RWE npower's response to Ofgem's Retail Market Review: Domestic Proposals Consultation dated 1 December 2012

Please find below our response to your Retail Market Review: Domestic Proposals consultation. We have organized our response according to the chapters of the consultation as follows:

- Chapter 2. Improving tariff comparability
- Chapter 3. Strengthen Probe Remedies - domestic
- Chapter 4. Standards of Conduct
- Chapter 5. Vulnerable consumers.

Chapter 2. Improving tariff comparability

Introduction

Ofgem's proposals are motivated by a presumption that a very simple evergreen tariff structure will improve comparability for customers, which will in turn stimulate customer engagement in the market and, consequently, enhance competition. Ofgem proposes to facilitate comparisons by publishing comparison tables. Ofgem has decided that standardization is better than choice.

There are already a number of very effective ways in which customers can compare products including switching sites, newspaper comparisons, supplier advertising and sales activity. In addition, the annual statements and bills already provide customer specific information by which comparison of a new supplier's annual charges can be made with those of the current supplier. It is therefore an open question as to whether Ofgem's proposals will add materially to the extensive range of vehicles which already facilitate effective competition or whether by imposing uniformity, at least in the evergreen market, Ofgem reinforces the misconception that energy suppliers are all the same. In our earlier response, we expressed concerns that Ofgem's proposals will significantly restrict customer choice and the dimensions across which suppliers can compete. Ofgem is supplanting decisions made by the market with its own views on product structure, creating a potential tension between these proposals and Ofgem's current emphasis on cost reflectivity in its licence conditions. Even though Ofgem has conducted consumer research, it is far from clear that Ofgem's approach will lead to superior consumer outcomes. Should tariff simplification be implemented in a manner whereby the regulated fixed and variable charges fail to reflect the fixed and variable costs incurred by suppliers, there will be two detrimental consequences:

- First, suppliers will be able to match the circumstances of individual customers less well, resulting in greater cross subsidy between customer

groups. Indeed, to a limited extent, Ofgem has itself shown some concern on this point through its proposal to set a consumption limit for the standard tariff.

- Second, Ofgem would be imposing basis risk on suppliers which must ultimately be factored into customer prices.

Nonetheless, we recognize that there is a need to reduce the complexity in the energy retail market. We also note that there is substantial stakeholder support for the objectives of Ofgem's proposals. We do not therefore intend to contest the general aims of Ofgem's proposals within the consultation. Indeed, we are actively exploring ways in which we can expedite the simplification of our own tariff structure irrespective of the outcome of Ofgem's consultation. We restrict our comments to the objective of maintaining the maximum scope for competition whilst still delivering Ofgem's objective of simplicity in customer choice.

We are also concerned that every restriction in a supplier's pricing freedom increases the risk that it faces in not being able to recover its costs in customer charges. This added risk will ultimately be detrimental to customers as it will need to be factored into customer prices. It may also act as a deterrent to entry from smaller less well capitalized potential suppliers.

Ofgem's proposals:

A. Have potential implications for a number of current features of the market;
B. Impose a rigid structure on the proposed evergreen market;
C. Raise some important issues around implementation and ongoing operation;
D. Potentially restrict the non-standard market.

In the sections below we discuss issues under each of these respective heads, applying the following three principles:

1) Customers should be free to engage with suppliers in ways where no other customer is disadvantaged;
2) The structure of licences need to evolve to reflect the future needs of the market; and
3) The standing charge should transparently reflect the costs which are included.

A. Current market features

Principle 1 is key to determining the treatment of features of the current market.

Bundled products

Bundling is a common feature of competitive markets and is valued by consumers: they benefit both from lower prices and the convenience of simplifying their relationships with service providers. Moreover, as with Airline options, consumer savings though bundling often reflect cost savings to suppliers. We believe Ofgem's proposals could readily co-exist with bundling as follows: standard electricity and gas contracts would be priced as per Ofgem's proposals. However, they would be

permitted to be bundled with other products and services. Any discounts would be applied to the non-energy product. As now, there could be a requirement that the pricing of products bundled with energy cover at least their incremental costs.

No other energy customers are disadvantaged by this proposal, tariff simplification is maintained and supplier costs may be reduced through the sharing of some fixed overheads.

Loyalty schemes

We do not believe that all forms loyalty schemes satisfy the requirement that other customers should not suffer a detriment nor are they consistent with Ofgem's proposals. To the extent that points or discounts accrue with the use of energy, those customers not signed to the scheme will effectively be cross-subsidizing those that do. The arrangement would also violate the key principle of a single simple standard tariff. Moreover, such schemes may actually, or be perceived to, create an incentive towards higher consumption, undermining energy policy objectives towards energy efficiency.

On the other hand, a scheme where points can accrue on products other than energy, but which can be redeemed against energy at the standard tariff rates should be permitted. The energy customer redeeming the points sees a benefit, but faces the standard price structure (his choice is just whether to pay in cash or points). And no other energy customer is disadvantaged because the costs are borne by the products on which the points accrue.

