

## **Appendix 1: Answers to consultation questions**

### **CHAPTER: Two**

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

SSE believes that the prescribed structure of the evergreen tariffs in the core proposal will have consequences that are to the long term detriment of competition.

The ERA has submitted a response including an independent impact assessment of aspects of the core proposal undertaken by Frontier Economics. Their report highlights two risks which we believe Ofgem should be mindful of in assessing responses to this consultation:

- “Optimism bias” is the human tendency to under-estimate the probability of bad outcomes.
- “Confirmation bias” is the human tendency, once persuaded of the merits of an idea or policy, to place more weight on supporting evidence or arguments and to either downplay or ignore completely any arguments that present a different view.

To some extent, energy suppliers have exhibited these traits in the past: having believed that the great diversity of tariffs available in the market were there because customers demanded them, suppliers were slow to realise the damage to consumer trust that this confusing choice engendered. SSE and several other suppliers have recently drastically reappraised our previous business models; this week we announced the first stage of our tariff simplification plans, which has reduced the number of tariffs we offer from 68 to 4 core products.

We would urge Ofgem to consider a similar reappraisal of its current proposals. If Ofgem is convinced that significant regulatory intervention in the market is still required, despite the recent strides made by a number of large suppliers, then we believe that the damage to competition as a result of unintended consequences could be minimised by the following:

- Ofgem allows suppliers to continue to set their own standing charge
- All tariffs comprise a standing charge and a single unit rate
- Ofgem introduces a simple EPR style of tariff comparator
- Ofgem loosens restrictions in the standard market to accommodate benefits such as paperless and prompt pay discounts and nil premium loyalty products
- Ofgem avoids imposing increased price risk onto suppliers by accelerating the move towards a fixed term/ fixed price market
- Suppliers should be free to choose whether discounts (including for MDD) are applied to the standing charge (defined benefit) or the unit rate (defined discount)

Of particular concern to SSE is the assertion made in the Impact Assessment (paragraph 1.168) that the “development of a two tier market would be an undesirable outcome, but would be no worse than the status quo in which sticky customers continue to pay more than non-sticky customers.”

SSE operates a fair pricing policy, whereby price differentials between different payment methods and service options are, as far as reasonably possible, cost-reflective. We do not offer any heavily discounted tariffs to a small segment of the market at the expense of our other customers. If Ofgem has evidence that any suppliers in the GB market are systematically operating a policy of price discrimination then the more appropriate remedy would be to take enforcement action under SLC 25A (“Prohibition of undue discrimination in supply”). Such evidence of price discrimination, if it were available, would certainly not be sufficient to justify the level of regulatory intervention currently proposed.

We are also concerned at the risk that, should the implementation of the RMR realise certain unintended consequences, further regulatory intervention will be required (which could potentially introduce further unintended consequences). For competition to flourish in the energy supply market it is absolutely fundamental that suppliers need to be able to operate in

an environment of regulatory stability. The perpetual threat of intervention creates a very significant barrier to entry and can act as a deterrent to investment for existing participants.

### **Potential for damage to competition**

The possible consequences of the RMR proposals are outlined below under three broad areas: timetabling, tariff choice, and the tendency for the best offers to be on fixed term contracts. (Further consequences arising from the proposal to set the standing charge are covered in detail under Question 2 below.)

#### Timetabling

Setting the standing charge will imply a timetable of tariff changes. Since suppliers will still have to react to changes in market prices over the year – and the time at which this change becomes necessary is unlikely to coincide with the date on which the standing charge is set – the core proposal is likely to increase the number of tariff changes over the year. The uncertainty and confusion this could cause customers is of particular concern; consumer groups have reported to us that the fear of future increases is almost as concerning to vulnerable customers as the actual increases themselves.

By reducing the likelihood that suppliers will be able to consolidate changes in network costs and market prices into a single price change, Ofgem will be directly responsible for the increased regularity of pro-rated bills, which make it harder for customers to keep track of what they are paying and increase confusion.

In order to aid customer understanding of tariff changes, SSE does not change prices twice within any six month period – this avoids any customer receiving a bill (credit customers) or statement (issued every six months to MDD customers) that pro-rates more than one price change. We believe this provides a clear benefit to customers. If Ofgem introduces a regime whereby there is a standing charge related tariff change on June 1<sup>st</sup>, then our only possibility of a price change to account for significant movement in commodity prices would be the start of December. To avoid this constraint on our ability to appropriately manage our market risk (or to pass savings on to customers in the event of commodity prices falling) we would need to either change our policy on bill clarity or increase the frequency at which we issue statements to MDD customers to quarterly (with a cost implication for customers).

The suggestion that the standing charge tariff change could occur on June 1<sup>st</sup> would introduce a two month window between new DUoS charges taking effect and suppliers being able to recover increased costs. This price risk would impact all suppliers but could be particularly disadvantageous to smaller suppliers less able to absorb any increased costs. A further complicating factor is the notice period required under SLC 23 which all suppliers must meet in the event of a unilateral variation.

#### Tariff choice

The proposals will not necessarily limit the number of tariffs – indeed the requirement for paperless billing discounts to be moved to the non-standard arena mean that there will be more tariffs.

