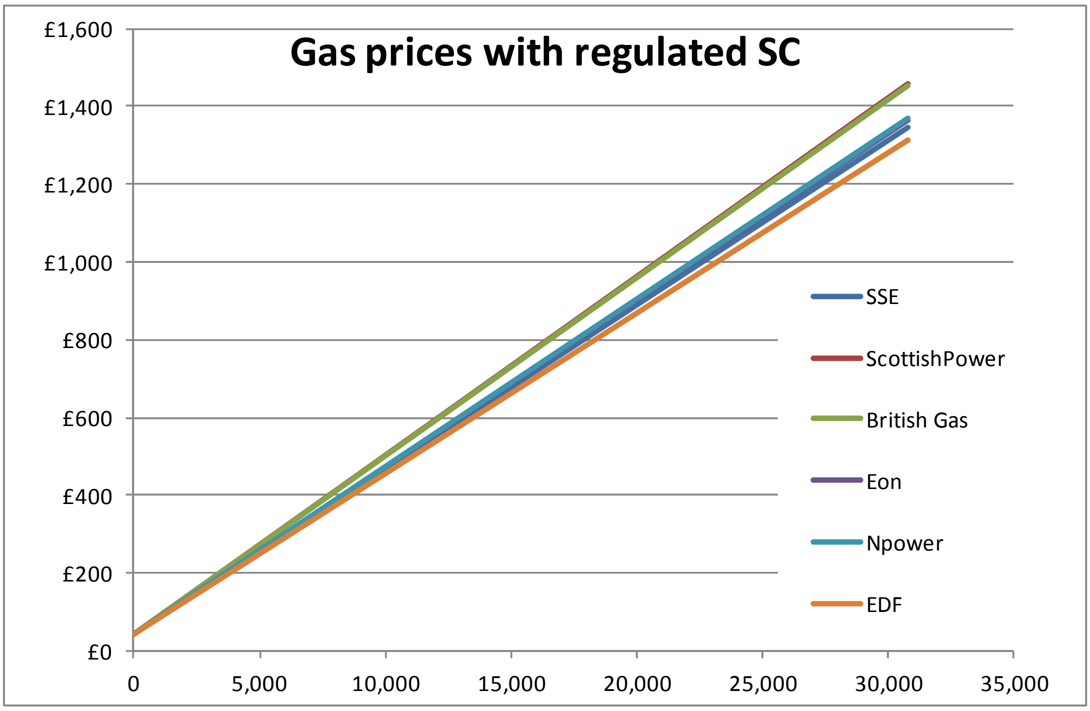
Table 7 - Tariff assumptions (inc VAT) - Electricity