Airline options

We do believe that a balance needs to be struck between establishing a simple means for customers to compare offerings and providing customers the opportunity to benefit from choice. The principle that engaged customers should be allowed to benefit provided no other customer is disadvantaged seeks to strike the right balance. This particularly applies to variations on the basic product which generate cost savings for the supplier which could be shared with the customer. Indeed, such discounts are both consistent with the licence condition on cost reflectivity and are likely to promote customer engagement. Such options send a clear message that the customer can save both by testing the market and by changing the way they interact with the market. Engaged behaviour is then more likely to spread to other important dimensions of energy policy such as appetite for energy efficiency measures under Green Deal/ECO and interest in switching consumption to more efficient time periods. So, in our view, suppliers should be able to offer discounts for prompt payment or paperless billing. We do not believe this would materially impact the improved comparability between supplier offerings: they could be offered as fixed deductions to the standing charge or as separate fixed discounts. Comparison of the basic product through the unit rate would be unaffected It is unlikely that suppliers would offer discounts for these options on a scale which would impact the basic comparison or disadvantage other customers. However, if Ofgem has concerns on this score, it could apply a cost reflectivity requirement.

A similar approach could be applied to the premium charged for a standard green product. Further consideration would need to be given as to how this would be charged.

White label arrangements

Where white label offerings differ substantially from that of the legal supplier, we have concerns that Ofgem's proposals are effectively eliminating an important source of competition in the market. This leads to our second principle which is that the licensing structure needs to evolve to recognize the actual and potential structure of the value chain. We identify 3 core component activities of the current supply licence: wholesale procurement, sales and service. If the current licence were to be split into these component activities, tariff simplification could be applied in a way which better reflected the distinct identity of certain customer facing white label arrangements.

If an interim measure is required before the licences could be restructured through the next Energy Bill, we would propose that where the white label offering is sufficiently distinct from that of the legal supplier, the licence condition should recognize that offering as distinct: Ofgem's proposals should apply separately to the white label offering and the legal supplier's offerings. We believe it would be straightforward for Ofgem to establish criteria to judge the distinctiveness of the white label offering from the legal supplier; for example, criteria might include whether the white label has its own customer billing and service operation and who "owns" the customer relationship.

B. Features of Ofgem's proposals restricting product structure

A third key principle which informs our comments on Ofgem's proposals is that the regulated standing charge should be fully and transparently reflective of the regulated charges and obligation costs to suppliers.

Standing charge

Some argue that it would be sufficient for Ofgem to set the format of evergreen tariffs, but not the level of the standing charge. In our view, the comparability issues for customers are not sufficiently different from the status quo if suppliers can choose both the standing charge and unit rate. In that event, it would be necessary to consider the size of the annual bill which is what the current post probe arrangements already deliver via LC 25 and annual statements. There are really no halfway houses on this issue. In our response to the March 2011 consultation, we argued that greater promotion of the information in the annual statements would give customers the tools they needed to make effective comparisons. If this view is rejected in favour of tariff standardization, ease of comparability requires uniform standing charges and a single unit rate for any given payment method.

As noted above, the general principle is that charges should be transparent and cost reflective. In order to limit competitive distortions, the standing charge should cover

all per customer regulated costs including regulated network, environmental and social obligation costs. In order to promote customer understanding of the costs of their energy bill, an objective endorsed by Ofgem, Ofgem would publish its allowances for the constituent parts of the standing charge and suppliers would reproduce this information on the bill and annual statement

There is discussion as to whether small suppliers, exempt from a range of increasingly costly obligations which affect per customer costs, should be required to set the same standing charge as larger suppliers. When the exemptions threshold was set at 50,000 customers for each of electricity and gas with the annual value of the exemption at around £32 per dual fuel household[1], it could be argued that the competitive distortion was tolerable. However, an exemptions level of 250,000 customers and a value per dual fuel customer of £72[2] represents a serious distortion of competition. Recognizing the set up costs associated with obligations, we would reiterate the proposal which we have advanced before, namely that small suppliers have the option of providing a per customer contribution to environmental and social obligations based on Ofgem's assessment of the contribution to the standing charge that these costs make for large suppliers and published by Ofgem and suppliers.

Unit charges

Unit costs vary by region. There is therefore no case for restricting suppliers to charging the same unit price in every region. Such a measure would have a number of disadvantages. First, it would undermine the scope for a supplier to offer exceptionally competitive rates in areas where it wished to expand its presence. This is likely to undermine competition and switching, contrary to one of the duties of the regulator. Second, it would force suppliers to cross-subsidize customers in higher cost regions from those in lower cost regions. We do not believe it is within the remit of the energy regulator to set up inter-regional redistributions of wealth.

There is no case in terms of tariff simplification for imposing a standard national unit charge. A given householder in a particular region will face the same decision between suppliers based on the unit charges of different suppliers whether that unit price is national or regional.

The economics of Economy 7, other multi-rate tariffs and, in future, smart tariffs do not lend themselves to Ofgem's ultra-simple approach. As now, customers should be making decisions based on their annual bill given their own consumption pattern. In these circumstances, we do not see any advantage in Ofgem seeking to regulate the day and night rates of multi-rate tariffs.

Price guarantee period for evergreen products

We disagree with this suggestion; there are a number of drawbacks.

[1] Paragraph 3.1 of the Appendix to Annex 1 of the CERT consultation May 2007
[2] Table 2.4 of the Standardised Element of Standard Tariffs under the Retail market Review consultation, 6 February 2012

First, it risks confusing customers as the price they face may not necessarily be the current price they see for their incumbent supplier in comparisons. This could mislead customers into making sub-optimal switching decisions.

Second, if the proposal were to operate symmetrically, we could have a situation where customers during the fixed term were paying more than other evergreen customers if prices had fallen in the meanwhile. This is likely to promote adverse comment and undermine the efforts by Ofgem and industry to restore trust. In particular, it risks promoting rocket and feather allegations from anyone adversely affected. Energy companies have been criticized for not responding quickly enough to wholesale price movements and artificial restrictions on faster response of retail prices to wholesale costs, whether upwards or downwards, should be avoided.