Our simplified tariff presentment seeks to provide customers with a clear path on price, built around rewarding behaviour that lowers costs (for example paperless billing, prompt payment or MDD). A customer selecting any one of these options would receive a discount against our standard variable or fixed tariffs. The key decision on price for customers should be around their appetite for risk – whether they prefer a fixed-price and fixed-term tie-in or a variable rate). Under our tariff simplification we believe this choice is very clear for customers. We believe that the RMR proposals deflect from this central choice by emphasising current price per unit.

By setting the standing charge, Ofgem would be forcing suppliers to offer discounts for MDD that are based on the unit rate rather than the standing charge. This further discourages more cost-reflective pricing policies, whereby customers are offered clearly defined savings at the

point they select their service and payment options. Discounts offered on the standing charge provide defined benefits, rather than the defined discounts offered on unit rates which unfairly result in large users realising bigger savings for the same choice.

Suppliers will still be able to offer no standing charge (NSC) tariffs in the non-standard market. As part of the tariff simplification we announced this week, all new SSE customers will be placed on a standing charge based tariff. NSC tariffs have been identified as a source of significant customer confusion and we believe that there is therefore a risk that some customers may select these tariffs inappropriately. These tariffs remain particularly popular with landlords, who may own one or more properties that potentially sit empty for a number of months of the year. Such customers benefit from an element of cross subsidy, and the removal of this from the market is therefore a benefit to the majority of customers.

#### Best offers all fixed term contracts

If the main avenue for innovation and competition is moved to the non-standard arena then it will disadvantage groups that are less engaged with the market, as they are less likely to take advantage of prices and product offerings that require regular input from them to re-confirm their choices.

A further consequence of this is that if the proposals do lead to greater uptake of fixed-term offers, more customers will be signed up to deals that are likely to have exit fees. If a significant portion of these deals are for multiple years then this development could result in a net reduction in annual switching activity.

We provide estimated costs associated with the introduction of the core proposal in the confidential annex to this response.

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

Regulating any element of the end user energy price is fraught with difficulties.

We do not support the proposal that Ofgem should set the standing charge. In our view, this will always bring about a worse outcome for low users.

If Ofgem does proceed with this proposal we would emphasise that we believe the process and considerations for Ofgem are fundamentally different from those that apply to suppliers setting their own standing charge. These considerations should result in Ofgem setting a charge that is cost reflective as far as possible. To rely on an element of cross subsidy risks distorting the market, and will expose some suppliers to an increased risk of under recovery of costs – this will particularly impact on small and new entrant suppliers, but will also affect larger suppliers with a portfolio that is skewed between low and high consumption customers relative to the average distribution across the market.

When suppliers set their own standing charge they are able to keep standing charges below their fixed costs because:

- a) They can monitor their portfolio of customers to ensure that they are not suffering unduly from cherry picking, and
- b) They are under political and market pressure to keep this charge low

(The second consideration is particularly important as any regulator that sets a component of end-user prices inevitably finds it very difficult to resist this political pressure.)

Figure A1 below represents the difficulty faced by suppliers trying to balance their recovery of fixed costs across their portfolio, between low and high consumption customers. The two graphs show the level of annual bill plotted against consumption levels. The top graph represents the situation where suppliers can set both elements of the price. There are an infinite set of combinations of standing charge and unit rate that would result in a customer with industry average electricity consumption of 3,300kWh paying a bill of around £495 per

year. If a supplier feels they are under recovering costs from low users (and are signing up increased numbers of low users as a consequence) they are able to slightly tweak their tariff such that the level of under-recovery is much reduced, and average consumers are not impacted.

The lower graph demonstrates that under the RMR core proposal, a supplier's freedom to adjust their cost recovery across their customer base is adversely impacted. In this regime, for whatever standing charge Ofgem sets, there is precisely one tariff that will result in an average bill of £495 per annum. If the standing charge is set too low, the only means of addressing under recovery of costs from low users is to inflate the unit rate. This impacts on all customers in the portfolio, resulting in average and high users being charged an increasingly unacceptable margin on their usage.