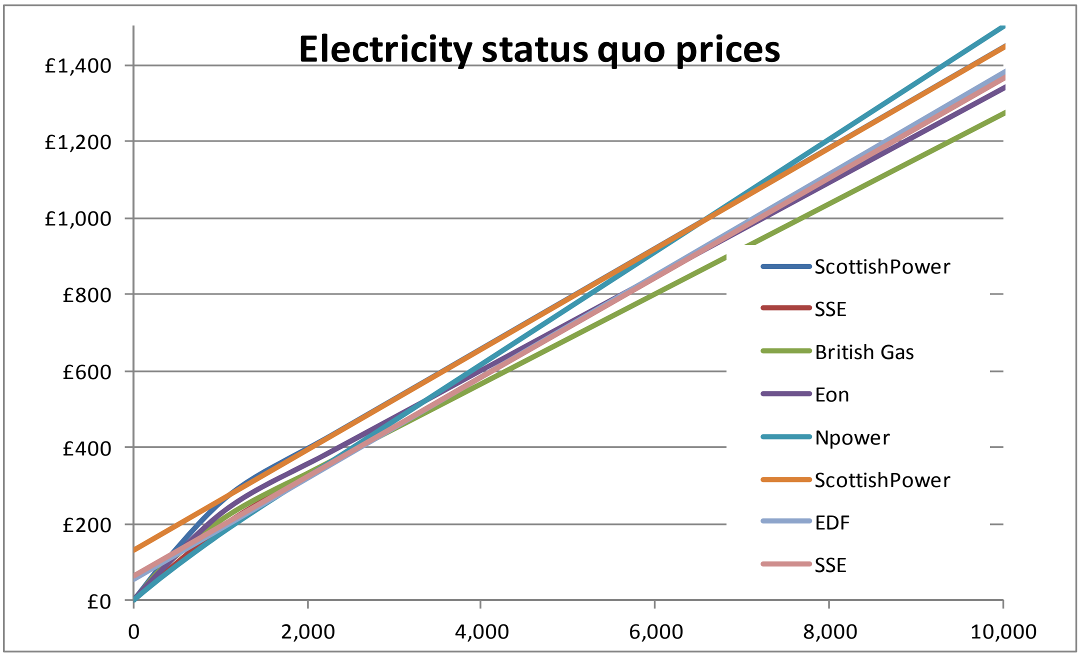
		Status quo - NSC			Status quo - SC		Regulated SC	
Supplier	Market share	Tier 1 (p/kWh)	Tier 2 (p/kWh)	Threshold (kWh pa)	SC (£ pa)	Unit rate (p/kWh)	SC (£ pa)	Unit rate (p/kWh)
ScottishPower	12%	27.8254	13.1431	900	£132.14	13.1431	£51.00	15.2395
SSE	20%	19.7280	13.0193	941	£63.20	13.0193	£51.00	13.2982
British Gas	22%	24.9911	11.7794	720			£51.00	12.9089
Eon	18%	24.4493	12.3060	900			£51.00	13.8008
Npower	14%	18.5355	14.7315	728			£51.00	14.0800
EDF	14%				£53.66	13.2570	£51.00	13.3290

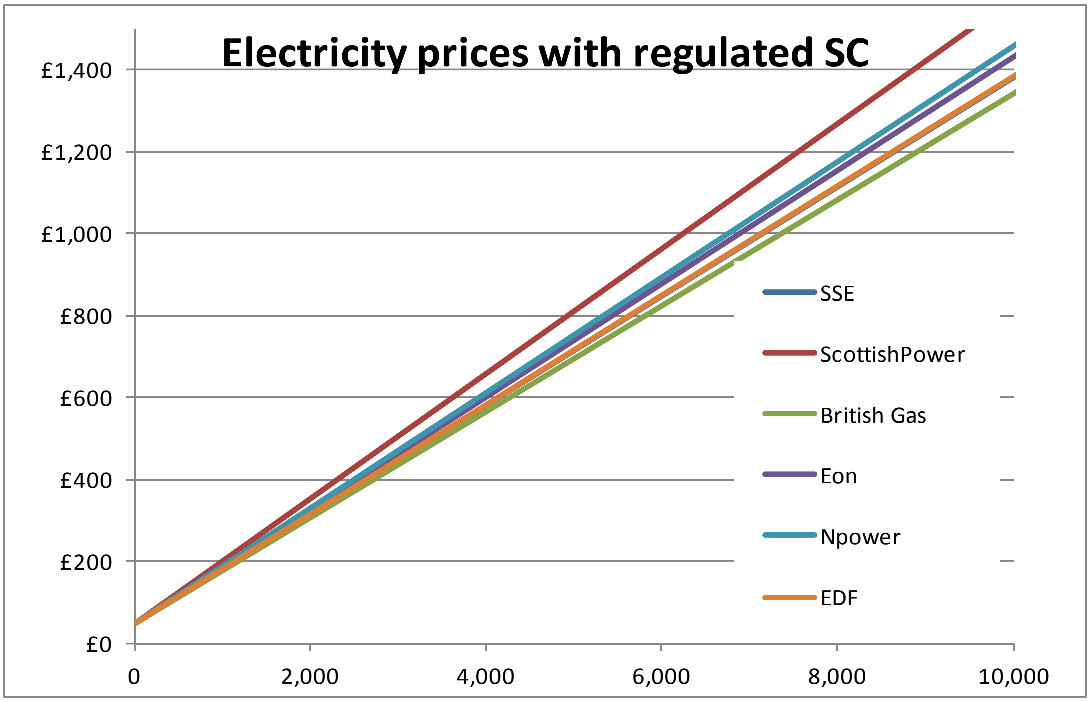
The regulated standing charges are set at the midpoint between the 'narrow' and 'broad' levels proposed in Ofgem's recent consultation.[38] The unit rates are set to maintain the same level of revenue as the supplier receives under status quo. (Where suppliers have both SC and NSC tariffs, low consuming customers are assumed to opt for NSC.)