Third, the proposal exposes suppliers to significant risk. They would be obliged to hold prices for customers for six months regardless of the development of wholesale costs. But, the opportunity to contain the risk by hedging would be undermined by the fact that the customer can leave on three weeks notice. Overall, the operation of the regulatory rules whereby suppliers would have to hold prices to six months, but customers could leave after 3 weeks (which they would do if there was a general reduction in market prices) creates significant extra risk for suppliers.

In other markets where similar arrangements exist, exit fees are charged. For example, for a 3 year mortgage fix, if the customer repays their mortgage in year 1, then the customer will have to pay a penalty equal to 3% of the original loan value, in year 2, this becomes 2% and 1% in year 3. In car insurance, where the customer takes out a 1 year contract, the charge for early cancellation is typically £25 -£35 (some charge up to £75). If energy companies were prohibited from charging early exit fees where this optionality was exercised, then the cost would have to be recovered from charges generally. Effectively, loyal customers would be cross-subsidizing footloose customers. In our view, this is not to be recommended.

We do not think this is in the interests of customers or conducive to new entry. If customers want the comfort of fixed prices, they have the option of taking out a fixed price, fixed term deal.

C. Implementation and ongoing timing issues

Synchronization issues

Ofgem's decision to set the allowed standing charge eliminates a significant competitive market freedom to reset prices in response to changing costs. At the same time, there are significant "menu costs" of changing prices. The implications of this are:

i) Ofgem should not change the standing charge too frequently, we would suggest not more than once a year.

ii) Ofgem needs to change the standing charge in synchronization with changes in underlying costs. Failure to do this would result in suppliers experiencing unrecoverable costs and/or increased risk which will need to be reflected in customer

prices. There are also implications for Ofgem's regulation of network companies: we have seen an increasing propensity for mid year increases in network charges as well as the traditional annual revisions. We would be looking to Ofgem to limit interim price adjustments to exceptional circumstances given the ability of regulated price controlled companies to carry forward under-recovery of allowed revenues.

iii) Ofgem needs to give sufficient notice of the new standing charge that suppliers can provide the required notice to customers. It is likely that suppliers will wish to change unit charges at the same time as changes to the regulated standing charge. There are two reasons for this: first, to minimize the costs experienced by both suppliers and customers associated with price changes and, second, to adjust unit charges for any under or over-recovery of changes to fixed costs which are not fully reflected in Ofgem's change to the regulated standing charge.

In summary, standing charges should apply the principle of full and timely automatic pass through of the elements which are covered by the standing charge. A prerequisite, therefore, is that the composition of the standing charge and Ofgem's calculations regarding the contribution of the individual components should be fully transparent. This will also make an important contribution to customer and stakeholder understanding of the drivers of cost in the energy retail market, thereby helping to restore customer confidence in prices.

Timing of implementation

The implementation issues associated with Ofgem's proposals are very significant. In addition to the greatly extended documentation which we have already noted, changing the tariff structure of around 6m customers will require extensive additional communication and is likely to generate substantial additional traffic to our call centres. The detriment to customer experience would be exacerbated if all companies were required to switch on a given day. In addition, companies will be required to make these amendments to their billing arrangements during the same period when they are implementing changes to facilitate recovery of payments due under the Green Deal and when they are introducing the ECO. We would therefore strongly represent that companies are permitted to implement phased introduction of the new tariff structures to a backstop date in Summer 2013.

Production and implementation of tariff information documents

In chapters 2 and 3, Ofgem is proposing a significant number of new documents. It is intending to prescribe the format of those documents precisely. So far, we have only seen draft templates for one of these. The production of this large amount of documentation will take significant resource and has non –trivial lead times. Particularly as the content depends on various tariff simplification decisions which have yet to be made.

In setting implementation dates, it is important that Ofgem recognizes the required lead times and interdependences. Ofgem will be aware that this was an issue on which the industry had concerns in respect of the proposed timescales originally put forward for probe remedies.

Derogations

We support the proposal to make derogations for social and discounted tariffs under social programmes. We also support the proposal that suppliers should not be required to supply high consumption consumers on standard evergreen terms as the cost structure of these users will depart markedly from that assumed by Ofgem in setting the standing charge. We will comment further on this topic in our response to the consultation on the Standardised Element of Standard Tariffs. Our initial view is that the thresholds should be set to distinguish users at SME consumption levels.

D. Non standard tariff issues

Under Ofgem's proposals, fixed term contracts will almost always also be fixed price. Our concern is that a significant proportion of customers will be deterred by the restrictive nature of this combination. This may push more customers into remaining in the standard evergreen sector than is likely to have been the case in a free competitive market. We therefore encourage Ofgem to explore the merits of allowing different forms of non standard variable price fixed period contracts. It would also be helpful if Ofgem were to set out its thinking on which indices would be acceptable to it as the reference points for tracker tariffs in the non-standard sector and confirm that no notice to the customer of price change would be required on changes in the index.

We note that the implied unit rate equivalent for any given fixed term product may well vary depending on the consumption level chosen. The conclusion is that the consumption level or levels would need to be specified by Ofgem. It is arguable whether comparing tariffs on the implied unit rate is more customer friendly than Ofgem's current metric of total annual bill size.