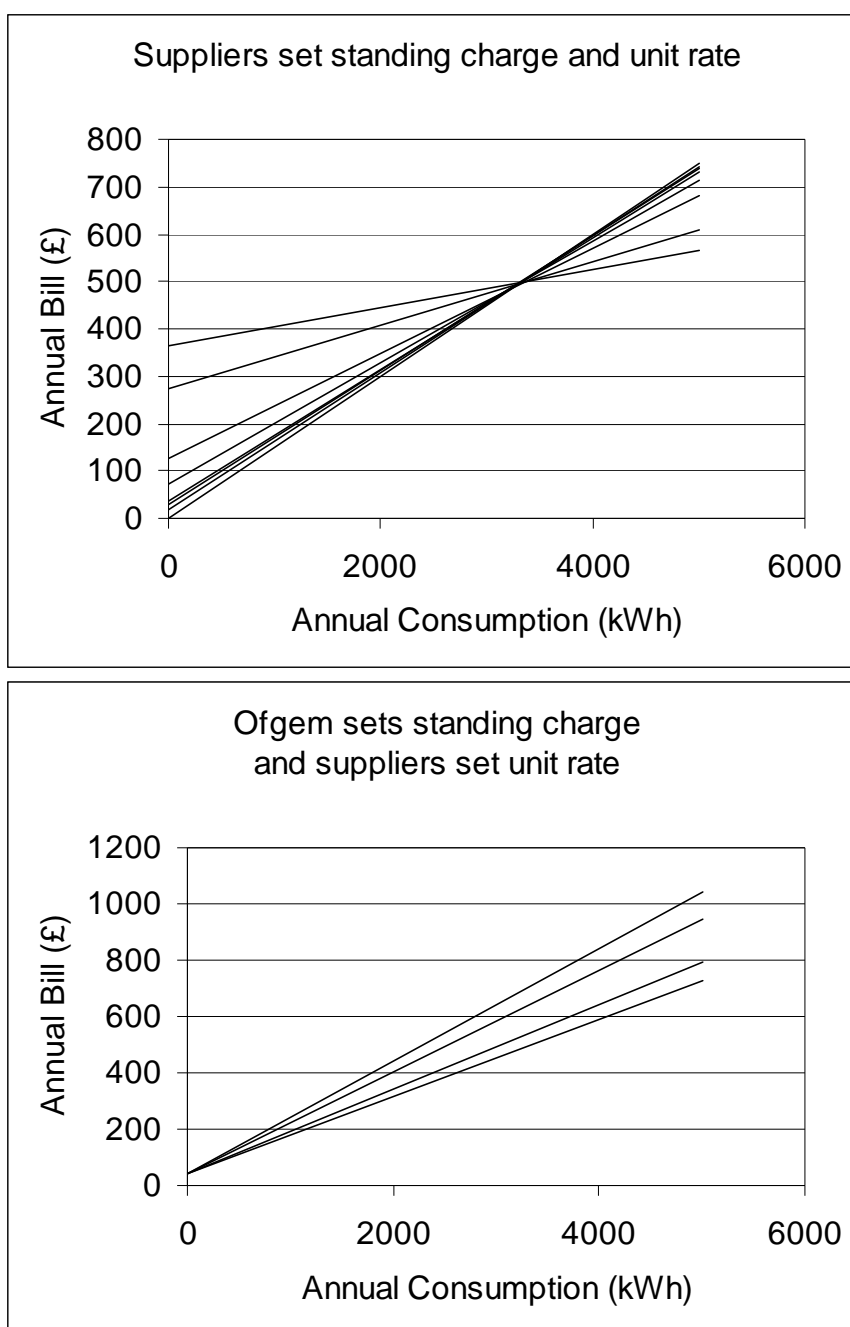


Figure A1 Scope for suppliers to affect cost recovery across their customer base

The problem Ofgem will be posing for suppliers in this scenario is how to optimise their cost recovery given one less degree of freedom. The result will be far from optimum, with a considerable risk that suppliers may feel compelled to add a risk premium to their unit rates if they suspect that Ofgem have set the charge too low for their particular customer base. This is unlikely to result in prices in the standard tariff market converging at a more competitive level than they otherwise would.

Suppliers' appetite for risk on the issue of recovery of fixed costs is clearly different because there is a wider variation in standing charges than is apparent in total price to customers between suppliers.

### **Consumer impact**

A consequence of this is that there is no "right answer" for Ofgem in setting the standing charge. We believe that if the charge is set too low there will be serious adverse consequences that will particularly disadvantage customers less likely to explore the non-standard market.

Conversely, if the charge is set according to a full apportionment of fixed costs (including gas capacity) there will be an adverse impact on fuel poverty and a worsening in the environmental incentive. A higher standing charge pushes up bills for lower users, and the corresponding lower unit rate would diminish the incentive to reduce demand (and would lower the cost savings from energy efficiency measures).

If they set it at a level lower than Supplier A's acceptable threshold (from a risk viewpoint), then this supplier will adjust behaviour to tilt his portfolio away from low users. These customers will end up with Supplier B, forcing his risk position to a tipping point where he will also try to get loss making low users out of his portfolio. Such considerations could lead to poor supplier conduct such as segmented customer service standards, tilted commissions or other measures designed to minimise the risk of increased acquisition of low users.

It is reasonable to assume that low consumption, low income customers have a higher propensity to stick to the evergreen offering. This observation is likely to lead to the fixed market being one of the ways that suppliers cherry pick larger users.

Fixed costs include those supply costs associated with account management (such as billing, collections and call centres). These differ between suppliers (i.e. they are subject to competition and so are not universal or consistent). Ofgem cannot include these costs in a regulated standing charge as that would damage competition, but a standing charge cannot be cost reflective if they are omitted.

A further point to consider is that to truly reflect the cost structure, the standing charge would need to reflect both the electricity distribution areas (the old PES regions) and the gas distribution zones (LDZ). Given the non-congruent boundaries of the PES and LDZ areas the end result will be a proliferation of regional variations – we calculate that the total number of combinations will certainly be in excess of 50 separate regions. Suppliers are currently able to simplify this issue by making an informed and risk assessed judgement of the degree to which they can consolidate the different zones. It is questionable whether Ofgem can legitimately make such choices on behalf of suppliers, but if they do not then the 50+ regional variations are likely to confuse customers further.

### **Jurisprudence**

The European Commission has outlined principles behind reasoned opinions issued regarding end user pricing, including the following:-

- End-user prices set by state intervention present obstacles to new market entrants and therefore deprive consumers and companies of their right to choose the best service on the market.