38 http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Standardised%20element%20consultation.pdf

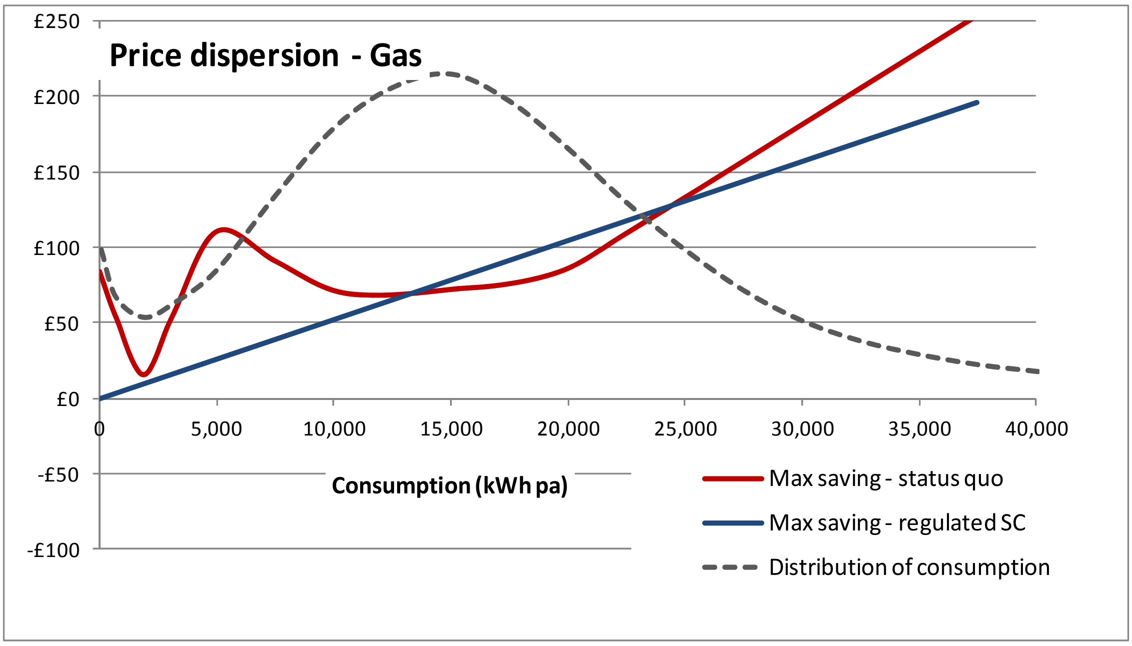

Gas prices with regulated SC
£1,600
£1,400
£1,200
£1,000
£800
£600
£400
£200
£0
0
5,000
10,000
15,000
20,000
25,000
30,000
35,000
SSE
ScottishPower
British Gas
Eon
Npower
EDF