Chapter 3. Strengthen Probe Remedies - domestic

Overview

We support the use of standard language and terminology and Ofgem's prescription of the format of notices, provided this is the result of proper consultation. We have already had exchanges with Ofgem on a number of licence conditions regarding requirements Ofgem regards as good practice. Examples include discussions about wording to comply with LC7A and the formulation of notices under LC31A. We do not think it is self-evident that the regulator always has better insights than regulatees as to what constitutes good practice in dealings with customers or has an adequate appreciation of practical constraints.

Ofgem's proposals apply to a number of existing regulatory documents:

- Advance notice of adverse contract changes (LC23)
- Bills (LC31A)
- Annual statements (LC31A).

They also introduce a number of new regulatory documents:

- Contract renewal notification (proposed LC22B)
- Tariff information label (Proposed LC22C).
- Price comparison guide/indicator (Proposed LC22C)

In the current climate, there is a strong argument in favour of these documents being in a format prescribed by the regulator. It should eliminate the possibility of accusations that companies are not being sufficiently transparent and, thereby, improve trust and confidence. It will reduce the regulatory risk that Ofgem will decide that companies have not followed good practice and are in breach of licence requirements. It is therefore disappointing that Ofgem has only produced a mock up for two of these documents (Figure 2: Example of Tariff Information Label page 19) and the price change leaflet (Figure 9: Appendix 3)) as this reduces the scope to meaningfully comment on Ofgem's proposals. We note Ofgem's recent statement that its consumer research endorses the need for simplification. Before introducing a raft of new and expanded documents, we would ask Ofgem to confirm through its focus groups both that its new documentation is understood and valued by customers and that this is their preferred channel.

At the present time, the energy industry is being subjected to an unprecedented amount of externally imposed new obligations and change. Recent experience is of Ofgem constantly tweaking requirements across a wide range of areas. Going forward, it will be more important than ever that Ofgem applies the self-discipline to "get it right first time": to decide what it wants and stick with it. Only in this way does the industry have the prospect of limiting initiative overload and the inevitable adverse consequences on customer experience. Poor customer experience would undermine the efforts of both industry and regulator to improve trust which we all agree are vital to the successful delivery of energy policy goals.

It is also noticeable that both DECC and Ofgem prescribe the content of bills. It would be appreciated if there could be an element of consultation and co-operation between DECC and Ofgem so that, again, there be one set of changes encompassing all matters introduced simultaneously.

We would also request that Ofgem recognises the systems complications of the changes that it plans and gives as long a lead time for the changes as it considers possible.

This backdrop motivates a number of concerns which we have with elements of Ofgem's proposals:

- Recent experiences have demonstrated the tensions between objectives. On the one hand, there is the imperative for simplicity and accessibility for customers. On the other hand, there is a growing regulatory obligation to provide ever more information to customers as the complexities of energy policy impact increasingly on customers. A particular risk is that every bill will turn in to an annual statement (in addition to the actual annual statement). The benefits of tariff simplification and terminology standardization could easily be undone by information overload.

- The proposed licence conditions in relation to all of the above documents provide that Ofgem may issue a direction to revise the content, format and display subject only to consultation. For some documents, the power to direct relates also to the method of undertaking calculations. These provisions amount to Ofgem granting itself powers to change licence conditions without the normal control of licensees being able to refer the matter to the Competition Commission. We consider this to be an unacceptable erosion of the checks and balances which have been built into the regulatory regime. It is therefore important that any changes to any of the regulatory documents and the timing of any changes have the status of changes to licence conditions.

- Similar concerns arise with respect to Ofgem's proposed ability to issue and revise guidance in respect of licence condition 22B and 23 and 31A. (See proposed paragraphs 22B.12, 23.12 and 31A.9).

Detailed points

Paragraph 3.31 proposes that bills and statements provide a summary box which includes the tariff rate in p/kWh. However, as standard tariffs, at least, will have a standing charge and unit rate, it is unclear how this figure would be calculated unless Ofgem intends that this figure would be just the unit rate component of the charge. If this is Ofgem's intention, we have concerns that this might generate calls and complaints from customers misinterpreting the information and objecting that their bill is overstated.

We note that the draft amendment to SLC31A includes a definition of "Relevant Charges" to be used when calculating an estimate of total annual costs. This would require the use of publicly announced charges, or in other cases, current charges. We believe that the licence drafting should not preclude the apportionment of current and

future prices where system capability permits this, to maximise the transparency of information provided.

Chapter 4. Standards of Conduct

Introduction

Ofgem is proposing to introduce "Standards of Conduct" (SOCs) into supply licences for both the domestic and non-domestic sectors. Draft wording has been included in a new condition 1A (See Appendix 6 to the Non-domestic Proposals (NDPs) or Appendix 4 to the Domestic Proposals (DPs)). These standards are more extensive than the present non-binding standards which were introduced as part of the probe.

The proposals are that the licensee must take all reasonable steps to deliver the Customer Objectives and avoid doing anything which might frustrate the Customer Objectives.

The Customer Objectives are that:

> "(a) the licensee, its staff and any Representative behave and carry out any actions in a fair, honest, transparent, appropriate and professional manner;
>
> (b) the licensee, its staff and any Representative provide information (whether in Writing or orally) to a Customer which:
> (i) is complete, accurate and not misleading (in terms of the information provided or omitted);
> (ii) is communicated (and, if provided in Writing, drafted) in plain and intelligible language;
> (iii) relates to products or services which are appropriate to the Customer to whom it is directed; and
> (iv) is otherwise fair both in terms of its content and in terms of how it is presented (with more important information being given appropriate prominence);
>
> (c) the licensee, its staff and any Representative:
> (i) make it easy for a Customer to contact the licensee,
> (ii) act promptly and courteously to put things right when the licensee, its staff and any Representative make a mistake, and
> (iii) otherwise ensure that customer service arrangements and processes are complete, thorough, fit for purpose and transparent."