- All companies must have the possibility to freely provide services all over the EU and set their own prices which reflect the real situation on the markets.
- Regulated prices distort the functioning of the market, defining prices which do not reflect the real needs of the market and prevent free competition and market integration
- [Regulated end-user prices] ...lead to either underinvestment or unnecessary high prices.

The European Court of Justice in its 'Federutility' judgement (Case C-265/08) clarified the criteria under which regulated prices could be compatible with Internal Energy Market legislation; these included the condition that end user prices be "clearly defined, transparent, **non-discriminatory** and verifiable." SSE believes that the non-discriminatory condition will make it very difficult for Ofgem to arrive at a single standing charge that is appropriate for the entire market. Our concerns outlined above point to the risk that low users and vulnerable groups are likely to be most affected by the adverse impact of the market distortions introduced.

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

The proposed information remedies, including the use of the Standard Equivalent Rate (SER) tariff comparator, will not necessarily promote consumer engagement with the whole market. If consumer engagement is restricted to the standard tariff market for a significant portion of consumers then the engagement cannot be described as 'effective'.

A consequence of the proposal for the standing charge to include a regional unit adjuster to reflect differences in network costs is that it will become harder for consumers to understand their bills. Instead of comprising a daily charge and a single unit rate, bills for standard tariffs will have to incorporate a daily charge, a regional unit rate adjuster and the supplier's nationally published unit rate. If Ofgem pursues the option of suppliers having to calculate and/or incorporate the regional adjuster into their own unit rate, then another of the intended benefits of the tariff reform (namely consistent national messaging on price) will be sacrificed. If that benefit is retained then any efforts to simplify billing and improve customer engagement could be compromised by the increased complexity of the tariff structure.

Ofgem has proposed radical reform and regulation of tariffs to enhance comparability. This is in the reasonable expectation that customer disengagement can be addressed by making it easier for consumers to spot the cheapest tariff for them. We agree that tariff simplification coupled with improved comparability could produce significant customer benefits. In particular, consumer confidence that they can correctly identify the most suitable tariff for their particular needs is a prerequisite in building trust. Such simplifying changes are at the heart of our own Trust initiative.

To successfully affect consumer engagement, tariff comparisons must be simple, clear and comprehensive. The core tariff proposal involves Ofgem setting the standing charge to be applied to all standard tariffs. This intervention would make comparison of standard tariffs trivial (requiring nothing more than the unit rate) but it does not provide a suitable means for comparing non-standard tariffs (so it passes the simplicity and clarity tests, but fails to provide a comprehensive comparator). An unfortunate consequence is that consumers may be provided with a false sense of confidence through misunderstanding this fundamental limitation of the proposed unit rate comparison. There is a very real danger that this could lead to some consumers selecting a relatively less competitive tariff and firmly believing that it is actually the best priced deal for them in the whole market! This would be a significant unintended consequence of Ofgem's proposed reforms.

We believe that there are better, simpler and clearer ways to compare tariffs. Many stakeholders have suggested that the clearest comparisons are based on the whole bill. We proposed this type of solution ourselves in response to the RMR consultation in June 2011,



and have now implemented our version of this Energy Price Rate (EPR) for all tariffs currently offered on our websites and where appropriate through our other direct sales channels.

Ofgem has argued that since not all customers know their annual consumption (even at the coarse resolution of low, average or high) it is inappropriate to rely on an EPR as a tariff comparison metric. This assertion possibly places a great deal of emphasis on consumers admitting that they do not know their consumption off the top of their heads. Yet Ofgem implicitly concedes that its own unit rate comparison, the Standard Equivalent Rate (SER), is not sufficient to inform consumer choices in the non-standard tariff market (fixed-term, fixed-price); instead, the proposed Tariff Information Label (TIL) includes indicative consumption based prices. The low, medium and high monthly costs provide exactly the same type of information that we advocate in our EPR. The TIL for a non-standard tariff therefore includes the unit rate applied to all consumption during the fixed term, plus the three Standard Equivalent Rates used for tariff comparison, corresponding to low, average and high consumption. It is not credible for Ofgem to suggest that quoting a total of four unit rates for each non-standard tariff will not lead to increased confusion amongst customers. In attempting to make its SER comparison appear comprehensive, Ofgem has made things less simple and less clear. It would be very unfortunate if one of the unintended consequences of these reforms is that a significant proportion of consumers utterly disregard the non-standard tariff sector, in which suppliers may offer their most competitive tariffs.

Under Ofgem's proposals, customers would still require the same knowledge of their consumption to make use of the SER as they do for whole-bill based comparisons. Given that it is therefore not possible to provide useful comparison information that does not compare the whole bill, we believe that it would be preferable for Ofgem to consider the best way to present an EPR type comparator that makes it absolutely clear that it is an estimate, rather than a fixed price quote, which consumer feedback has suggested some consumers may have mistaken it for. Principles could be agreed to define the types of discounts and reward schemes that could be factored into the EPR and which could not. This would provide a simple basis for tariff comparisons and could be applied consistently by all suppliers across the whole market.

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

SSE believes that customers can more easily recognise the value of a comparison expressed as either £ per year or £ per month. Not only does this identify the lowest cost, it quantifies the size of the benefit to a customer. Evidence suggests that where cost differences are not material, customers may prefer to pay slightly more if it means they can stay with a supplier offering a better standard of customer service. Expressing the comparison as p/kWh underplays the importance of this consideration for many customers.

