Promoting choice and value
for all gas and electricity customers

The Retail Market Review: Draft Impact Assessments for Domestic Proposals

Consultation - supplementary appendices

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Publication date:	1 December 2011	**Team:**	Retail Markets
Response deadline:	23 February 2012	**Tel:**	020 7901 7000
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Overview:

This consultation document marks the next stage of Ofgem's Retail Market Review (RMR). We are proposing to implement a range of reforms that are aimed at enhancing effective consumer engagement in the retail energy markets in Great Britain (GB), leading to greater and more effective competition.

Our aim is to make it easier for consumers to choose the tariff that is right for them, and for new suppliers to enter the market. We also plan to strengthen and continue to enforce the Probe remedies. We believe our proposals represent the most effective and fastest way of enhancing effective engagement and competition in the retail energy markets. If, however, it becomes likely that suppliers will oppose our proposals, we retain the option that we have flagged in our previous consultations of referral to the Competition Commission for a market investigation reference.

These proposals represent an important development in the functioning of the retail market and it is important to consult fully to allow stakeholders time to present their views. Our deadline for responses to this consultation is 23 February 2012.

Context

Ofgem's principal objective is to protect the interests of consumers, present and future, wherever appropriate by promoting effective competition. The Retail Market Review (RMR) represents Ofgem's attempt to enhance competition in the retail energy markets and make it work more effectively so that the benefits can be realised by more consumers than at present.

The proposals presented in this document are the results of two of the five workstreams initiated in the March RMR consultation. These are proposals to improve tariff comparability and proposals to strengthen the Probe remedies in the domestic market. We summarise their key elements below. Proposals on strengthening the Probe remedies in the non-domestic market were published in a separate consultation document on 23 November 2011[1]. Proposals to improve market liquidity are expected to be published before the end of the year and the initial findings from the accountant's study of company segmental accounts will be published early in 2012.

In conjunction with this consultation document we also publish draft Impact Assessments on the proposals covered herein and the draft legal text for new and amended licence conditions. We have also published our latest consumer research undertaken to inform our findings.

Associated documents

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

- The Retail Market Review – Domestic Proposals, November 2011, Reference: 116/11
- The Retail Market Review – Non Domestic Proposals, November 2011, Reference: 157/11
- The Retail Market Review – Draft Impact Assessment for Non Domestic Proposals, November 2011, Reference: 157A/11
- Retail Market Review: Energy bills, annual statements and price rise notifications; advice on the use of layout and language. A Research Report For Ofgem, Lawes Consulting and Lawes Gadsby Semiotics, November 2011
- Tariff Comparability Models, Volume 1 - Consumer qualitative research findings, Creative Research, October 2011

[1] Please see the following link: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=70&refer=Markets/RetMkts/rmr.

- Consumer reactions to varying tariff comparability models, Quantitative Research conducted for Ofgem, Ipsos MORI, 18 October 2011
- Ofgem's Retail Market Review – update and next steps (non-liquidity proposals), June 2011
- Ofgem's Retail Market Review – update and next steps (liquidity proposals), June 2011
- The Retail Market Review – Findings and Initial Proposals, March 2011, Reference: 34/11
- Ofgem Consumer First Panel, Year 3 2010/11, Findings From The Second Set Of Workshops, Opinion Leader, March 2011
- Customer Engagement with the Energy Market – Tracking Survey, Ipsos MORI, March 2011
- Vulnerable Customer Research, FDS International, March 2011
- Energy Supply Probe - Proposed Retail Market Remedies, August 2009, Reference: 99/09
- Ofgem Consumer First Panel, Research Findings from the Second Events – Billing Information and Price Metrics, March 2009
- Ofgem Consumer First Panel, Research findings from first event, January 2009
- Energy Supply Probe - Initial Findings Report, October 2008, Reference: 140/08

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Appendix 7 – Tariff Comparability Proposals: Draft Impact Assessment

Executive Summary

1.1. The key objective of our tariff proposals is to enhance effective engagement by consumers. This can be achieved by improving tariff comparability, simplifying the structure of standard energy tariffs and improving decision-making by consumers. We also want our proposals to retain choice for consumers and leave scope for innovation, especially as smart meters are rolled out.

1.2. We described high-level proposals in the March RMR consultation document[2]. These proposals involved:

- Allowing those on standard tariffs to see 'at a glance' whether or not they are on the cheapest standard tariff. This would also allow Ofgem to easily monitor any difference between standard tariffs and non-standard tariffs across the market;

- Allowing those on standard tariffs to see 'at a glance' how much they are paying compared to non-standard tariffs; and

- Allowing those who wanted further engagement in the market to be able to choose from a wider range of tariffs (thereby still incentivising innovation by energy suppliers). Suppliers could not change the terms and conditions of these tariffs adversely (including supplier-led price increases) without the consumer making a conscious and active choice on whether to accept such changes.

1.3. The main components of our March proposals were:

- suppliers would be allowed to offer only one standard tariff per payment method;
- Ofgem would set a standardised element for all standard tariffs;
- suppliers would set a single unit rate for each standard tariff;
- suppliers would set all elements of non-standard tariffs including structure;
- all non-standard tariffs would be fixed duration;
- no adverse unilateral variations to non-standard tariffs would be permitted;
- no auto-rollovers for non-standard tariffs; and
- adequate switching windows to be provided with no exit fee.

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[2] The Retail Market Review – Findings and Initial Proposals, March 2011, Reference: 34/11.

1.4. The features of the RMR core proposal are described in more detail later in this document. Our proposals would simplify the structure of standard tariffs, provide transparency and retain choice for those consumers that choose to engage in the market. Those customers who opt for a non-standard tariff and come to the end of their contractual term would be placed onto the supplier's standard tariff if they do not make an active choice of a new tariff. Those that do not engage will remain on, or be placed onto, a standard tariff.

1.5. As part of our work we have considered a wide range of other potential tariff features, based on our initial findings, responses to our March RMR consultation, and our consumer research. From the features considered, we produced four main alternative proposals. We also considered two options for a backstop tariff, which could be designed to apply to all consumers or to certain consumers, such as vulnerable groups.

1.6. On balance, we consider that the RMR core proposal remains the best approach to tackling tariff complexity and promoting effective engagement. Our quantitative research indicates that a fixed standing charge with single unit rate[3] and price comparison guide (both elements of the RMR core proposal) significantly improve consumer decision-making[4]. Approximately 74 per cent of non-Economy 7 (E7[5]) respondents and 76 per cent of E7 respondents stated that they would be more likely to switch if these elements were introduced.

1.7. The same research found that 81 per cent of non-E7 respondents selected the cheapest standard tariff (for the consumption value they were given) when faced with a number of tariffs with a fixed standing charge and single unit rate, but without a price comparison guide. This success rate rose to 85 per cent when a price comparison guide was provided (an indication of cost for an average low/medium/high user). For E7 respondents, in the tests with a common standing charge and separate day / night unit rates, 47 per cent selected the cheapest tariff in the test without a price comparison guide but 70 per cent were successful when a price comparison guide was provided. This highlights the importance of a price comparison guide to E7-type consumers.

1.8. Our research demonstrates that the likely net benefit of this policy option exceeds that of the other options considered and that the RMR core proposal meets our objectives most effectively. This evidence is consistent with the strong messages we had from other aspects of our research, and the behavioural economic theory we set out in our March consultation document. We consider that the RMR core proposal is a proportionate response to the problems with the retail market that were identified in the March RMR consultation document.

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[3] For E7 tariffs, there would be separate unit rates for daytime consumption and night time consumption.

[4] Ipsos MORI (October 2011), "Consumer reactions to varying tariff comparability".

[5] Note that there were no Economy 10 customers in either the E7 or the non-E7 group of customers. Therefore the non-E7 group can be considered to represent those on a single rate or normal meter.

1.9. Figure 1 summarises our assessment of the proposals against the policy objectives. It also includes an assessment of the likely scale of implementation costs and the risk of unintended consequences. These issues are discussed further in the main section of this draft Impact Assessment.

Figure 1: The RMR tariff proposals

	Improve tariff comparability	Simplify tariff structure	Increase engagement	Facilitate innovation and choice	Improve decision-making	Low implementation cost	Low risk of unintended consequences
RMR core	Green	Amber	Green	Amber	Amber	Amber	Amber
Variable standing charge	Amber	Amber	Amber	Amber	Red	Amber	Amber
Single tariff structure	Green	Green	Amber	Red	Green	Red	Red
Price comparison only	Amber	Red	Amber	Green	Red	Green	Green
Airline options[6]	Red	Red	Red	Amber	Red	Amber	Amber

Note: Green = high benefit, or low cost / risk, amber = medium benefit, or medium cost / risk and red = low benefit, or high cost / risk.