We support the sentiments and aspirations in the SOCs. However, we do have a number of concerns about hard-wiring them as a licence condition in the way Ofgem is seeking to do. Our concerns are set out in detail in the following paragraphs. In summary, we have concerns that the proposal:

- Duplicates consumer protections which already exist and where there is already more than one enforcement agency;

- Undermines the potential for companies to differentiate themselves in terms of the service standards they offer customers and the role of competition in establishing the service level that customers seek;

- Will not avoid micro-regulation on the evidence of Ofgem's current approach to regulation, contrary to its suggestion;

- Will markedly increase regulatory risk due to the ambiguity in the requirements and Ofgem's multiple roles as lawmaker, prosecutor, judge, jury and executioner. In particular, Ofgem will have broad scope to interpret and re-interpret the standards without any effective constraints. This, in turn, will inevitably lead to regulatory creep, thereby undermining incentives for customers to engage in the market, raising costs and regulatory risks which will ultimately feed through to customer prices to the detriment of customers.

A radical new licence condition such as this with broad scope and discretion would need to go hand in hand with developments in the appeals process. We would expect a similar right of appeal as applies to price control determinations, namely a full review on the merits by an expert independent body such as the Competition Commission where Ofgem would be expected to demonstrate that the proposals truly were in the interests of consumers.

Overlap with existing legislation

Most of the elements of (a) and (b) of the Customer Objectives are covered by existing legislation which is already administered by Ofgem or covered by existing or prospective licence conditions.

Ofgem's own consultation on the Draft Enforcement Guidelines on Complaints and Investigations notes (p.14) its role in enforcing the following legislation:

"Community infringements

- The Consumer Protection from Unfair Trading Regulations 2008 ("CPRs"), which prohibit the use of misleading, aggressive or otherwise unfair commercial practices by businesses in interactions with domestic consumers.

- The Control of Misleading Advertisements Regulations 1998 (as amended), which are aimed at protecting the interests of consumers and traders from misleading or unacceptable comparative advertising;44

- The Consumer Protection (Cancellation of Contracts Concluded Away From Business Premises) Regulations 1987, which provide consumers with a seven-day cooling off period when they agree to buy goods or services worth more than £35 from a trader during an unsolicited visit to their home;

- The Unfair Terms in Consumer Contracts Regulations 1999, which protect consumers against unfair standard terms in contracts they make with traders;

- The Consumer Protection (Distance Selling) Regulations 2000, which are aimed at businesses that sell goods or services to consumers by: the internet; digital television; mail order, including catalogue shopping; phone or fax;45

- Sale of Goods Act 1979, and Supply of Goods and Services Act 1982, which cover consumers' statutory rights in respect of goods and services.

Domestic infringements

- Trade Descriptions Act 1968 (which covers false descriptions applied to goods and services);

- Consumer Protection Act 1987 Part III (which covers misleading price indications)."

This clearly creates the potential for double jeopardy in these areas of consumer protection regulation and legislation, where much of this is enforced by local authority trading standards services.

Indeed, we note a specific example where Ofgem's proposals would extend the overlap. In its Non-domestic proposals, Ofgem includes a marketing licence condition (LC) aimed, inter alia, at regulating the conduct of TPIs. At para 5.25 of the NDPs, Ofgem notes that this LC might not be needed if the SOCs are introduced as LCs. However, Ofgem explicitly proposes to extend the double jeopardy problem by also asking government for powers to enforce the Business Protection from Misleading Marketing Regulations.

It is unclear why the additional general protection is required for energy customers and not for consumers of any other product or service, bearing in mind that Ofgem already has wide powers to address any specific issues through specific licence conditions.

In addition, standards of conduct are already regulated across a wide range of company activities by the energy ombudsman (EO) the framework of and for which is set by the CEAR Act and subordinate legislation. Indeed, in recent times, the EO has acquired a wider-ranging remit to determine the standards to which companies must adhere, at we believe, Ofgem's behest and with its imprimatur.

In the summer of 2011, the EO issued a paper entitled 'Commercial Decisions Document'. This extended EO involvement to being able to decide disputes referred to it which involve what might be called supplier 'business as usual' services (for example, a matter relating to the collection of a debt). We believe that this encroachment into such areas could, when it makes a binding decision, result in the EO impacting on and being able to determine suppliers' commercial policy.

This is surely not what Ofgem envisaged when an ombudsman scheme was first mooted in its response[3] to the billing super-complaint brought by energywatch. In that document, Ofgem required suppliers to establish "***a dispute resolution body that will provide a means for customers to seek consistent and independent resolution of account and billing disputes that they have been unable to resolve with their suppliers.***" This is a much more circumscribed definition of the EO's locus than its present role today; which one could argue, in some areas, seeks to replicate Ofgem's own role of regulating conduct through licence conditions. Our conclusion is that the scope of EO activity has been expanded so that it now already broadly covers the same issues as the proposed SOCs. Consequently, introducing the standards into licences would be disproportionate.

Having noted that the SOCs cover much the same ground as consumer protection legislation, we also note that most customer protection legislation is aimed at domestic consumers. We have a particular concern that a SOC licence condition covering the whole non-domestic sector will distort the balance of the contractual relationship which one would expect between energy companies and larger industrial and commercial consumers.