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

Yes – SSE agrees with the proposed exception for **legacy social tariffs**.

SSE has accounts on legacy social tariffs. If an exception were not allowed for these tariffs under the RMR it would have serious implications for our ability to meet our obligation under the Warm Home Discount.

No - SSE does not agree with the exception for **high consumption domestic consumers**.

However, we do not understand the rationale for the exception for high consumption domestic consumers. If the cost structure is right then it should apply equally as well to high consumption as low consumption users. If this exception arises from some kind of acknowledgement of the risk of setting the standing charge too low, leading to suppliers charging higher unit rates than they otherwise could and this being to the detriment of

extremely large users, then we would urge Ofgem to reconsider the proposal to set the standing charge.

**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?*

SSE believes this exception should be allowed.

In the absence of such an exception, there is a danger that the relative lack (or potentially the complete absence) of competition in the market for green standard tariffs may cause customers who would otherwise choose a green product to become sceptical of the level of premium charged on these tariffs. Competition is a prerequisite in building and maintaining consumer confidence in the market, and this principle is as relevant in niche markets such as green tariffs as it is in the market as a whole. It would also undermine the significant work undertaken by Ofgem and industry to develop the Green Supply Certification Scheme.

**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?*

This would greatly increase the complexity of implementation and would introduce the requirement for further potentially costly systems development work (needed to facilitate charging different customers on the same tariff a different price depending on when they signed up).

This suggestion also misses the point of the likely impact of the RMR proposals: if the proposals are successful to any degree in boosting customer engagement, the largest area of activity is likely to be in the non-standard market, where suppliers will have more freedom to innovate. Therefore customers who desire greater price certainty will already be provided with more than enough choice amongst fixed-term fixed-price tariffs. It would be counterproductive to attempt to render the variable evergreen tariff a quasi-fixed price/ variable tariff instead.

### **CHAPTER: Three**

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

SSE supports elements of Option 3.

We believe that the introduction of standardised terminology across the industry will yield significant benefits in helping to reduce consumer confusion. This will be of particular benefit in regards to the terms highlighted in the footnote on page 37 of the consultation. The synonyms for bill are particularly problematical – whilst ‘statement’ can reasonably be applied to the document describing costs incurred and payments received from monthly direct debit customers, it is obvious that there is a risk of further confusion when customers also receive an Annual Statement, which serves a different purpose.

We do not however support the introduction of standardised summary boxes on bills, or the requirement to provide a standardised ‘Tariff Information Label’ on the statement. It is preferable to stipulate the information that is required and allow suppliers to design the most appropriate layout to deliver this. This is particularly important in reducing the risk of repetition of information in different areas of the same document.

There are increasing pressures on bill layout and design, reflecting both the information requirements that followed the implementation of the Probe remedies and now the new requirements arising from the Green Deal. Customers are bound to find the increasing array of information they are confronted with on reading their bill confusing or bewildering – indeed, feedback from customers often highlights that there is too much information on bills and statements, to the extent that they are overwhelmed by it. We do not believe that



standardising formats of bills and statements is the correct means of addressing this. We would favour a drastic simplification of both documents, which we describe in more detail under Question 13 below.

**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”)?*

As noted above in relation to SLC 31, we are not in favour of the imposition of prescribed formats. In the case of price increase notifications we would support Ofgem highlighting particular formats that they have evidence cause confusion, perhaps in the format of guidance that could also suggest styles of presentation that are more helpful. This would provide suppliers the necessary stimulus to clarify their presentation format whilst avoiding the costs of implementing standardised formats being imposed on all suppliers.

Whilst we support moves to clarify policy intent we remain very concerned by the language used in the drafting of the proposed amendments to SLC 23. The definition for Consumer Information under SLC 23.13 refers to “information which relates to encouraging a Domestic Customer to consider changing their Electricity Supplier”. We continue to question the reasonableness of this proposition. It is one thing to point out to customers that changing supplier is an option that is open to them, but the notion that a supplier should *encourage* a customer to do so is utterly irrational. We can think of no other sector of the economy where such an imposition is made on a service provider. Whereas there are several areas where notices or announcements to the effect that “we know that other service providers are available and appreciate your continued custom” are commonplace, and indeed can be one factor in delivering a good customer experience. Whilst we recognise Ofgem’s role in encouraging competition in energy supply, we do not consider that it is reasonable or proportionate to ask suppliers to do any more than to highlight that a customer has the choice to choose their supplier, and to provide them with all of the information required in order to make a suitable switch should they so wish.

**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.*

If Ofgem are minded to make changes to price change notifications, we would favour Option 2 over Option 3. The imposition of prescribed formats imposes costs on all suppliers, possibly for very limited benefit when compared to the improvements that would arise under Option 2. We do not believe that Ofgem has made a sufficient case to justify the imposition of the extra costs associated with prescribed formats.

If there are areas where suppliers performance could be improved, we would also highlight to Ofgem the option they have to engage in appropriate dialogue with the suppliers in question – not necessarily in the context of possible enforcement action but in the context of helping all suppliers raise their performance to match the levels of those that have done the most to meet the spirit of the Probe remedies.