Key issues and objectives

1.10. The March RMR consultation demonstrated that further action is needed to make sure energy retail markets in Great Britain (GB) work in the interests of consumers. Recent research with the Ofgem Consumer First Panel[7] found that many consumers are disillusioned with the retail energy market and feel a sense of frustration in the face of rising prices. It will take a great deal to persuade many of these customers that engagement in the market is worthwhile.

1.11. Given this disillusionment, it is not surprising that many consumers are currently disengaged from the market[8]. We are particularly concerned that the growing complexity of pricing information is making engagement increasingly difficult and has led to high number of sticky consumers[9]. Those consumers who try to switch

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[6] i.e. a list of sequential choices like those available when you book an airline ticket online.

[7] The Consumer First Panel comprises of around 100 consumers across Great Britain who are chosen to be broadly representative of the population.

[8] We reported in the RMR that 20-30 per cent of consumers are disengaged and a further 20-30 per cent are permanently disengaged.

[9] Sticky consumers are those that choose not to switch, cannot switch due to their circumstances, or are put off switching due to other features of the market such as tariff complexity. We estimate that around 40-60 per cent of consumers in the energy sector are

find it difficult to make a well-informed choice which leads some to switch to more expensive tariffs. In addition, 75 per cent of consumers[10] are on standard tariffs[11] which lack any obvious decision or trigger points for engagement.

1.12. Many of the remedies following the 2008 Energy Supply Probe were designed to increase consumer engagement and enhance competition. There has been notable progress against some of the Probe remedies (e.g. SLC 25A and 27.2A removed unjustified differentials from prepayment meter and off-gas-grid tariffs worth around £300m), but we are disappointed with the reaction of suppliers to many of the measures aimed at enhancing effective engagement.

1.13. According to an OFT survey, 61 per cent of consumers found it difficult to choose suppliers in the energy sector, which was more than for any other sector surveyed[12]. This was supported by a uSwitch survey which found that 39 per cent of respondents believe that the most important reason for consumers not switching their energy tariff is that they find the range of tariffs offered by suppliers too confusing[13]. An experiment conducted by Which? found that only one person out of 36 correctly calculated their bill given a consumption value and the details of a Big 6 supplier's standard tariff[14]. This suggests that tariffs are too complex for consumers to understand at present and that some consumers could switch to more expensive tariffs as a result of this confusion.

1.14. Behavioural economics can provide an explanation for many of these observations. The behavioural economics research published alongside the March RMR consultation document found that consumers' limited capacity to deal with the large number of tariffs and their complexity causes many to completely disengage[15]. When consumers do engage, many are likely to miss the best offers because they use short cuts or rules of thumb to navigate the information. For example, consumers may use their existing deal as a reference point and stop searching when they find a better deal, rather than continuing until they find the best deal. They may also restrict themselves to using the information provided by a sales agent, rather than searching the markets. These factors – low engagement and short cuts – are likely to dampen price competition.

1.15. Our behavioural economics research also found that in the GB energy retail markets, loss aversion means that consumers focus too much on potential losses (e.g. higher prices, worse service) compared to potential gains. One reason for this is

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currently sticky (although we recognise they may have switched in the past) and that vulnerable customers are likely to be disproportionately represented in this group.

[10] DECC (January 2010) 'Energy Trends', p. 48 and 49. This figure is the simple average of the percentage of GB gas and electricity customers on standard tariffs.

[11] Standard (or 'evergreen') products are those that have no termination date.

[12] OFT (2010), 'Advertising of prices', OFT1291.

[13] uSwitch (June 2011), 'Consumer opinion on the energy market'.

[14] Which? (October 2011), 'It's time for simple energy deals'.

[15] Ofgem (March 2011), 'What can behavioural economics say about GB energy consumers?'

that consumers have doubts over the information they have access to, or lack confidence in their own assessment of energy deals. This can make them reluctant to act on their assessment and so reduce switching rates. Loss aversion, especially when combined with complex information is likely to make consumers disengage from the market.

Objectives

1.16. The key objective of our tariff proposals is to enhance effective engagement by consumers. This can be achieved by improving tariff comparability, simplifying the structure of standard energy tariffs and improving decision-making by consumers. We also want our proposals to retain choice for consumers and allow innovation, especially as smart meters are rolled out[16].

Options

Tariff simplification options

1.17. There was general consensus among respondents to our March consultation that the current complexity of tariffs is a problem and that action should be taken to help consumers engage more effectively. We agree with these views and do not consider that doing nothing is a reasonable option for consumers.

1.18. The consultation document describes the key features of the proposals that we consulted on in March and explains how the RMR core proposal has developed since then.

1.19. As part of our work we have considered a wide range of other potential tariff features, based on our initial findings, responses to our March consultation and our consumer research. From the features we considered, we produced four main alternative proposals. We have also considered how information might be better communicated to prompt and enable effective engagement.

RMR core proposal

1.20. The key features of the RMR core proposal are shown in the box below.

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[16] These proposals chime with the government's consumer empowerment strategy 'Better Choices: Better Deals' in terms of "putting power in the hands of consumers, so that they are better able to choose between suppliers, [which] will both enable them to get the best deals for themselves individually and collectively, while also putting pressure on businesses to be more efficient and innovative".

For **standard (evergreen) tariffs**:

- No end date and a maximum notice period of 28 days for termination.
- All suppliers limited to one standard tariff per payment method for consumers whose premises are fitted with single rate meters.
- All suppliers limited to one standard tariff per payment method for consumers who are on E7 tariffs. Derogations available for E10 and DTS tariffs.
- All standard tariffs will be structured to consist of a compulsory standing charge, plus a single unit rate (day/night rates for E7 tariffs) set by suppliers.
- All suppliers will be prohibited from offering discounts and combining standard tariff supply contracts with other goods and services.
- The compulsory regional standing charge will be set annually by Ofgem. We may also set a regional adjuster to the unit rate to account for regional differences in network costs that vary with consumption.
- All non-E7 consumers in each region will have the same standing charge, regardless of payment type.
- All E7 consumers in each region will have the same standing charge, regardless of payment type, but this could differ from the non-E7 charge.
- All other revenue would be recovered through a single unit charge (day/night rates for E7 tariffs) per payment method set by suppliers in a p/kWh format.

For **non-standard tariffs**:

- No limitation on number or type of tariffs, but they must be fixed term, with a clear end date and clear switching windows. Exit fees will be allowed.
- Price information must be presented in a 'standard equivalent' format that allows price comparisons with standard tariffs. This will be through the price comparison guide described in the 'Information Remedies' section below.
- All penalties and key contract terms must be made clear to customer in advance of agreeing a contract.
- No auto-rollovers: at the end of each fixed-term consumers would default onto a standard tariff with the same payment method unless they expressly agree to extend the contract or enter into a new contract with a supplier.
- Adequate switching window provided with no exit fee and no notice periods. We are minded to require this window to be 42 calendar days. Suppliers would be required to write to consumers in a format prescribed by Ofgem to notify them at the beginning of the switching window which will prompt further engagement. Consumers would be free to switch with no exit fee and, if they inform their supplier that they intend to switch during the switching window, they may benefit from the same prices until the switch is completed.
- No unilateral price increases or other adverse unilateral variations. This means that a supplier could not, during a fixed term period, increase the price or unilaterally change any other terms or conditions in any way that would leave the consumer being worse off.
- Regular disclosure by Ofgem of suppliers' average non-standard tariff price presented in a 'standard equivalent' format. This will aid transparency between suppliers' standard and non-standard tariff prices.

For all tariffs:
- We are minded to require all suppliers to include key tariff information in a Tariff Information Label, with the format mandated by Ofgem (this is described in the 'Information Remedies' section below).

- We are minded to regulate the manner in which the supplier and customer may mutually agree to change the terms and conditions of their tariff, as described in the variations to contracts section below.

- Suppliers could use regional names for their tariffs.

1.21. To implement and facilitate the RMR core proposal, we are minded to make changes to some existing rules and introduce a number of new rules[17].

Exceptions to the RMR core proposal

1.22. The consultation document explains that we are minded to allow certain exceptions to the RMR core proposal. These would include:

- Allowing suppliers to have tariffs that automatically provide for an increase in price;

- Allowing suppliers to apply for derogations for legacy social tariffs; and

- Allowing suppliers to agree bespoke contracts with domestic customers that have a very high level of consumption.