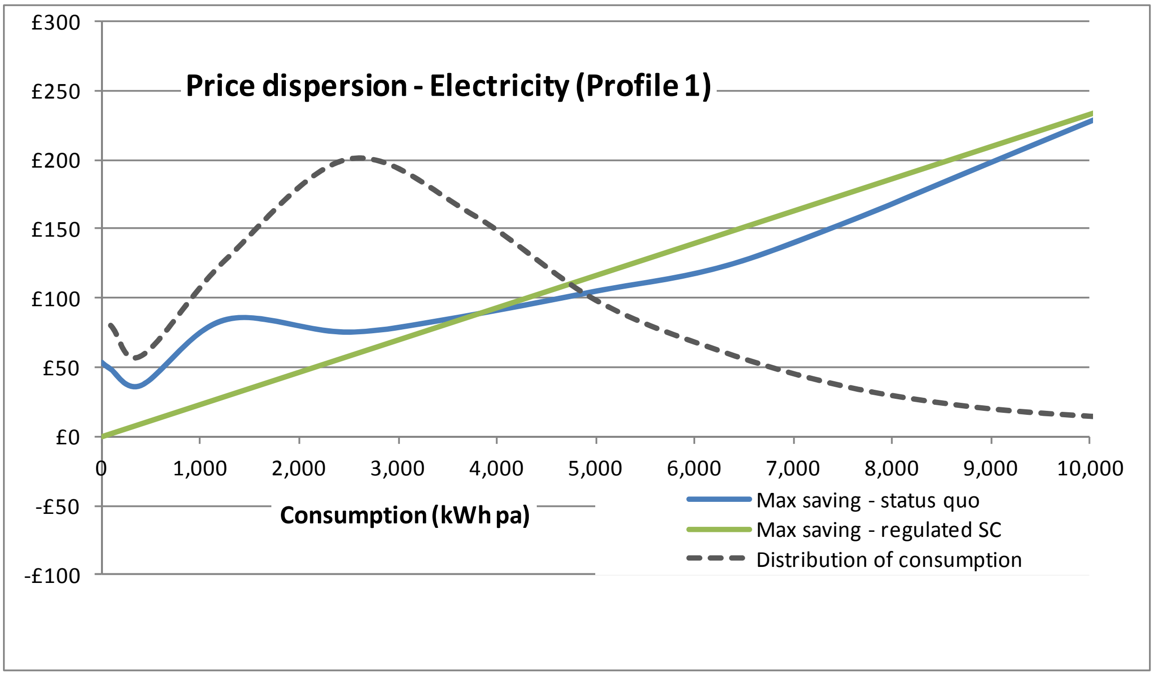

Electricity status quo prices
£1,400
£1,200
£1,000
£800
£600
£400
£200
£0
0
2,000
4,000
6,000
8,000
10,000
ScottishPower
SSE
British Gas
Eon
Npower
ScottishPower
EDF
SSE



Price dispersion

The effect on price dispersion (maximum available saving) is shown in the charts below, with the distribution of consumption (2007) overlaid.





Sensitivity analysis

The central case above assumes that the regulated standing charge is set at the midpoint of the range identified by Ofgem in its January 2012 consultation and is based on 2007 consumption statistics.

The first table below shows how the results vary when the standing charge is set at 25% and 75%. The second shows the impact of using extrapolated "2012" consumption data instead of 2007 consumption data (assuming standing charge at midpoint of range)

Table 8 - Sensitivity analysis

	Mean of Electricity and Gas					
	(25%)		**Central Case (midpoint)**		(75%)	
Proportion of consumers who would be willing to switch based on:	Status Quo	Fixed SC	**Status Quo**	**Fixed SC**	Status Quo	Fixed SC
Maximum saving (most expensive supplier versus cheapest supplier)	88%	75%	**88%**	**78%**	88%	79%
Actual saving (own supplier versus cheapest supplier)	50%	39%	**50%**	**45%**	50%	49%

	Mean of Electricity and Gas					
			"2012" consumption			
Proportion of consumers who would be willing to switch based on:			Status Quo	Fixed SC		
Maximum saving (most expensive supplier versus cheapest supplier)			88%	73%		
Actual saving (own supplier versus cheapest supplier)			49%	38%		

<u>Annex 3</u>

ScottishPower response to Ofgem's Retail Market Review consultation questions

Question 1: Do stakeholders agree that we should introduce the RMR core proposal?