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

Price change notifications are in themselves a very significant spur to action for consumers – they tend to generate increased contact and increased complaints from customers. Ofgem’s current proposals risk reducing all customer decisions regarding choice of supplier to a matter of cost, which we recognise as obviously being the most significant factor. However, there are other factors that are rightly considered of great importance by many consumers, including customer service, loyalty rewards and bundled products.

The inclusion of marketing material in SLC 23 notifications provides an opportunity for suppliers to promote other aspects of the services they provide to customers. Banning such material risks exacerbating the possibility already present in the current proposals that rather than leading to improved service levels from all suppliers they will instead deliver a market focused on cheapness, possibly to the detriment of consumers.

More importantly however, it will often be in the customer's interests that marketing material is included with SLC 23 notifications. Price changes introduce uncertainty and stress for customers over budgeting decisions and so can often prompt customers to investigate what fixed price offers may be available. Therefore, allowing suppliers to include information about such fixed price offers with the price change notification can provide customers with valuable information at the time when they are most likely to act upon it, potentially to their financial advantage. In any event, customers are able to opt out from receiving marketing material.

**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.*

We do not have an issue with the provision of most of the items under Option 4.

We have noted under Question 9 our concern at the language used in the drafting of the amended SLC 23. In particular we would highlight the difference between "Impartial advice on changing supplier" as used in the consultation document (3.72) and "encouraging" a customer to switch supplier as used in the draft of the amended licence condition (Appendix 12). We continue to question the reasonableness of expecting suppliers to be 'impartial' in terms of a customer's choice of supplier.

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

We believe that the increased pressure on the layout and design of bills and annual statements, arising from both the RMR and the Green Deal, are such that it is time for a drastic rethink of these documents. Our preferred remedy would be to conduct a fundamental review of information on bills, with the goal of simplifying and clarifying as far as possible the information that is actually required.

We believe that this is the most appropriate response to the feedback we get from our customers and also to the findings from Ofgem's Consumer First Panel. We are not surprised to learn that around half of customers were unaware that they had received an Annual Statement and believe that this research should trigger a bottom up reassessment of the appropriate content for these documents.

There is merit in this review going right back to basics and considering whether gas prices should be quoted per unit of volume, rather than per unit of energy – this would allow suppliers to get rid of conversion factors and formulae that confuse customers. There may be issues around the variation of calorific value (CV) between different distribution zones but it is likely that the errors introduced by standardising the CV across the country would be no more significant than the errors in the temperature and pressure adjustments currently incorporated into the conversion factor.

A similar fundamental review of annual statements should be undertaken to identify the extra information that is actually needed by customers. We would also suggest reconsidering how the issuing of the annual statement could be triggered – we believe it would be appropriate to issue it in response to a price change, with a backstop of at least once every 18 months in the unlikely event of no price change having occurred.

Simplification and clarification of these documents could resolve the issue of confusion without resorting to standardised formats.

We present some of our work on simplified billing in the confidential annex to this response.

**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.*

A key element of SSE's simplified presentation of tariff options is the ability to present a basic tariff with service options that affect the price (similar to the 'airline options' model in the consultation document). We believe that we can use this approach through our own sales channels to simplify the decision making process through the presentation of a series of what the Lawes Consulting report on the use of language refers to as binary oppositions (simple paired oppositions, which are easily understood by customers). These contrasting pairs make tariff choices more readily understood: fixed or variable rate selects the basic tariff, and the choices between paper bills or paperless and MDD or quarterly credit select different service options. We will monitor and test customer reaction to this presentment but we believe that it will more appropriately address customer needs when trying to navigate through the tariff options available.

We believe that as it stands the Confidence Code does not facilitate simplified tariff presentation as filtering choices are limited. For instance, it precludes showing discounts that require "customer action" (for example activating online billing). So in this case, instead of one tariff with two billing options, suppliers have to enter a standard tariff and an online tariff in order for internet comparison sites (ICS) to show the cheaper price. If the Confidence Code could be altered such that ICS could do a better job of filtering tariff options it could help to reduce customer confusion at the apparently vast array of tariffs from which to choose.

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

We note that Ofgem have not published an impact assessment of enhanced monitoring.

There are obvious concerns about the potential cost implications for suppliers of having to provide further data to support any increased monitoring.

Where data is already being compiled, such as complaint handling statistics, it is obvious that care has to be taken to ensure that anything that is made public has been sufficiently processed to ensure that the performance of different suppliers is being presented on a consistent basis. Whilst monitoring data is likely to be of use to Ofgem in terms of establishing supplier compliance it is questionable to what degree such specialised data would be useful to customers. It is likely that the publication of data could increase customer disengagement as it could be seen as further evidence of suppliers failing to provide a good service, when in fact the simple fact that Ofgem is closely monitoring supplier conduct would in itself act to increase customer confidence in suppliers (without any data needing to be made public).

We would also urge caution in terms of the proposal to name and shame suppliers guilty of poor performance. Such a step should not be considered before the supplier has been made aware of any concerns that Ofgem may have of the supplier having failed to meet the spirit of a particular remedy and *been given sufficient opportunity to address these concerns*. The reputational damage that this practice could engender may not be proportionate to the detriment caused by their poor performance. Such censure would therefore need to be applied with extreme care.

**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.*

Cost estimates are provided in the confidential annex to this response.