1.23. These exceptions are described in greater detail in Chapter 2 of the consultation document.

Setting the standardised element

1.24. A regional standing charge (set annually by Ofgem) combined with a single unit rate tariff structure would enable consumers to select the cheapest standard tariff by simply comparing the unit rate[18]. Our proposed approach would involve setting a single standing charge to cover the non-locational incremental fixed costs of serving an additional customer and a regional adjuster to account for differences in transmission and distribution charges. We are consulting now on what elements

[17] For the avoidance of doubt, this may include additional modifications to licence conditions to those illustrated in the appendices to this document.
[18] To facilitate this simplicity we consider that a number of rules and prohibitions will be necessary, including (but not limited to) a prohibition on suppliers offering discounts or linking standard domestic supply contract to contracts for other goods and services.

should be included in the standing charge and will consult on the detailed methodology that would be used to set the standing charge in early 2012.

1.25. The purpose of an Ofgem-set standing charge would be to allow suppliers to recover some of the fixed costs of supplying each customer. The standing charge would be policy-neutral and would not be used for the purpose of promoting environmental, social or other policies. Policy development would continue to take place by the relevant regulatory authority and supplier obligations arising from such policies would continue to be determined by the appropriate processes. While costs associated with such policies may be recovered if a wide standing charge were set, we would set the charge such that it allowed suppliers only to recover the cost of their obligations.

1.26. The standing charge element of our proposals would have a sunset clause. We propose that the initial sunset would occur five years after the licence condition comes into force. Ofgem would be able to revise the duration of the 'setting the standing charge' part of the licence condition by issuing directions. If we do not issue directions and the sunset occurs, suppliers would still be required to comply with the standing charge and single unit rate tariff structure, but would be responsible for setting their own standing charge.

1.27. Our high-level approach is described in Chapter 2 of the consultation document, as are the key pros and cons of setting a 'wide' standing charge that would include both network costs and additional cost elements. These pros and cons are discussed in more detail in the 'Impacts on consumers', 'Impacts on competition' and 'Other impacts' sections of this draft Impact Assessment.

Alternative proposals

1.28. As part of our work we have considered a wide range of other potential tariff features, based on our initial findings, responses to our March consultation and our consumer research. From the features considered, we produced four main alternative proposals. The alternative options are described in Table 1.

Table 1: Alternative regulatory options

Proposal name	Description
Variable standing charge	identical to the RMR core proposal, other than one major difference: Ofgem would not set the standing charge of standard tariffs and so suppliers would have greater freedom.
Single tariff structure	would require all tariffs to be structured as a single standing charge (set by Ofgem for all tariffs) and unit rate. All other features of the RMR core proposal would remain. This proposal goes further than that proposed by Which? in that we would still require suppliers to distinguish between standard and non-standard tariffs[19]. Suppliers would be permitted to offer only one standard tariff per payment method.
Price comparison only	would require suppliers to present a price comparison guide with their tariffs. As today, there would be no restriction on the range or number of tariffs a supplier could offer. Ofgem would design the methodology to calculate the price comparison guide and the format in which it should be presented.
Airline options[20]	would retain the elements of the RMR core proposal, the only difference being that Ofgem would allow suppliers to offer a defined set of optional extras with their standard tariff. This proposal would allow suppliers to offer a wider range of standard tariffs.

Improving information provision

1.29. Our key objective is to enhance effective engagement by consumers. One aspect of our proposals is to simplify the structure of some tariffs but we consider this will not significantly increase consumer engagement without additional information to aid consumers.

1.30. Our proposals to strengthen the Probe remedies (see Chapter 3 of the consultation document) and Standards of Conduct (see Chapter 4 of the consultation document) would help to maximise the benefits of our tariff simplification proposals, and vice versa. In particular, our proposals to improve the information provided on bills, annual statements and price notification letters would prompt consumer engagement with the market. The additional information remedies described in this section would help consumers to engage more effectively and make correct switching choices.

1.31. We have developed a price comparison guide to help consumers compare the price of different tariffs and have begun to develop a Tariff Information Label to

[19] See www.which.co.uk/campaigns/energy-and-environment/tackle-tariffs/the-which-simple-energy-tariff/ for a description of the Which? proposal.

[20] i.e. a number of sequential choices like those available when you book an airline ticket online.

help them compare non-price features of tariffs. These information remedies could be associated with any of the tariff simplification options, including the RMR core proposal that we are minded to introduce. The remedies would interact with and reinforce our tariff simplification proposals.

1.32. We describe the likely impacts of the price comparison guide and Tariff Information Label within our assessment of each of the tariff simplification options.

Price comparison guide

1.33. A price comparison guide would help consumers to compare the cost of tariffs available in the standard and non-standard segments of the market. It could be presented as a 'standard equivalent' unit rate (p/kWh) or as an indicative cost at certain consumption values (e.g. 'tariff X costs £Y per month for a low electricity user'). Our research identified advantages and problems with a price comparison guide being presented as p/kWh or in pounds and pence. Using p/kWh may avoid the need for a consumer to know their consumption, as is necessary with a £ per month guide. However, a guide expressed in £ per month will be more tangible to many consumers than expressed in kWh. At this stage, we are minded to require suppliers to express price comparisons using both approach, but seek stakeholder views.

1.34. Under the standard equivalent rate approach, it would be easy for consumers to select the cheapest standard tariff and it would not be necessary for them to know their level of consumption. The indicative monthly cost approach requires an assumption to be made on the level of consumption even for standard tariffs and, while it would remain easy to select the cheapest standard tariff, there is a risk that consumers would believe that the indicative price is that price that they would actually pay for their energy.

1.35. Both approaches require assumptions on consumption to be made for non-standard tariffs[21]. Research with the Ofgem Consumer First Panel found that very few Panellists understood the concepts of low, medium and high users[22]. Most looked at prices first and extrapolated from that whether they were a low, medium or high user, rather than using their own knowledge of their consumption to estimate which of the three categories of user might be most relevant to them. This is a concern given that comparisons between standard and non-standard tariffs depend on consumption, such that a low user may find 'standard tariff A' to be cheaper than 'non standard tariff B', whereas a high user may find the opposite. Our consultants suggested that 'pen portraits' of types of household users (e.g. family of five, home

[21] To calculate the 'standard equivalent rate' of a non-standard tariff we could subtract the annual cost of the relevant standardised element for a consumer in a particular region from the annual estimated bill of the fixed-term contract. This residual could be presented on a p/kWh format by dividing by the customer's actual (or estimated) consumption to compare with the price of suppliers' standard tariffs. A slightly different calculation would be employed for non-standard tariffs that have a two-tier rate structure.
[22] Initial results from the Consumer First Panel in November 2011 are based on emerging analysis from the workshops. Full, final findings will be provided in the Panel report which Ofgem will publish later in the year or early 2012.

during the day, working couple) might help consumers to understand these estimated costs. However, greater awareness and understanding of energy use and kWh will be necessary before the comparison guide will be used correctly.

Consumer preference

1.36. We tested both price comparison approaches with consumers in our qualitative research[23]. Overall, respondents expressed a preference for price comparisons to be shown in a monetary format. However, some respondents mistakenly believed that the monetary estimates represented the price that all low, medium and high users would pay. This suggests that the indicative monthly cost approach has the potential to mislead consumers and result in higher bills than they had expected.

1.37. It would be difficult for consumers to calculate the cost of their own energy if the only information provided to them is cost estimates at indicative consumption levels. Some respondents to the qualitative research noted that it would be important to know the unit price to enable them to calculate their value of their bill, given their own consumption.

1.38. However, many consumers do not know how much energy they consume – which was illustrated by our qualitative consumer research where none of the participants had any idea how much energy they were consuming[24]. While some consumers would be comfortable with, and would see the value in having price comparisons presented in terms of a 'standard equivalent rate', the approach could confuse some other consumers.

1.39. In addition to testing the format that would be of most help to consumers, our qualitative research also assessed whether consumers would prefer indicative monetary figures to be presented on a monthly, quarterly or annual basis. More than two thirds of respondents expressed a preference for monthly costs, as this was taken to be a familiar way in which they budget their expenses. It should be noted, however, that presenting comparisons on an annual basis may be more likely to promote engagement and switching because the saving would appear to be larger. Our proposals will improve consumers' awareness of their consumption.

Our assessment

1.40. Given that some consumers would prefer to see price comparisons in terms of standard equivalent unit rates while others would prefer to see comparisons in monetary terms, we have included both means of comparison. We would, however, like stakeholders to comment on this approach.

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[23] Creative Research (2011), 'Tariff Comparability Models - Consumer qualitative research findings'.
[24] See Creative Research (2011), 'Tariff Comparability Models - Consumer qualitative research findings', page 26.

1.41. One reason that consumers prefer monetary values to the equivalent rate is familiarity. Our qualitative research demonstrated that monetary estimates provide consumers with an immediate anchor point because while many have no idea of their energy consumption, they do have some idea of how much they pay[25]. Given this, it is natural for consumers to prefer to see price comparisons expressed in this manner.