No, we do not agree with the RMR core proposal. In particular, we are strongly opposed to:

- standardising the fixed element of evergreen tariffs, which we believe carries significant risks to competition;
- the prohibition of 'behavioural' discounts in evergreen tariffs, which will lead to inefficiencies and higher costs for consumers;
- the prohibition of discounted and capped fixed term products, which significantly limits customer choice (and the scope to incentivise switching) for no obvious benefit.

We think that the core tariff proposals have not been fully considered in the wider context of the impacts on competition and on customers more generally. In contrast to the proposed 'information measures' (which we believe will have an entirely positive effect), we do not think that these tariff restrictions will increase or encourage customer engagement in the market. For customers to engage, they must first be interested and motivated to engage. Our own research demonstrates that customers do not actively want to engage in energy, unless there is a 'push' for them to do so, such as a price change and also an expectation of an appropriate payoff in terms of saving versus 'hassle.'

We are concerned that Ofgem's proposals may ultimately create more complexity for customers, by creating an unnecessary level of protection through over-regulation, and failing to give customers the basic tools that they need to understand the nature of the market, and appropriate incentives to learn about tariff options. Ofgem's underlying theory, that customers need to gain confidence in comparing simple tariffs before they can be weaned onto more complex Time of Use tariffs (enabled by smart meters), is not supported by evidence.

We also believe the proposals to restrict tariffs may have an adverse effect on competition and consumer welfare, as explained in paragraphs 20 to 50 of Annex 1, and in the independent economic appraisal commissioned from Oxera.

Question 2: Which cost elements should be included in the standardised element of standard tariffs?

We do not support a regulated standing charge for standard tariffs. We think that this will force prices to converge at lower consumption levels, reducing the potential savings from switching between tariffs, and hence reducing consumers' propensity to switch. It may also strengthen those features of the market which indicate a risk of tacit collusion.

If the fixed charge is to be standardised, it should be set at a level which strikes the correct balance between economic efficiency and cross-subsidy of low users.

Economic efficiency dictates that the fixed and unit charges should reflect underlying fixed and variable costs respectively, since this will lead to efficient consumption decisions by consumers.

We are currently considering the wider cost implications of this proposal and will respond in full in our response to Ofgem's separate consultation on this point.

Question 3: Do stakeholders agree that our information remedies would help consumers engage effectively? If not, what would be more appropriate remedies?

We fully support proposals to help customers engage in the market and become better informed on their tariffs and products. Information remedies are strongly to be preferred over more radical remedies (such as limiting customer choice) since they will achieve most of the benefits with virtually none of the costs and risks. Ofgem should confine its intervention at this stage to information remedies, and only when these have been properly tested should it consider more radical remedies.

Generally, we are comfortable with the nature of the proposed information remedies.

We have already been working with the ERA on a tariff comparison label similar to that proposed by Ofgem. While we understand the rationale for most of the proposed content, we are concerned about the 'customer satisfaction' rating. It is not clear whether this would be by supplier or product, and how this measure could be developed in a sufficiently clear and objective manner.

Question 4: Do stakeholders consider that the price comparison guide should be presented in a p/kWh figure, a £ per month figure or both?

We think the price comparison guide should be presented in a £ per year figure rather than £ per month, since:

- £ per year will be more easily comparable with actual bills, and will result in larger savings (in absolute terms) in tariff comparison tables, which is more likely to motivate customers to switch;
- credit customers may make misleading comparisons between the "£ per month" figure from the price comparison, which is an annual average, and their monthly billed amount, which varies seasonally.