**CHAPTER: Four**

**Question 17:** *Do you consider the revised SOC's will help achieve our objectives?*

We strongly disagree with the introduction of legally binding SOC's via an overarching licence condition. There are various issues with the introduction of a principle based regulation (PBR) of this type that would encompass all interactions between suppliers and consumers.

Despite discussion of this topic with Ofgem, we are unclear regarding the intended approach to enforcement of SLC 1A and whether it is really aligned with the requirements of PBR: we would expect increased dialogue and co-operation between Ofgem and regulated companies under a principles based approach, and possibly even a two stage enforcement process. What we would not expect is a zero tolerance approach to compliance likely to result in a more adversarial relationship. Uncertainty on this point is also likely to result in the imposition of a greater than anticipated burden on suppliers and may have the unintended consequence of creating a barrier to entry or a disincentive to expansion.

The ERA has submitted a paper on the proposed SOC's that we believe makes some very valid points regarding the appropriateness of PBR and the conditions necessary for it to operate successfully. We do not believe that Ofgem have satisfactorily established these conditions and it is therefore inappropriate to seek to introduce the SOC's into the licence. We also recognise the risk of regulatory creep that the ERA identify, arising from the freedom Ofgem would have to issue revised guidance on the interpretation of the SOC's without consultation.

**Question 18:** *Do you agree the revised SOC's should apply to all interactions between suppliers and consumers?*

No.

Interactions between suppliers and customers that are not already fully covered by existing regulations can more appropriately be dealt with through self-regulation. We already have in place a Customer Charter that defines the standards of conduct we operate by, and our assessment of customer complaints takes account of these standards. We believe that the public commitment we have made through the Customer Charter is the most effective way to ensure that our customers are treated fairly. The requirements of the SOC's are the way we run our business now without the need for additional regulation.

**Question 19:** *Do you agree that the SOC's should be introduced as an overarching, enforceable licence condition?*

No.

We would support Option 2 ('Non-binding + industry commitment')

Whilst we believe that the Standards of Conduct are a fair reflection of how we treat our customers, we do not think that Ofgem has established a sufficient case for these standards to be included as a condition of the Supply Licences. Existing regulations (including the Complaint Handling Standards, Consumer Protection Regulations, the Guaranteed Standards and existing licence conditions) already provide the protection that Ofgem now claim is required. The introduction of the SOC's as an enforceable licence condition would therefore introduce a risk of double jeopardy and as such cannot be consistent with the principles of better regulation.

The fact that Ofgem has been unable to provide clear examples of the types of behaviour that SLC 1A would allow it to address which are not already covered under existing powers also brings into question the necessity for such a licence condition. Such examples, if they were provided, would be necessary but not sufficient to demonstrate the need for an over-arching principles based licence condition. If enforcement action really cannot be taken already as a consequence of poor drafting of existing regulations, it would be better to resolve the root problem rather than simply to treat the symptom.

We are also extremely concerned by the use and interpretation of the term 'representative.' The development of collective switching in the domestic market needs to be taken forward with care to ensure it does not bring with it some of the problems encountered with Third Party Intermediaries in the non-domestic market. We believe that Ofgem's proposed interpretation of 'representative' will result in an undue burden being placed on suppliers to monitor and account for any actions taken by independent companies with whom they have no contractual relationship. We do not see how holding suppliers responsible for such third parties can be consistent with the claim made in the impact assessment that this proposal would not be "unreasonable or overly burdensome."

In considering Option 2 (which we would prefer) we do not believe that Ofgem has fully acknowledged the significance of the reputational damage that would result from a supplier failing to live up to such a public commitment. It is very unhelpful for Ofgem to suggest that such a commitment would provide a less effective measure to raise standards than the proposed licence condition. We believe that a public commitment to uphold such standards, especially when accompanied by a company specific document such as SSE's Customer Charter, would allow companies the scope to differentiate themselves through their commitment to customer service. Improved performance would be the result of commercial decisions in a competitive market, based on a recognition of the importance and value customers place in higher standards of service.

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

SSE believes that the drafting of SLC 1A sets a very high standard through the requirement to take "all reasonable steps." Equally the extension of the SOC's to cover the activities of representatives with only an indirect relationship to a particular supplier could result in suppliers seeking to put in place contracts with all such representatives to provide some protection against licence breaches. The costs of drafting and negotiating these contracts could be significant.

Alternatively some suppliers may prefer to avoid having any dealings at all with representatives who are not already constrained by a contractual relationship – this could result in damage to competition as internet comparison sites or brokers of collective switching deals present only a subset of the market to consumers wishing to switch supplier.

We believe that the costs of introducing the SOC's as a licence condition are likely to outweigh the benefits given the fact that a substantial part of the protection offered by the SOC's replicates existing regulations and would therefore be completely redundant.

## **CHAPTER: Five**

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

We fear that many vulnerable consumers will be adversely affected by the RMR proposals. In particular the concerns we have highlighted above regarding the impact of Ofgem's intention to set the standing charge will disproportionately impact on vulnerable consumers.

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

We believe that many of these unintended consequences could be avoided by Ofgem adopting a slightly less interventionist approach at the outset. In particular Ofgem should continue to allow suppliers to set the standing charge for themselves. This would immediately avoid the impact of suppliers having to add a risk premium to the unit rate charged on their standard tariffs to protect against their increased exposure to falling demand or rising network costs causing them to under recover their fixed costs.