1.42. However, the experience of the financial services sector suggests that concepts that are unfamiliar when introduced can become familiar and useful to consumers relatively quickly. For example, the annual percentage rate (APR) was introduced to the UK under the Consumer Credit Act 1974 to ensure comparability of loans and is required to be published for all regulated loans. The APR concept would have been unfamiliar to consumers in 1974 but is now an accepted means of comparison, used by consumers and widely published in marketing by loan providers. We consider that, over time, the standard equivalent rate would be used in a similar manner and would become accepted by consumers as a means of comparison. There is an important role for communications from Ofgem, suppliers and other stakeholders in building this familiarity.

1.43. It is also interesting to note that the consumer organisation Which? advocates an approach to tackling tariffs that would allow consumers to compare energy tariffs on the basis of the unit rate[26]. Which? suggests that its approach would allow consumers to work out the cheapest tariffs by looking only at unit charges and would avoid the need for consumers to have detailed information about their consumption. This suggests that it believes consumers would be able to understand the unit charge concept. By extension, and with the correct communication from stakeholders, it should be possible for consumers to understand the equivalence concept as well.

1.44. We note that some suppliers supported the idea of expressing tariff prices in a comparable manner and have been discussing how this could work in practice[27]. However, we believe it is vital that all suppliers express price comparisons in the same way and that the comparison guide is designed such that it helps consumers to make correct switching decisions and does not confuse them further. We are sceptical that the necessary consistency and simplicity would be achieved in the absence of regulatory intervention.

1.45. The impact of the price comparison guide on decision-making by consumers is discussed in our assessment of the Impacts on consumers later in this document.

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[25] See Creative Research (2011), 'Tariff Comparability Models - Consumer qualitative research findings', page 52.
[26] Which? Briefing (September 2011), 'Tackling Tariffs', Page 4.
[27] Suppliers have proposed the price comparison guide as a standalone proposal. As described in our analysis of the price comparison only proposal, we believe that greater intervention is required in order to meet the objectives of our tariff simplification proposals.

Tariff Information Label

1.46. One unintended consequence of tariff simplification might be that consumers begin to focus on price to the exclusion of non-price features of tariffs. We consider it important that consumers have access to a range of key tariff information and so have begun to develop a 'Tariff Information Label'. We envisage that this information would be easily available if a consumer wishes to see it, though some consumers may find it to be too much information[28].

1.47. It is important that the Tariff Information Label is accessible to consumers. Many consumers find the terminology used by energy suppliers unfamiliar and have limited understanding of terms used. We believe that this currently acts as a barrier to consumer engagement and so to the fully effective functioning of the market.

1.48. We commissioned expert research on the way in which language is currently used by energy suppliers and changes that could be made to the benefit of consumers[29]. The research found that one possible explanation for this lack of familiarity and understanding is that terminology differs both within and between suppliers:

- within suppliers – at present, some suppliers use different words to describe the same thing in a single document (e.g. suppliers currently use the word 'tariff' interchangeably with 'package', 'product', 'plan' and 'deal'); and
- between suppliers – there is limited consistency between suppliers at present.

1.49. The research also found that consistent format and language can aid understanding of and engagement with information. This suggests that, to maximise consistency and the benefit to consumers, Ofgem should set the terminology that would be permitted in the Label, and the format in which it would be presented. This would include standardising the descriptions that could be used to describe tariff types.

1.50. An early example of the Tariff Information Label for standard tariffs is presented in Figure 2 for illustration. An early example for non-standard tariffs is presented in Figure 3.

1.51. The Label will be further refined following consultation so as to have maximum benefit for consumers.

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[28] By way of example, we envisage that the Tariff Information Label will need to be provided at the same time suppliers are required to provide information about key contractual terms pursuant to standard licence condition 23.1).

[29] Lawes Consulting (November 2011), 'Energy bills, annual statements and price rise notifications: advice on the use of language'.

Figure 2: Example of Tariff Information Label for standard tariffs

Supplier	ABC Energy		
Fuel	Electricity		
Tariff name	ABC Standard		
Tariff type	Standard		
Payment method	Direct debit		
Unit rate	10p/kWh		
Standing charge	£10 per month		
This tariff lasts for	There is no end date to this tariff		
The price is guaranteed for	N/A. The supplier will notify you at least one month before the price changes		
Exit fees	There is no fee if you switch from this tariff		
Additional products / services included	N/A for standard tariffs		
Consumer satisfaction rating	*****		
Standard Equivalent Rate (SER)	**10p/kWh (all users)**		
Estimated monthly price	Low user £ 23.75	Medium user £ 37.50	High user £ 48.33

Assumptions for annual consumption: Low user = 1,650 kWh; Medium user = 3,300 kWh; High user = 4,600 kWh.

Figure 3: Example of Tariff Information Label for non-standard tariffs

Supplier	ABC Energy		
Fuel	Electricity		
Tariff name	ABC Fixed Renewables		
Tariff type	Green, Fixed price		
Payment method	Direct debit		
Unit rate	11p/kWh		
Standing charge	£13 per month		
This tariff lasts for	12 months		
The price is guaranteed for	12 months		
Exit fees	£50		
Additional products/ services included	Loyalty points		
Consumer satisfaction rating	*****		
Standard Equivalent Rate (SER)	**Low user 13.2p/kWh**	**Medium user 12.1p/kWh**	**High user 11.8p/kWh**
Estimated monthly price	Low user £ 28.13	Medium user £ 43.25	High user £ 55.17

Assumptions for annual consumption: Low user = 1,650 kWh; Medium user = 3,300 kWh; High user = 4,600 kWh.

1.52. We envisage that the Label would be available on switching sites. As part of our response to a Department for Business, Innovation and Skills consultation on institutional changes to the GB consumer landscape we nominated ourselves to take responsibility for the Confidence Code, which gives domestic consumers assurance about switching sites[30]. One benefit of this would be a greater ability for Ofgem to influence the format in which information is presented on switching sites. In particular, it would allow effective implementation of the RMR proposals to standardise / simplify the language used on switching sites and to require consumers to have access to a Tariff Information Label at point of comparison. With responsibility for the Confidence Code, Ofgem could specify the format in which the Tariff Information Label would be presented on switching sites and the manner in which it would be available (e.g. as an item that appears when a consumer hovers over an icon on the switching site). Issues surrounding the impact of Ofgem taking responsibility for the Confidence Code are discussed in greater detail in Chapter 3 of the consultation document.

1.53. We also believe that it would be valuable to present a Tariff Information Label on annual statements such that the consumer would have the necessary comparison information to hand at a point when they are likely to engage in the market. A standardised format with consistent language would enable consumers to clearly identify the different features of various tariffs and to compare alternative tariffs with their current tariff.

Additional features and backstop tariff

1.54. We are consulting on two additional features and have considered two options for a backstop tariff. These could be associated with any of the tariff simplification proposals.

1.55. The additional features that we are consulting on are: to include an exception to allow suppliers to offer a green standard tariff; and to include a six month price guarantee for standard tariffs. The first of these features would ensure that a wide range of non-time limited green tariffs would continue to be available. The second would give consumers the assurance that when they switched to a new tariff or supplier, their price would not change for the first six months. This could increase confidence in switching.

1.56. A backstop tariff, for example priced relative to a basket of other tariffs available in the market, could potentially benefit consumers who are unable to navigate the market as it would be an alternative to participating in the competitive market. The backstop tariff could be designed to apply to certain consumers, such as vulnerable groups. Alternatively, a wider backstop could potentially replace the standard tariff in the RMR core proposal, essentially acting as the backstop tariff to all non-standard tariffs.

1.57. The pros and cons of the additional features and the backstop tariff are discussed later in this document.

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[30] See Ofgem (October 2011), 'Press Notice: Radical Reform For A Simpler, More Competitive Energy Market' for our policy statement on this issue.

Consumer research

1.58. At the start of 2011 we commissioned research to inform the March RMR consultation document. We used our Consumer First Panel to explore a range of options for simplifying tariffs, including a backstop tariff. We commissioned qualitative work with vulnerable groups to explore their engagement with the market and their views on the tariff options. We also ran our regular switching omnibus survey which tracks engagement with the energy market[31].

1.59. We have since commissioned additional research to test our tariff proposals with consumers. The first, a qualitative piece, was designed to explore the reactions of domestic consumers to the proposals and to establish which model would enable consumers to compare tariffs most easily[32]. The research also explored whether respondents would be likely to switch supplier if a proposed model were introduced and drew out differences between the reactions of vulnerable and non-vulnerable consumers. The research was conducted through face-to-face interviews with groups of one, two or three respondents.