Regardless of what metric and other information remedies are implemented, a strong education campaign is needed to help customers understand what that metric is, how it varies with consumption and how consumers can apply it to their circumstances.

Question 5: Do stakeholders agree that the proposed exceptions for legacy social tariffs and extremely high consumption domestic consumers are appropriate?

Beyond our general reservations with the core proposal, we are generally in agreement with the proposed exemptions for legacy social tariffs and high consuming domestic consumers. It would be a further level of upheaval for customers on social or discounted tariffs if they were forced to move to a standard evergreen tariff before their current tariff was phased out.

Question 6: Do stakeholders agree that we should not allow an exception for suppliers to offer a green standard tariff in addition to an 'ordinary' standard tariff?

Notwithstanding our comments on the wider core tariff proposal, we do not agree with Ofgem's approach here. Customers who have opted for a 'green' tariff have expressed a clear preference to support the environment and should be allowed to follow that preference in addition to their choice of tariff. Green tariffs are sufficiently distinct that they are unlikely to add to tariff confusion. Similar arguments apply to charity affinity products.

Question 7: Do stakeholders believe it would be appropriate to introduce a six-month price guarantee for standard tariffs, or do you consider that this would undermine the simplicity of the RMR core proposal?

We consider that the six month guarantee proposal would be a major barrier to entry as it increases the risk that an entrant supplier would be unable to adjust its prices fast enough to remain solvent in the event of a sudden rise in world energy market prices. It would also drive established players to significantly longer hedging strategies, which might not be in the consumer interest.

Looking at the proposal from the point of view of the dynamics of the retail market we also question the practicalities of a 6 month price guarantee for every customer when moving on to a standard tariff. To fully understand its impact, it is necessary to understand how it would work in practice. For example:

- would it mean that suppliers could not change the unit rate of a standard tariff within 6 months of the date of the last change, or would it mean that each individual customer is guaranteed to receive the price that they start supply on for 6 months, and each new price for 6 months after that?

- what happens if the gaining supplier's price is *reduced* within the first 6 months? Do new customers benefit immediately from the reduction (ie does it behave like a 'capped' product) or do new customers have to wait for the 6 months to elapse before they can benefit?

Each of these options presents an additional level of impact for suppliers and customers.

Fundamentally, we are dubious that the guarantee will have any material impact on consumer welfare or competition. The guarantee is equivalent to offering switchers a fixed (or capped) price for the first 6 months. Given that fixed products are normally priced at a premium to variable, this represents a cross-subsidy from disengaged customers to engaged. The consequence of this will be to increase the effective price differential between disengaged and engaged – which would appear to be contrary to the spirit of the RMR. Removing barriers to switching is one thing, but introducing distortive subsidies for switchers is an entirely different matter.

Question 8: Do stakeholders agree with our recommended proposal of Option 3 (introduce more prescriptive rules) for bills and annual statements?

We accept that Ofgem feels that the original intent of the Probe remedies has not been fully met. We would like to explore options to meet this intent and work with Ofgem to agree these in a less regulated way. We note that Ofgem feels that a reliance on the current SLC 31A along with further guidance to suppliers would not go far enough to address all of Ofgem's concerns, but we do not feel that this is fully explored in the document.

We would prefer to make improvements for the benefit of customers without additional regulation (Option 1), unless this is proven to be strictly necessary and appropriate. On the whole, we agree with the intent of Option 3, which would be to ensure clear and transparent language and consistent information for customers. To that end, while we would prefer to achieve this without the need for additional regulation, we accept in principle the recommended proposal of Option 3 for bills and annual statements.

A key point that Ofgem should recognise is that information provision needs to work for and with customers. Licence Conditions already require a sizeable amount of information to be given to customers in a specified format. In order to avoid 'information overload' actually causing customers to disengage with the market, we would advocate a review of the overall information effects of the proposals as a whole, and how these do or don't work to provide customers with clear, understandable and necessary information (see paragraph 70 of Annex 1).