Usurping the role of competition

The points covered under paragraph (c) of the Customer Objectives would normally be regarded as issues on which companies compete. We therefore regard it as inappropriate for Ofgem to regulate with standards on these matters, bearing in mind that the GB energy market is widely acknowledged as one of the most competitive in Europe.

Ofgem acknowledges (para 5.30 of NDP) that:

> "given current practice in the market, suppliers are likely to need to make changes to their systems and/or processes to make sure their actions are in line with the SOCs."

We believe Ofgem's approach violates the principle of competition where possible and regulation where necessary.

A proportionate approach which works with the grain of competition, rather than against it, would be for Ofgem to collect and publicize information of key dimensions of company performance. This would enable customers to choose their own preferred trade-offs between characteristics. We note that Ofgem has already embraced the information provision role on one dimension, namely price. However, in doing so, Ofgem has reduced the scope for companies to compete on price structures. We believe it would be unhelpful for Ofgem to further restrict the form of competition by setting prescriptive standards of service.

[3] Ofgem's response to the Super-complaint on billing processes made by the Gas and Electricity Consumer Council ("energywatch") Decision document - July 2005

Principles-based regulation

Ofgem holds out LC1A as building on the high-level principles approach to regulation which it adopted as part of the probe (NDP para 5.9). It also claims (NDP para 5.10) that the SOCs could enable Ofgem to limit the need for more prescriptive measures in the future.

In fact, the evidence of Ofgem's current approach to regulation contradicts the likelihood that Ofgem would not adopt a belt and braces approach. Since the probe, Ofgem has pursued a twin track approach of seeking to regulate at both the macro level whilst at the same time micro-managing the operations of companies. For example:

- Ofgem introduced high-level principles into clause 1 of the marketing supply licence condition (SLC 25), but, in addition, introduced a large number of highly prescriptive additional requirements into the condition;

- In addition to introducing standards of conduct under the probe, Ofgem also introduced a large number of highly prescriptive requirements including additional information on bills and annual statements, amendments to debt and customer transfer arrangements, detailed financial information reporting and prescriptive requirements for the rollover of business customer contracts;

- Since the probe, Ofgem has introduced further highly prescriptive regulation such as the requirement to give 30-days' notice for variations in contract terms.

- Under the Retail Market Review, Ofgem is taking and has already taken steps to increase further the level of prescription in areas where prescriptive arrangements were introduced under the probe including detailing exactly the format and content of customer information and more detailed prescription regarding the compilation of the annual financial statements.

It is notable that at para 5.26 (NDPs), Ofgem states:

> "We consider that there is still a need to retain the prescriptive requirements of SLC 7A to deal with certain particular issues that the condition was designed to address."

The evidence therefore points overwhelmingly to the conclusion that Ofgem will continue to micro-manage the industry with or without the standards of conduct as licence conditions. In addition, Ofgem's own instincts will be reinforced by requirements emanating from the UK and European governments which are themselves showing an increasing predilection for micro-regulation.

Ambiguity in high-level regulation

A key objection to high-level regulation is the degree of ambiguity in the requirements and consequent discretion on the part of the regulator in interpretation. This is particularly important when allied to two other features, namely:

i) the very high standard required to deliver the objectives: "all reasonable steps"; and
ii) the absence of an effective appeals mechanism against regulatory decisions.

The net effect is to confer on the regulator the power to determine that a company has breached the requirements in a very wide range of unspecified ways. Given the lack of effective appeal, companies will therefore need to take an ultra-cautious approach to interpretation across a very wide range of topics. We do not believe this is in the interests of customers as the costs and regulatory risk will ultimately find their way into consumer prices.

An illustration of the ambiguity in high level (so-called principles regulation) is the proposed text for a non-domestic marketing licence condition in the NDPs:

> **Standard Condition 7B. Sales Activities with Non-Domestic Customers**
>
> "7B.1 In respect of any Sales Activities, the licensee must take all reasonable steps to ensure that all information which the licensee, its staff and any Representative provides (whether in Writing or orally) to a Non-Domestic Customer is:
>
> (a) complete, accurate and not misleading (in terms of the information provided or omitted); and
>
> (b) communicated (and, where applicable, drafted) in plain and intelligible language.
>
> 7B.2 For the purposes of this condition:
> "Sales Activities" means any activities of the licensee, its staff or any Representative which are directed at or incidental to identifying and communicating with Non- Domestic Customers for the purpose of promoting the licensee's Non-Domestic Supply Contracts to them and includes entering into such contracts with such customers."

At paragraph 4.7, Ofgem claims that, as a minimum, this licence condition would require:

i) Third Party Intermediaries (TPIs) to make customers aware which suppliers they act for;
ii) TPIs disclosing to customers whether the supplier has paid them a fee;
iii) TPIs to record and retain phone calls with customers.

It is far from self evident that these requirements flow from the wording of the licence condition. It is entirely possible that companies would not necessarily establish such arrangements under LC 7B. And yet, Ofgem would apparently regard this as a breach of the licence condition.