1.60. The qualitative work was followed by quantitative research[33]. This was designed to test the ability of consumers to select the cheapest tariff when presented with different tariff structures and information. Participants were repeatedly asked to choose the cheapest tariff, given an energy consumption value and a simplified table of energy tariffs. Some of the tariff tables included a price comparison guide while others did not. In this way, we tested a range of different features of the five proposals assessed in this paper.

1.61. The quantitative testing was conducted via both an online sample and through face-to-face hall tests that helped to boost the sample of vulnerable consumers, including those that do not have internet access. The research software recorded whether or not the consumer had made the correct choice and the time taken to reach a decision. The test also included questions on consumer preferences for different tariff types.

1.62. The focus of both the above pieces of consumer research was to test elements of the proposed options, including the price comparison guide and a simplified tariff structure.

1.63. In addition, we used one round of the regular Ofgem Consumer First Panels to test the Tariff Information Label. Participants were provided with laminated cards, each of which had the names and explanations of pieces of information that consumers might wish to include on a Label (e.g. 'standing charge'). Using these cards they designed a Label that would help them to compare different tariffs. Participants were reminded to use the language and format that would make most

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[31] All of our research can be found at www.ofgem.gov.uk.
[32] Creative Research (2011), 'Tariff Comparability Models - Consumer qualitative research findings'.
[33] Ipsos MORI (October 2011), "Consumer reactions to varying tariff comparability".

sense to them as consumers, and to include anything they thought was relevant and was not included on the laminated cards. Participants were encouraged to make a trade-off between essential and nice-to-have pieces of information.

Impacts on consumers

1.64. This section sets out the potential impacts on consumers of the regulatory options outlined above. The aim of this section is to identify what we consider to be the overall effect on consumers of each of our proposed options, and why we consider the RMR core proposal represents the best option for consumers.

1.65. In the analysis below, we provide a full discussion of the likely impacts of RMR core. Where the impacts of other regulatory options are similar, we do not repeat the discussion but note that the point was covered in the assessment of RMR core.

RMR core

1.66. The RMR core proposal is designed to tackle some of the barriers to consumer engagement that were identified in our review of behavioural economics theory and its application to the energy retail market[34]. That research showed that consumers' limited capacity to deal with the large number of tariffs and their complexity causes many to completely disengage. When consumers do engage, many are likely to miss the best offers because they use short cuts or rules of thumb to navigate the information.

1.67. Our proposals would reduce tariff complexity and limit the number of standard tariffs, which would encourage more consumers to engage. The information remedies, and the proposed restriction on the structure of standard tariffs, would make it easier for consumers to compare tariffs and so would reduce the need for consumers to use 'rules of thumb'. The result would be more effective engagement with the energy retail market.

Tariff comparability

1.68. We noted above that many consumers find it difficult to work out the cheapest tariff at present because of the complexity of tariff structures and the difficulty of comparing the large number of tariffs currently available. A key objective of our proposed intervention in the retail market is to make it easier for consumers to compare tariffs and to assess whether or not they are on the best tariff for their circumstances. Our initial assessment is that the RMR core proposal, supported by our information remedies, would lead to improved accessibility of information and improved tariff comparability across the market. Our consumer research suggests

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[34] Ofgem (March 2011), 'What can behavioural economics say about GB energy consumers?'

that this package of interventions would encourage more consumers to engage with the market.

1.69. For standard tariffs under RMR core, ease of comparability is ensured by strictly limiting the number of tariffs available, requiring tariffs to have a 'standing charge plus unit rate' structure and setting the same regional standing charge for all suppliers. The latter measure would mean consumers would only need to compare unit rates to work out whether they could save money by switching to another standard tariff. To aid comparability between standard and non-standard tariffs we have proposed that all tariffs should be expressed on a 'standard equivalent' basis through a price comparison guide. To ensure that consumers can easily access information on the non-price features of energy tariffs we would require suppliers to compile a Tariff Information Label for each of the tariffs it offers.

1.70. A common standing charge set by Ofgem would enable consumers to select the cheapest standard tariff by simply comparing the unit rate. It would also allow suppliers to advertise price information for standard tariffs and should increase the range of media in which tariff information can be presented. The proposal should therefore directly improve the transparency and accessibility of tariff information. This effect would be reinforced by our proposals to introduce a price comparison guide and Tariff Information Label. It would also be reinforced by our proposed improvements for bills and annual statements, which are designed to encourage and help consumers to compare tariffs.

1.71. All participants in our qualitative research were of the view that action was needed to reduce the number of tariffs and to make it easier to compare tariffs and identify the most suitable tariff for their circumstances. Most respondents liked the idea of simplifying the structure of standard tariffs and felt that restricting standard tariffs to the 'standing charge plus unit rate' structure would be a helpful change[35].

1.72. Approximately 95 per cent of respondents to a uSwitch survey[36] supported our proposal to standardise the format of standard tariffs across suppliers and 94 per cent supported our proposal that prices for fixed-term tariffs should be expressed in a format that is readily comparable to standard tariffs. The provision of clearer and more transparent information was also considered important with 98 per cent of respondents supporting our proposals.

1.73. Our quantitative research found that a fixed standing charge and price comparison guide (both elements of the RMR core proposal) significantly improve consumer decision-making. When standing charges differed between suppliers and consumers were shown just the standing charge and unit rate, only 44 per cent of non-E7 consumers selected the cheapest tariff for their given consumption value. Approximately 81 per cent of non-E7 respondents selected the cheapest standard tariff for their circumstances when faced with a number of tariffs with a fixed

[35] Most respondents were unaware of the two-tier method and, when it was explained, they found it difficult to understand.
[36] uSwitch (June 2011), 'Consumer opinion on the energy market'.

standing charge (but without a price comparison guide). The time taken to make a correct choice was 28 seconds, the fastest of all the options tested. Interestingly, with the inclusion of a price comparison guide there was a further improvement in the proportion of consumers correctly choosing the cheapest tariff, to 85 per cent of respondents. However, the average time taken to make the correct choice increased by almost 50 per cent to 41 seconds. The research also showed that providing the price comparison guide without setting a common standing charge would have a limited impact on the ability of non-E7 consumers to correctly identify the cheapest tariff.

1.74. Only 19 per cent of E7 consumers correctly selected the cheapest tariff when standing charges differed between suppliers and they were shown only the standing charge and the day / night unit rates. When standing charges were fixed across suppliers, 47 per cent selected the cheapest tariff in the test without a price comparison guide but 70 per cent were successful when a price comparison guide was provided. The time taken to make a correct choice fell from 58 seconds to 48 seconds when a price comparison guide was provided. This highlights the importance of a price comparison guide to E7 consumers and suggests that price comparisons will become increasingly important as smart meters are rolled out and innovative ToU tariffs introduced.

Number of tariffs

1.75. Our proposal to limit suppliers to just one standard tariff per payment method should lead to a reduction in the total number of standard tariffs available to consumers. Our qualitative consumer research found that consumers are confused by the large number of tariffs currently available and this is often used as a justification not to engage in the market. Similarly, approximately 74 per cent of respondents to a uSwitch survey felt that there are too many tariffs available and 80 per cent felt that this makes it confusing to compare prices[37]. Reducing the number of tariffs should therefore encourage consumers to engage.

1.76. The majority of participants in the qualitative research recognised the benefits of having some degree of choice (e.g. the ability to find a tariff that matches their specific needs) but many felt that having so much choice made the selection process cumbersome. Rather than encouraging switching, this degree of choice served as a justification to not switch – the hassle of comparing tariffs was deemed to be much greater than any potential saving from switching. There was some recognition that price comparison websites could help filter the choice of tariffs to a more manageable number, but this is not available to those without internet access and requires the ability to interpret the websites’ results.

1.77. Restricting the number of standard tariffs would reduce the range of offers in this segment of the market and would mean that some tariff features would no longer be available. For example, suppliers would not be able to offer features such as online or dual fuel discounts to standard tariffs. The removal of these features

[37] uSwitch (June 2011), ‘Consumer opinion on the energy market’.

from standard tariffs may be disliked by some consumers and may mean that the new standard tariff structure would not appeal to them[38]. However, we would expect a wide range of tariffs to be available in the non-standard segment of the market.

1.78. As described in Chapter 2 of the consultation document, the requirement for no adverse unilateral variation in the terms and conditions of non-standard contracts will restrict the range of tariff types available in this segment of the market and ensure that tariffs are in line with the requirements of general consumer protection law.

Consumer engagement

1.79. In conjunction with our proposed amendments to the structure of standard tariffs and the new terms and conditions for non-standard tariffs, our proposals for clearer information on price and non-price features of tariffs is likely to increase both the level and quality of consumer engagement[39].