Taking that simple step would remove a great deal of the risk that the standard tariff market will reach an equilibrium that is relatively higher than where it is today. If Ofgem were to relax the constraints around the discounts that could be offered on standard tariffs it would allow certain vulnerable customers, who may be more likely to remain disengaged, to benefit from savings such as dual fuel or prompt payment discounts.

The real risk to vulnerable consumers arises from the fact that Ofgem has proposed tariff reforms that will move the most innovative (and hence the lowest priced) tariffs to the non-standard market. This immediately creates a market where consumers who are less inclined or less well equipped to engage with the market will lose out. Ofgem's assessment that this will be no worse than the situation today misses the significance of the decision to intervene in the market by setting a part of the price.

We do not believe that further regulation to introduce a backstop tariff is the right approach. This strategy would herald a constant stream of further interventions each seeking to rectify the unintended consequences of the last, and ultimately risks bringing in re-regulation of the retail market.

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

Ofgem needs to be mindful of the needs of less literate or less numerate consumers in vulnerable groups. A particular risk of the proposed market reforms is the likely perception amongst some vulnerable customers that the standard tariff market is somehow Ofgem approved and therefore cheaper than the non-standard market. In such a scenario a wide range of vulnerable consumers could miss out on the best tariff for them by virtue of it being in a portion of the market that they ignore completely. The best defence against this outcome is ensuring that Ofgem does not implement the proposal to set the standing charge, or to restrict the simple discounts such as prompt payment that many customers in the standard market could benefit from without having to take any specific action to 'opt-in.'



## **Appendix 2: Tariff simplification press release**

### **SSE introduces dramatically simplified range of energy tariffs**

22 February 2012

We have introduced a dramatically simplified range of energy tariffs today to meet the needs of the vast majority of customers through a choice of just four core products. This means that:

- Our product range is reduced to four core products: two variable and two fixed
- Customers will need to answer just five simple questions to find the best deal
- The same approach and product range is available online, face-to-face or over the telephone
- There is a new price comparison metric

Customers will now be able to identify the cheapest SSE product for their needs, and be provided with a simple comparative price for each alternative product, by answering just five key questions:

- Where they live (postcode)
- The type of meter they have
- How much energy they use
- Their preferred payment method
- How they wish to manage their account

The simplified approach will be used whenever a customer speaks to an advisor about the best product for their needs, and the new product range and new approach can be accessed directly with just one click from the home page of each of our Southern Electric, Scottish Hydro, SWALEC and SSE supply brand websites.

To achieve this level of simplification we have removed the 'no standing charge' option from all products. All new customers will now be placed on a tariff which consists of a standing charge, which covers a proportion of the fixed costs in a customer's bill, and a single unit price for all units consumed. Existing SSE customers who have selected a 'no standing charge' tariff option and wish to remain on it, will not see any change as a result of this decision.

To further help customers make a comparison between products, we have introduced a new price comparison metric which allows customers to see the relative cost of each product even when they don't have their precise annual energy consumption immediately available.

SSE would like to see a simple industry-wide price comparison metric adopted by all energy suppliers, so that customers can compare prices simply and easily, and we continue to pursue this with Ofgem, consumer organisations and other suppliers.

Once customers have identified which product best suits their needs, they will have the opportunity to tailor their product even further by choosing from a range of free 'optional add-ons' such as Argos points, an iPlan energy monitor, or supporting a charity like the British Heart Foundation. Later this year, customers will also have the opportunity to select complementary products such as shield cover, energy efficiency measures or micro-renewable products.

The new range of products is very similar to that already chosen by the vast majority of our existing customers. Where existing SSE customers are on a different tariff, they will remain on this unless they choose to switch to an alternative product. Over time we hope to encourage all customers to move onto one of the four core products.

Alistair Phillips-Davies, Generation and Supply Director, said: “Buying energy has become too complex. Energy customers want choice, but most customers have a straightforward set of requirements and when they look at the products offered by an energy supplier, it should be easy for them to find out which is the best deal for them.

“In October, SSE committed to end the complexity that surrounds tariffs and significantly reduce the number of tariffs it offers. That is exactly what we are doing and I believe this is the most significant change SSE has ever made to its product range.

“It has been suggested that forcing customers onto a single type of product will deliver a simpler approach to supplying energy to UK customers. But this kind of simplicity can actually be detrimental to customers. Some suppliers have already chosen to only offer one product, and in doing so excluded millions of customers who wish to have a choice of payment method or don't want to buy their product online.

“Simplicity doesn't have to mean a lack of choice, as long as the choice is presented in a simple way, and the changes we have made today prove that.”

### **Building Trust**

A commitment to reduce the complexity that faces a customer when they are seeking to identify the best energy product for their needs was a key element of SSE's package of proposals to build customers' trust announced in October 2011.

Other elements of the Building Trust proposals that have already been delivered include:

- A commitment not to engage in predatory pricing – where significantly discounted products are offered to new customers at the expense of existing loyal customers.
- Ensuring all customers have the opportunity to access any product SSE offers.
- Introducing a sales guarantee, which means we will make good any financial loss suffered as a result of a mistake made in our sales process.
- Publishing a breakdown of the costs that make up a typical energy bill, including the amount of profit we make.
- Publishing an externally-sourced and objectively-produced tracker showing the movements in costs that make up an energy bill.