Ofgem itself notes the similarity between its proposed LC 7B on non-domestic marketing and the proposed LC1A – standards of conduct. Indeed, it notes that if LC1A goes ahead, LC 7B may not be needed. However, the above discussion of LC 7B confirms the interpretation problems which high level obligations impose on obligatees. This teleological approach (the obligation means whatever the regulator wants it to mean or that it has a special, unique, purpose) is convenient for the regulator. However, it imposes enormous difficulties on companies as well as markedly increasing their regulatory risk. Ofgem claims (para 5.18) that the revised SOCs are drafted in a way which enables suppliers to understand what types of activity will meet the standards. However, the above example illustrates that this is plainly not the case. Moreover, there have been a number of recent examples where Ofgem has asserted that, although the meaning of an LC or obligation is perfectly clear, it is issuing an open letter or guidance. Recent examples include the application of LC27 (ability to pay), wording to comply with LC 7A and the eligibility of CFLs in the period Jan –March 2011. In our opinion, it is by no means self-evident that an independent and experienced member of the judiciary would conclude that the words on the face of the licence or legislation bear the interpretation that Ofgem seeks to apply.

Also in para 5.18, Ofgem states:

> "We will in due course also consider what compliance and enforcement processes may be the most appropriate when enforcing principles-based requirements."

It would be entirely unsatisfactory for Ofgem to try to introduce a licence condition of this nature without specifying in advance how, if at all, the enforcement regime might differ from its standard approach. And yet, this issue receives no mention in the consultation on the Draft Enforcement Guidelines on Complaints and Investigations which was issued shortly after the LC1A proposal (on 16 December 2011).

The ambiguity and regulatory risk which would be introduced by SOCs as licence conditions is well illustrated by the issue of objections. Ofgem issued an open letter "to remind suppliers of their obligations and to provide examples of good practice." (Appendix 3, para 1.1). Pararaph 1.5 of the letter states:

> "The contents of this open letter will be reviewed in the event that Ofgem decides to proceed with legally binding standards of conduct. In that event, it is envisaged that many of the areas of good practice discussed in this open letter could be enforceable as part of the binding standards of conduct. "

Para 5.27 highlights the uncertainty which the SOCs would create for licensees. It states:

> "Our initial view is that the good practice issues we highlight in the letter would be caught by the SOCs."

It continues:

> "It is also possible that other issues related to Objections but not expressly captured in our licences (see chapter 3) at the moment may also be captured by this proposal."

Ofgem concludes that the open letter may need to be recast if SOCs were implemented.

What does this tell us about the introduction of SOCs? First, anything that Ofgem deems "good practice" would automatically be a licence requirement. Second, even though Ofgem has given this topic considerable thought and identified a whole range of good practice issues which are not currently licence requirements, it recognizes that there may be others which it has not thought of which would become licence requirements. However, if even Ofgem cannot identify the full range of topics which could be caught under its own criteria for determining good practice, what chance do licensees have? And yet the exposure of companies to this LC is severe given that it is cast in terms of companies taking "all reasonable steps" to achieve compliance with something that is not on specific requirements but on broad principles.

We have already had exchanges with Ofgem on a number of licence conditions regarding requirements Ofgem regards as good practice. We do not think it is self-evident that the regulator always has better insights than regulatees as to what constitutes good practice in dealings with customers or has an adequate appreciation of practical constraints. Licence conditions such as the proposed LC1A erode the need for the regulator to expose its proposals regarding the application of SOCs to the checks and balances of proper scrutiny and challenge. They thereby facilitate bad regulation.

Tilting the scales of justice

We have already noted the limited scope to appeal an enforcement decision of the Authority. These arrangements were originally established under the Electricity Act 1989. They were not amended, however, when the seriousness of an adverse finding by the regulator was reinforced by the introduction of the power to impose a financial penalty. The ability to levy a penalty combined with limited appeals emphasize the importance of the Anglo-Saxon rather than the European approach to lawmaking, namely that those affected by a regulation should have reasonable certainty as to what it means.

Guidelines

LC1A also proposes that Ofgem may issue and revise guidelines on the interpretation of the SOCs. Guidelines are another development which have grown in popularity with Ofgem and which also subvert the checks and balances which were put in place at privatization.

Guidelines effectively confer upon Ofgem the ability to change obligations without consulting and without granting licensees the power to challenge the justification for changes at the Competition Commission. We do not think the resulting lack of effective scrutiny or potential for challenge is consistent with regulatory best practice or with the making of regulations consistent with better regulation principles as required by Ofgem's statutory duties.

Whilst we support the greater clarity which guidelines might bring to the interpretation of LC1A in respect of particular issues, we cannot support the lack of appropriate governance.

Conclusion

The above discussion has demonstrated that if the proposed SOCs are cast as licence conditions, they will substantially overlap with existing consumer protections, thereby creating double jeopardy. By establishing common standards potentially prescribed by the regulator in detailed guidelines, there is a risk of undermining the role of competition and the incentive for customers to engage with the market.

The discussion has demonstrated the huge ambiguity which the standards would introduce, raising regulatory risks and costs to companies which would eventually need to be reflected in customer prices. The licence condition amounts to requiring that companies are in breach if they do anything which Ofgem would decide is not good practice, even if Ofgem has never been explicit about it. Given the potential for large fines and the highly restrictive grounds for appealing any penalty levied by Ofgem, this proposal is entirely unacceptable.

In some cases, Ofgem proposes that the ambiguity would be alleviated by guidelines, but, in most cases, Ofgem proposes that it shall have a unilateral right to vary guidelines. This amounts to a power to amend licence conditions without the due process of a right of appeal to the Competition Commission and is also unacceptable.

Ofgem claims that the introduction of a high level obligation would obviate the need for more prescriptive regulation. However, the overwhelming weight of evidence contradicts this claim.