1.80. Our consumer research has found that the provision of clear tariff information is likely to encourage more consumers to engage with the energy market. In the quantitative research, 71 per cent of E7 respondents and 48 per cent of non-E7 respondents said they would be more likely to consider switching if the standing charge was fixed for standard tariffs. If a price comparison guide were also provided, 74 per cent of non-E7 respondents and 76 per cent of E7 respondents would be more likely to consider switching. These findings highlight the importance of the price comparison guide to E7 consumers, for whom it is more difficult to compare tariffs because of the need to trade-off the day rate and night rate.

1.81. Our qualitative research found that the likelihood of engaging with the market and considering switching is directly linked to the potential savings. This suggests that when consumers look at this information, they are more likely to switch if they can easily estimate and compare their bills under each tariff. In this regard, displaying price comparison information in terms of pounds per year (compared to pence per day and even pounds per month) was found to offer more of an incentive to switch because the size of the saving appeared much greater.

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[38] Ofgem remains concerned that suppliers are using dual fuel discounts to cross-subsidise the prices of one fuel with the revenues from another. In the RMR March consultation document we showed that, on average, suppliers make around three times the margin on their legacy fuels than on their non-legacy fuels. Dual fuel tariffs obscure this difference, removing a consumer's ability to tell whether their supplier is offering both the cheapest electricity and the cheapest gas in the market. Our own analysis has shown that across the 14 ex-PES regions, consumers on dual fuel, direct debit tariffs could save up to £60 per annum by switching to the lowest price supplier for both tariffs. Removing dual fuel discounts would make these price differences more obvious and is likely to benefit consumers.

[39] Quality of consumer engagement refers to the proportion of switches that benefit the consumer.

1.82. The quantitative research looked at consumers' understanding of and appetite for fixed, variable[40] and tracker tariffs. Interestingly, it found limited enthusiasm for variable tariffs among consumers despite the fact that many respondents will currently be on such tariffs. Only six per cent of consumers stated that they would select a variable tariff and only 40 per cent would want the tariff to be available. These figures were unchanged and fell by just three percentage points, respectively, when respondents were informed that variable tariffs would have a restricted set of features relative to other tariffs. This suggests that the removal of additional features from standard tariffs might have a limited impact on consumer choice.

1.83. However, the majority of consumers stated that they would like variable tariffs to offer the same range of features as other tariffs. This indicates that some consumers would dislike the range of standard tariffs and may switch to a non-standard tariff under RMR core.

1.84. Banning automatic rollovers to another non-standard tariff would protect consumers from being rolled onto a potentially more expensive tariff without their express consent. It would also ensure that consumers would not be rolled onto a tariff for which they would be required to pay an exit fee in order to switch and would also be able to switch supplier with relatively little notice.

1.85. The proposal would also create incentives for suppliers to promote consumer engagement if they wish to encourage consumers to agree another offer with them. Suppliers would be required to notify consumers in advance of their fixed-term tariff ending. This would remind them that they will default onto the supplier's standard tariff if they do not make an active choice to take another fixed-term tariff and so would prompt consumers to find a new tariff.

1.86. Behavioural economics suggests individuals are 'loss adverse' and so a loss has a significantly higher impact on an individual than the equivalent gain[41]. As a result, financial losses to the consumer in the form of termination fees are likely to have a greater impact on switching than the same level of savings available from switching to a new deal. This suggests that consumers would be more likely to actively engage in the market if suppliers were required to offer an adequate switching window with no exit fee than if termination fees were applied to fixed-term tariffs for the full term. On this basis, we propose that suppliers offer a switching window of 42 calendar days with no exit fee before the date any fixed term period of a contract is due to expire.

1.87. To help ensure a smooth transition between fixed term contracts and avoid the need for consumers to default onto a standard tariff for a short period of time following the end of a fixed term contract, we will be requiring suppliers to charge

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[40] Variable in the sense that the supplier can vary the price (which would only be permitted with standard tariffs).
[41] Kahneman, D., Knetsch, J. and Thaler, R. 1990, 'Experimental tests of the endowment effect and the Coase theorem', The Journal of Political Economy. 98, 1325-1348.

customers the same prices for up to 41 days after any fixed term period has expired[42]. This would reduce the hassle of switching to another supplier and so would promote regular engagement.

1.88. These proposals are designed to encourage and enable consumers to engage with the market. The transition from current market arrangements to those proposed under RMR core has the potential to engage more consumers and we are considering what information and communications can support this. However, if problems arise during the transition process it may disengage active consumers or miss an opportunity to engage others. It is also possible that the prices faced by some consumers on standard tariffs might increase as they are migrated to one of the new standard tariffs. This could frustrate some consumers but with the right information it could encourage them to engage with the market and compare tariffs.

Consumer trust

1.89. We consider that building consumer trust in the retail market is a pre-requisite for increased consumer engagement of a significant scale. The RMR core proposal will help to re-build trust in the market, especially if suppliers engage with our proposals effectively.

1.90. Opinium Research's Brand Trust Monitor recently found that approximately 50 per cent of consumers trust their energy supplier, though other surveys have found significantly lower levels of trust[43]. Interestingly, the Opinium research found that trust of alternative suppliers was significantly lower than trust of own supplier. This lack of trust in the market as a whole, and alternative suppliers in particular, reduces the likelihood of consumers engaging in the retail market.

1.91. Our recent qualitative consumer research, and the research published in the March consultation document, found that an Ofgem-set standing charge would increase consumer trust in their tariffs and the energy retail market more generally. This could lead to greater consumer confidence in the energy market and so to greater future engagement. However, there is a risk that some consumers would mistakenly believe that Ofgem regulates the price of standard tariffs and so could lead consumer preferences to swing towards these tariffs because of the perceived price security. This would not necessarily be in the best interests of consumers and highlights the importance of communicating Ofgem's role in setting the standing charge effectively.

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[42] To gain this protection we propose the following two conditions: (a) a customer would need to inform their current supplier of their intention to switch supplier within the switching window (which would include the date the fixed term period was due to expire); and (b) the new supplier would need to have completed the process for switching that customer within 42 days of the date the customer informed their current supplier.
[43] Opinium (September 2011), 'Brand Trust - Home Energy'. Also see, for example, Which? (2011), 'RMR Consultation Response', Page 4.

1.92. The lack of trust is not limited to energy suppliers. Earlier research with the Ofgem Consumer First Panel found that some consumers do not trust switching sites to provide a complete picture of the tariffs available in the market and had faced out-of-date, conflicting or complex results[44]. These experiences can reduce trust in switching sites and, by extension, in the energy retail market more generally. Our RMR proposals should help to improve consumer trust in switching sites (see Chapter 3 of the consultation document).

Distributional impacts on consumers

1.93. Our assessment of distributional impacts shows that almost all consumers should benefit from the introduction of the RMR core proposal. This proposal does not require all consumers to engage with the market to make it work better, only that the increase in engagement is great enough to put competitive pressure on prices to the benefit of all consumers. RMR core could benefit some consumers more than others, however, and in some circumstances one or more groups of consumers may be adversely affected. The table below summarises our assessment of the impact of the proposal on certain groups of consumers.

Table 2: Distributional impacts of the RMR core proposal

Consumer group	**Overall impact of RMR core**
Proactive	Positive
Reactive	Positive
Passive	Neutral / Positive
Disengaged	Neutral / Positive
Permanently disengaged	Neutral / Positive
Vulnerable	Neutral / Positive
Consumers currently on non-standard evergreen tariffs	Neutral / possible negative if take no action

1.94. The key factors that underlie the assessment of distributional impacts are:

- Proactive and reactive consumers will benefit from tariffs which are more comparable and simpler to understand. They will also be able to make better decisions due to the increased transparency of tariffs and the clearer information available to them;

- Proactive consumers already on low-price tariffs could possibly to lose out if they take no action and are migrated to their supplier's standard contract. However, given that these consumers have already engaged in the market, it is likely that many of them would switch to lower priced, non-standard tariffs rather than be migrated to the supplier's standard tariff;

[44] See page 91 of the March RMR consultation.

- Vulnerable, disengaged and permanently disengaged consumers would indirectly benefit from increased competitive pressure in the standard segment of the market[45]. Our information remedies and accompanying proposals to enhance the Probe remedies are designed to further encourage and help these consumers to engage in the market and switch. This increases the chances that they become proactive customers, but we acknowledge that not all customers in these groups are likely to engage;

- All domestic consumers will benefit from tariffs that are clearer and consist of a single unit charge[46];

- Disengaged and permanently disengaged consumers are likely to benefit from the migration to standard tariffs as they are likely to be on suppliers' higher price standard tariffs. They would also benefit from any 'ripple effect' if switching among suppliers' standard tariffs by more active consumers were to keep standard prices at competitive levels; and

- Consumers currently on non-standard evergreen deals may be frustrated that certain tariff features would no longer be available in the standard market. However, we would expect these tariff features would be available in the non-standard market and so these consumers need not lose out if they are willing and able to engage with the market.