A key point to bear in mind with this proposal is the potential scale of IT change needed to introduce these remedies, and the costs associated with these, given that we will shortly be commencing a move to a new customer billing and management system, which will ultimately make our existing (legacy) billing system redundant. It would be helpful if changes could be phased in a way that would mitigate clashes with our system migration, recognising that more straightforward changes can be made sooner (see paragraph 71 of Annex 1).

We do have a concern about the scope for differences of interpretation of the proposed SLC 31A obligation to ensure all information is provided in format that is 'clear and easy to understand …'; we believe a two stage enforcement approach would be appropriate here (see paragraph 74 of Annex 1). We have also suggested that if bills and annual statements are sent under separate cover, it should also be possible to use the annual statement mailing for other regulatory or similar information (see paragraph 72 of Annex 1)

Question 9: Do stakeholders agree with our recommended proposal for SLC 23 notifications, including price increase notifications of option 3 (Additional information plus prescribed format) and option 4 (Tighten and clarify policy intent)?

We are generally comfortable with the proposals to prescribe a format for the price increase notification and agree that this will provide comfort for suppliers in creating a standard and consistent template for such notifications.

However, we are concerned about the proposed amendment to require suppliers to include 'a statement to consider switching supplier'[39], in addition to a reminder that they can change supplier. This is counter-intuitive and at a time when trust in the industry is low, and sends a poor message to customers, implying that "you are not valuable to us". It could also constitute bad advice (see paragraph 80 of Annex 1).

[39] Condoc Figure 5, page 47

Question 10: We seek views from stakeholders on the additional requirements outlined in option 3 (Additional information plus prescribed format) for SLC 23 notices including price increase notifications.

Question 11: We seek views on any proposals to restrict the inclusion of additional materials (e.g. marketing material) along with SLC 23 notifications.

We agree that key price change messages should not be obscured behind a mass of marketing copy but we are concerned that an overall ban on marketing materials would not be in the interests of consumers. In particular, price increases or product maturities are active switching prompts and present a key opportunity for suppliers to encourage customers to engage with their product options. Restricting this would run contrary to the overall aims of the RMR (see paragraph 79 of Annex 1).

Question 12: We seek views along with any supporting data or evidence for our proposals for information signposted to consumers in option 4 (Tighten and clarify policy intent) for SLC 23 notifications including price increase notifications.

Response rates from customers indicate that messages within recent price change notifications have been clear and provide the customer with a clear call to action. We have also had response rates which indicate that consumers value information on other products that may be available to them in the time of a price increase, which may otherwise be considered marketing material. For example, ScottishPower has previously offered customers the opportunity to take advantage of selected energy products (e.g. Fixed/Capped Offers) within price change communications. The response from customers indicated that this is welcomed, for example, we have received a 10% response from customers taking up a product offering, which is a good response rate. It is in the interests of consumers to allow suppliers to offer alternatives when increasing prices.

Question 13: We seek views on any additional recommendations which stakeholders consider relevant for bills, annual statements and SLC 23 notifications.

We consider that any increase in information regulation should be considered as part of the overall information requirements for consumers. It has been widely recognised, including in a paper by the National Consumer Council and Better Regulation Executive[40], that 'too much information can harm' consumers. It is important to ensure that any additional information provision strikes the right balance in informing customers without leading to information overload.

There is already a sizeable amount of information to be provided to customers in SLCs 23 and 31A and we would recommend that the final proposed changes to the Licence Condition are considered within a robust review of the overall level and value of the information to be provided to consumers (see paragraph 70 of Annex 1).

Question 14: We intend to consult on the content of the Confidence Code separately if and when we take over the governance responsibility for it. However at this stage we welcome any early views on developing the Confidence Code.