Both Ofgem and the Secretary of State have a duty, under the Electricity and Gas Acts, to have regard to best regulatory practice. This means:

> "(a) the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and
>
> (b) any other principles appearing to him or, as the case may be, it to represent the best regulatory practice."

Taking each principle in turn:

- Proportionality: regulators should intervene only when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised.
- Accountability: regulators should be able to justify decisions and be subject to public scrutiny.
- Consistency: government rules and standards must be joined up and implemented fairly.
- Transparency: regulators should be open, and keep regulations simple and user-friendly.

- Targeting: regulation should be focused on the problem and minimise side effects.

For the reasons cited in this letter, we believe that elements of the SOC proposals are problematic against all five of the principles of better regulation.

An approach consistent with better regulation would be for Ofgem to proceed on a case-by-case base, only introducing new obligations when it has a sound evidence base on which to act. "Just in case" regulation as exemplified by the SOC proposal is not consistent with the principles of better regulation. Targeted regulations should be precise enough both to achieve their specific objective and to eliminate ambiguity as to what constitutes compliance. However, they should avoid micro-managing compliance processes as this eliminates the scope for companies to use different techniques to deliver compliance.

Chapter 5. Vulnerable consumers

At paragraph 5.10 Ofgem raises the possibility of further interventions on behalf of vulnerable customers such as: (a) a backstop tariff or (b) an obligation on suppliers to offer the best tariff. However, we think there is more scope to integrate Warm Homes Discount (WHD) into tariff simplification.

Taking each of these in turn:

(a) A backstop tariff

The first issue relates to the definition of vulnerability. Different groups are vulnerable in different contexts. Ofgem is well aware of the difficulties which arise when there is a poor match between the eligibility criteria for recipients and the benefit: the Winter Fuel Payment, costing approximately £2bn in 2011/12, is received by all pensioners. However, by no means all pensioners require this support. Consequently, there is now a high profile initiative whereby the more well-off recipients can redirect their benefits to those in greater need. In our view, this illustrates a requirement for a clear definition of vulnerability based around those who struggle to pay their bills.

Second, it is unclear what Ofgem has in mind. During the transition to full competition, incumbent suppliers were subject to retail price control, effectively a form of backstop tariff. However, the relationship with competitive tariffs can be problematic. Suppose the backstop is set above the level of evergreen tariffs, then it serves no real purpose. Vulnerable customers would be better off on the evergreen tariff.

If the proposal is to set the level below that of evergreen tariffs, different issues arise.

The third issue is whether there is a case for offering a certain group of customers a discount to standard tariffs given the existence of WHD and that Ofgem's reviews of margins on standard tariffs have not found that there are excess margins being earned on standard tariffs, quite the reverse.

There is an argument for giving a particular group of customers a better deal than the generality of customers. Indeed, this is the argument for WHD.

Assuming the obligation is cast as a requirement that suppliers take all reasonable steps to offer vulnerable customers the backstop tariff, then the challenge is substantial. Suppliers would need to establish whether each individual customer met the vulnerability criteria. In respect of other obligations, suppliers have already expressed their concerns about the difficulties of identifying vulnerable or priority group customers as suppliers do not have automatic access to the relevant data. Even if the group of eligible customers was precisely defined and identification was aided by improved data sharing, the costs of identifying the eligibility of every customer would be substantial. Depending on the extent to which identification could be automated there could also be further substantial costs in confirming eligibility of those to whom the backstop tariff is paid.

Our conclusion is that a backstop tariff would not satisfy the principle of better regulation given that it essentially duplicates the purpose of Warm Homes Discount. But, unlike Warm Homes Discount, it would be necessary to check every customer's eligibility because if we failed to offer the backstop tariff to an eligible customer, it would be a breach of licence. We do not believe that these high administrative identification and verification costs can be justified given their impact on bills and the existence of WHD.

Fourth, the question of the level and eligibility for support would seem, in any case, to be a matter of social policy and should therefore be determined by government rather than Ofgem. Any decision about increasing the scale or scope of support should therefore be addressed through amendments to the mechanism which already exists, namely WHD.

Fifth, if the obligation is imposed only on larger suppliers, the measure will distort competition and provide a barrier to vulnerable customers from transacting with new entrants

Sixth, a licence condition such as this would also be in direct conflict with the non-discrimination licence condition. The differences between the charges made to the vulnerable customers and other customers would not be cost reflective.

(b) Best tariff

A best tariff obligation poses all the same issues a backstop tariff as noted above.

An additional problem is that the notion of best tariff is subjective. Some customers place a higher importance on price certainty than absolute price, others may be willing to pay a premium for a green tariff.

Integrating Warm Homes Discount (WHD) into tariff simplification

In principle, we believe that fuel poverty issues are better addressed through the tax/benefits system, not least because Government has direct access to the relevant data required to identify those who should be eligible for support. However, we recognize that, in practice, the delivery of social support through energy suppliers has been increasing.

We do think there is scope to better integrate WHD and Ofgem's tariff simplification proposals. This could be achieved by applying a reduced or even zero standing charge to customers satisfying well defined vulnerability characteristics which are communicated to energy companies through data sharing by government departments. This proposal would dovetail with our proposal for full transparency of the components of the standing charge. It would facilitate targeting exemptions at particular elements of the standing charge. For example, since social and environmental obligations are targeted at vulnerable customers, there is an argument

that they should not pay towards the cost of these obligations. An equalization process would operate between suppliers as now for WHD.