1.95. The proposal to ban automatic rollovers for fixed-term tariffs would have a positive impact on consumers that would otherwise have been automatically rolled onto another (potentially more expensive) non-standard tariff without their full understanding. Under these measures, such consumers would be rolled over to a standard tariff and so would not incur termination fees to switch tariff. They would also be able to switch supplier with relatively little notice.

Standardised element

1.96. The design of the Ofgem-set standardised element will also affect the distributional impacts of the RMR core proposal. A 'narrow' approach would include only network costs while a 'wide' approach would also include other incremental costs of serving an additional customer.

1.97. The choice of a wide or narrow standing charge would have a distributional impact on consumers. If a wide approach is taken, low users would pay more (in total) for each unit of fuel consumed than would high users. If a narrow approach is taken the difference in cost per unit between low and high users would be smaller but a cross-subsidy would be introduced such that high users would subsidise low users. The wide approach is more reflective of the costs imposed to serve one

[45] The possible impact of our proposals on vulnerable consumers is discussed more fully in the Sustainable development section and in Chapter 5 of the consultation document.
[46] E7 tariffs would have day and night unit rates. Suppliers would be able to apply for derogations under some circumstances and, in these cases, tariffs may have a different structure.

additional customer and would ensure that low users do not become unprofitable. This would avoid any possibility that suppliers would try to avoid serving low use consumers.

1.98. It is not clear which approach to setting the standing charge would be most beneficial to vulnerable consumers – some vulnerable consumers have high consumption levels while others have low consumption levels. Previous research has shown that those on low incomes typically consume less energy than do those on higher incomes[47]. However, approximately 1.4m consumers in the bottom income quintile have greater than average energy consumption[48]. We do not have detailed evidence on the consumption patters of other vulnerable groups.

1.99. Table 3 shows ballpark estimates of the cost of components of the standing charge which we consider would fall within our 'wide' definition. A range is presented for transmission and distribution costs to reflect the regional differences in these costs. This table refers to the current costs to suppliers and should not be taken to be the level at which a standing charge might be set. It is also important to note that the table presents only those network charges that are set on a per customer basis and does not include network charges that are based on consumption.

Table 3: Estimated range of costs to suppliers

	Gas		**Electricity**	
Cost element	**Additional annual cost per customer (£)**	**Rolling total (£)**	**Additional annual cost per customer (£)**	**Rolling total (£)**
Transmission	1 to 19	**1 to 19**	6 to 26	**6 to 26**
Distribution[49]	110 to 143	**112 to 152**	9 to 20	**24 to 39**
Environmental programmes[a]	27	**139 to 179**	27	**51 to 66**
Metering[b]	23	**162 to 202**	15	**66 to 81**
Warm Home Discount	6	**168 to 208**	6	**72 to 87**

a *Includes the Carbon Emissions Reduction Target (CERT) and the Community Energy Saving Programme (CESP). May be replaced by ECO in the future if DECC chooses to define supplier obligations on the basis of market share.*

b *Including the cost of meter reading.*

1.100. Figure 4 plots the current level of standing charges against our estimates of network costs that are charged on a per-customer basis ('fixed' network costs) [50].

[47] Centre for Sustainable Energy (2010), 'Understanding 'High use low income' consumers', Page 7, Figure 2.

[48] Centre for Sustainable Energy (2010), 'Understanding 'High use low income' consumers', Page 8, Table 3.

[49] The minimum / maximum network cost does not always equal the sum of minimum / maximum distribution and transmission charges. This is because the cheapest / most expensive distribution region is not always the cheapest / most expensive for transmission.

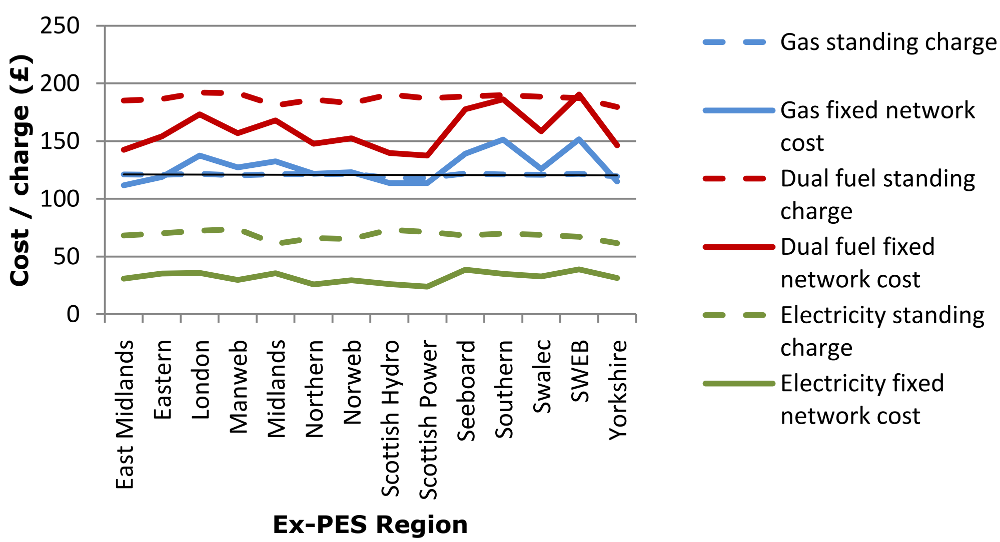
[50] For tariffs that have a two-tier structure, we calculated an 'effective standing charge' as:

The estimates are based on all tariffs that were available to consumers on 28 October 2011.

1.101. Figure 4 shows that the average standing charge of electricity and dual fuel tariffs is above fixed network costs whereas the standing charge of some gas tariffs is below fixed network costs in some regions. Given that suppliers incur per-customer costs other than network charges, this analysis indicates that there is, on average, a cross-subsidy from electricity to gas consumers. In addition, there appears to be less variation in regional standing charges than there is in regional network costs. This may suggest that there are cross-subsidies between regions, though differences in other costs to serve between regions may explain some of the smoothing.

1.102. Comparing Figure 4 with Table 3 indicates that the cost to suppliers of components of the 'wide' standing charge is greater than current standing charges for gas and electricity. The average standing charge for gas is currently £121, compared with costs of between £168 and £208 for a wide RMR standing charge. For electricity, the average standing charge is currently £68, compared with costs of between £72 and £87 for a wide RMR standing charge. This implies that the wide standing charge would be higher than those faced by most consumers on standard tariffs at the moment, and there would be a distributional impact as a result.

Figure 4: Standing charges and fixed network costs



Source: Ofgem analysis, in part based on data from TheEnergyShop.com

1.103. The fact that standing charges would be set on a regional basis would mean that customers in some regions would pay more for standard tariffs than those in

Effective standing charge = (Tier 1 unit rate – Tier 2 unit rate)*Tier 1 threshold.

other regions. As shown in Figure 4, this is already the case. The extent to which current standing charges and a narrow standing charge based on network costs might differ will depend on the detailed methodology for the standing charge.

1.104. In addition to setting a regional standing charge, Ofgem may set a regional adjuster to the unit rate to account for differences in the consumption-based cost of transmission and distribution. Any regional adjustment to the unit rate would be narrow in scope and would include only the costs of transmission and distribution. Currently, consumption based network charges are approximately £48[51] higher in the most expensive region than in the least expensive region, all else being equal. The extent to which the regional unit rate adjuster would differ between regions will depend on the detailed methodology used to set it. We invite stakeholders to comment on whether they favour a regional adjustment to the unit rate.

Variable standing charge

Tariff comparability

1.105. Under this policy option Ofgem would not set the same regional standing charge for all suppliers. The standard segment of the market would have a variable standing charge, set individually by each supplier. Relative to the RMR core proposal this would limit the extent to which tariff comparability would be enhanced. Our research demonstrates that it is likely to lead to a relatively small improvement in the accuracy of consumer decision-making compared to the status quo.

1.106. Our quantitative research found that 44 per cent of non-E7 respondents selected the cheapest standard tariff for their circumstances from a selection of tariffs with different standing charges (but without a price comparison guide). This is significantly less than the 81 per cent of respondents that made the correct choice in the test with a fixed standing charge. The time taken to make a correct choice was 87 seconds when standing charges differed by supplier but 28 seconds where they were fixed. Interestingly, even with the inclusion of a price comparison guide respondents performed significantly better under the approach with a fixed standing charge. Approximately 85 per cent of respondents selected the cheapest tariff when standing charges were equal, compared with 50 per cent when they differed by supplier.