We support this and look forward to a separate consultation on this issue. However, we believe that there is scope for Ofgem to take this further and develop an

[40] Better Regulation Executive and National Consumer Council (2007), Warning! Too much information can harm

independent, trusted switching advice site that would provide consumers with a ready source of switching information (but not a switching service *per se*). We believe customers would respond to this and it would help to address some of the concerns that Ofgem has expressed elsewhere within the RMR, while avoiding the significant adverse impacts to the competitive market.

Question 15: We welcome views from stakeholders on our proposals for enhanced monitoring.

Question 16: We invite specific views on costs and other implications if we were to introduce our proposals. Please provide details and cost estimates where appropriate broken down by each proposal.

Indicative costs are given in Table 9.

Table 9 - Indicative direct administrative costs of selected Ofgem proposals

Proposal	Costs (indicative)	Recurring or one-off cost
Core Tariff Proposal	£1.5m - £2.5m	Recurring, in line with Ofgem annual review of fixed standing charge (includes IT costs, communications costs, amendments to pricing literature and contact centre impact
Proposals on bills and annual statements: Split out Annual Statement	£1m	~80% of the cost will recur annually (to reflect cost of 2 separate communications, incremental mailing costs and contact centre impact)

We believe that the more significant costs to customers and suppliers will arise from the removal of discounts and the fixed standing charge element of the RMR Core Tariff proposal. We will give further consideration to these costs in our response to Ofgem's Fixed Standing Charge Consultation.

Question 17: Do you consider the revised SOCs will help achieve our objectives?

Yes, we think that the Standards of Conduct will help Ofgem achieve the standards that they are looking for within the market.

Question 18: Do you agree the revised SOCs should apply to all interactions between suppliers and consumers?

We agree that these are generally standards that we would expect all suppliers to offer their customers. We would be concerned if the Standards of Conduct were used to amend legislative obligations within primary legislation, such as the Electricity and Gas Acts (as amended), as the Licence cannot be used to amend primary legislation. We also think that the SOCs should not apply to relationships between a supplier and larger industrial and commercial customers. This is not because we would not aim to apply those standards in our interactions, but because such customers will have their own purchasing departments and may be legally represented in negotiations with suppliers. It is not necessary for such discussions to be subject to regulatory supervision.

Question 19: Do you agree that the SOCs should be introduced as an overarching, enforceable licence condition?

We agree with this proposal. However, in order to make this process workable and appropriate, this would need to be introduced in conjunction with a two stage enforcement process to under-pin the Condition. There is appropriate precedent for this in relation to SLC 25A and we think that this works well in allowing the introduction of more principles-based regulation within the Licence Condition while maintaining a manageable burden on suppliers (see paragraphs 89 to 94 of Annex 1).

Question 20: Do you have information regarding potential costs this may impose on suppliers?

We do not anticipate the introduction of a Standards of Conduct licence condition on the basis we have suggested would impose significant additional costs on suppliers *per se*, although there may be some costs which have yet to be identified. However, the licence condition would give Ofgem greater discretion to require changes to supplier behaviour, eg through issuing guidance, and such consequential changes could impose significant costs.

We think that costs to suppliers would be better managed if the Standards of Conduct Licence Condition were to be introduced in conjunction with a two stage enforcement procedure, which would allow enforcement issues to be addressed in a bilateral discussion with Ofgem as a first stage of any investigation. This would give suppliers an opportunity to make representations with a view to minimising costs where appropriate.

Question 21: Do you agree with our analysis of the impact on vulnerable customers?

No. We consider that the RMR core proposal would be likely to work against the consumer interest, as set out at length in Annex 1 and the Oxera Report.

Question 22: What are your views on the need for further intervention?

One of the key risks of the RMR core proposal is the risk that it will demonstrably make things worse, causing calls for more intervention. Such intervention would be likely itself to create further problems.

Question 23: Who in particular should any additional support be targeted at?

We think this question is best addressed by the Secretary of State through the Warm Homes Discount framework. This provides a transparent and coherent approach to the support that is required to be given to customers at risk of fuel poverty.