1.107. For those respondents that have E7 tariffs, the success rates for the tests with equal and unequal standing charges (without a price comparison guide) were both low at 19 per cent and 47 per cent, respectively. When the price comparison guide was included, the success rates were above 70 per cent for each option – significantly greater than in the absence of the comparison guide. This implies that an Ofgem-set, common standing charge is less important for E7 consumers than for non-E7 consumers but the price comparison guide is crucial for E7 consumers. This result is not surprising given that E7 consumers need to compare two unit rates and

[51] Per annum for an average consumption level.

so appear to focus more on the price comparison guide than on the components of tariffs.

1.108. The impact of the Tariff Information Label would be the same as under RMR core.

Number of tariffs

1.109. The impact of the variable standing charge proposal on the number of tariffs is likely to be identical to the impact under RMR core.

Consumer engagement

1.110. The fact that standard tariffs would be more difficult to compare under the variable standing charge proposal than under RMR core would, we expect, lead to a lower level of consumer engagement.

1.111. This expectation is supported by our quantitative consumer research. Given that a price comparison guide would be available, 67 per cent of non-E7 consumers stated that they would be more likely to switch when standing charges differed by supplier compared with 74 per cent when a common standing charge was in place. The corresponding statistics for E7 consumers are 70 per cent and 76 per cent respectively.

Consumer trust

1.112. We expect that the variable standing charge proposal would have a lower impact on consumer trust than would RMR core. The variable standing charge proposal would not increase the transparency of standard tariffs to the same degree as RMR core and the reassurance of Ofgem involvement in the market would not be present.

Distributional impacts on consumers

1.113. The distributional impacts on consumers are likely to be similar to RMR core. However, we would expect benefits to be of a smaller magnitude for all consumers because of the lower level of tariff comparability and engagement. For a full description of the types of distributional impacts, see the above discussion of RMR core.

Single tariff structure

Tariff comparability

1.114. The single tariff structure proposal would set the structure of all tariffs and the regional standing charge would be equal for all tariffs[52]. At first glance, this policy option appears to lead to greater tariff simplicity and comparability than would RMR core. However, suppliers would be free to offer discounts to non-standard tariffs and so to compare the price of standard and non-standard tariffs it would be necessary to use a price comparison guide. Therefore, the benefit of the single tariff structure proposal over RMR core is not clear.

1.115. As our quantitative research focused on standard tariffs, it is not possible to distinguish results for the single tariff structure proposal from those discussed in the RMR core sub-section above. The research suggests that 85 per cent of non-E7 consumers and 80 per cent of E7 consumers would be able to select the cheapest tariff if all tariffs had the same standing charge and a price comparison guide was provided. This is encouraging, but does not provide justification for selecting the single tariff structure proposal over RMR core given the complexity that would remain in the non-standard segment of the market.

1.116. To allow all tariffs to be compared simply by inspecting the unit rate, the single tariff structure proposal would need to be far more restrictive such that suppliers would not be permitted to offer discounts or additional features on any tariff. In effect, the proposal would need to restrict suppliers to offering only standard tariffs. We do not believe that this degree of intervention would be a proportionate response to the problems identified.

1.117. The simple energy tariff proposed by Which? does not overcome these difficulties. Which? proposes that all tariffs would have a standing charge plus unit rate structure but does not differentiate between standard and non-standard tariffs. This means that a wide range of tariffs with no termination date could be available and dual fuel standard tariffs would remain available. There would be no overall reduction in the number of standard tariffs.

1.118. Ofgem remains concerned that suppliers are using dual fuel discounts to cross-subsidise the prices of one fuel with the revenues from another[53]. This practice prevents consumers from assessing whether they are on the cheapest tariff for both gas and electricity. This problem would remain under the Which? proposal and so it would be more difficult for consumers to compare tariffs than under the single tariff structure proposal.

1.119. One positive aspect of the Which? proposal is that discounts would be built into the standing charge of all tariffs. This restriction would make it easier for consumers to compare tariffs by simply inspecting the unit rate. However, given that not all consumers would benefit from discounts such as dual fuel, online billing or prompt pay, suppliers are likely to offer a number of very similar tariffs with different unit rates. This would make it more difficult for newspapers and other media to

[52] For E7 tariffs, suppliers would set day and night unit rates under this proposal.
[53] See further discussion below.

present price comparison tables and would make it more difficult for consumers to select the cheapest tariff.

Number of tariffs

1.120. The single tariff structure proposal would restrict the number of standard tariffs and should lead to a fall in the total number of tariffs available to consumers. The single tariff structure proposal places more restrictions on non-standard tariffs than does RMR core because all non-standard tariffs would have a standing charge set by Ofgem and a standing charge plus unit rate structure. Suppliers may respond by offering a relatively small number of non-standard tariffs. We expect that the single tariff structure proposal would lead to the greatest reduction in choice for consumers.

1.121. The Which? proposal would place no limit on the number of tariffs available and could lead to suppliers offering numerous very similar tariffs. It is not clear that the Which? proposal would lead to a reduction in the number of tariffs available.

Consumer engagement

1.122. The single tariff structure proposal could lead to a lower level of engagement than would RMR core. The increased transparency of tariff prices and the common structure for all tariffs means that price convergence is a greater probability under the single tariff structure proposal[54]. This convergence could be the result of price competition among homogenous products or price co-ordination. Given that a key reason for consumers to switch is the prospect of saving money, the erosion of price differentials could result in lower levels of engagement, lower levels of switching and so to a less competitive market.

1.123. It is possible that the apparent simplicity of energy prices under the single tariff structure proposal would lead some consumers to engage in the market who would not engage under RMR core. As noted above, however, the fact that discounts could be applied to standard tariffs would probably mean that it would not be possible to compare standard and non-standard tariffs on the basis of unit rates. If consumers were to make such a comparison, they may make an inappropriate choice and so may disengage from the market.

1.124. On the other hand, our quantitative consumer research found that setting a common standing charge has an appreciable impact on the ability of consumers to select the cheapest tariff when a price comparison guide was provided. This may mean that the proportion of switches that save the consumer money would be higher under the single tariff structure proposal than under RMR core, but at the expense of consumer choice (see below).

Consumer trust

[54] See paragraph later in the document for further discussion on this point.

1.125. The single tariff structure proposal is the most interventionist of the proposals and the most likely to increase consumer trust in the energy market. Our qualitative consumer research found that consumers would take reassurance from an Ofgem-set standing charge. This reassurance would apply even though suppliers would be free to set the unit rate.

1.126. Given that Ofgem would set the standing charge for all tariffs under the single tariff structure proposal, we consider that the impact on consumer trust would be greater than under RMR core. As a result, consumers may be prompted to engage in the market and may be less drawn to standard tariffs because all tariffs would have an element set by Ofgem.

Distributional impacts on consumers

1.127. The single tariff structure proposal places significant restrictions on energy tariffs and is likely to lead to a reduction in choice relative to RMR core. This could frustrate engaged consumers because it may be more difficult to match their preferences to an available tariff. The restrictions may also frustrate those that are currently on non-standard evergreen tariffs. Some of these consumers may move to the standard market and become sticky, meaning that our intervention would be somewhat counterproductive.

1.128. Reactive and passive consumers may benefit from the single tariff structure proposal. The apparently simple tariff structure may encourage some of these consumers to engage more effectively in the retail market and switch to a cheaper tariff. However, we question whether this proposal would actually lead to greater tariff comparability than would RMR core and hence it is not clear that reactive and passive consumers would be any more likely to engage.

1.129. Permanently disengaged consumers are less likely to benefit from this proposal than from RMR core. These consumers may benefit indirectly from our proposals through a 'ripple effect' that would occur if other consumers engaged more effectively with the energy retail market and created a general competitive pressure that would drive down the price of standard tariffs. We expect that the single tariff structure proposal would lead to a smaller increase in engagement than would RMR core. This is because some currently engaged consumers would choose not to participate in a market with relatively little tariff choice, though other consumers may choose to engage due to the apparently greater tariff simplicity. If the increase in engagement were lower for the single tariff structure proposal than for RMR core, the ripple effect would be smaller in scale and so disengaged and permanently disengaged consumers would benefit less. Given that vulnerable consumers are more likely to be disengaged or permanently disengaged, the single tariff structure proposal is expected to benefit vulnerable consumers less than RMR core.

Price comparison only

Tariff comparability

1.130. The price comparison only proposal was proposed by a number of the Big 6 suppliers in their responses to the RMR consultation document and suppliers have carried out subsequent work on the price comparison only approach. While our research shows this option would be better than the status quo, in light of our Panel research findings of consumer disillusionment we believe that a more significant intervention is required encourage consumers to engage in the market.

1.131. In consultation responses, suppliers argued that the price comparison only proposal would allow consumers to compare different tariffs through a standard price comparison guide while maintaining innovation and product development in the market. Suppliers generally agreed that the guide would need to be consumer-friendly, but there was no common view of the type of information that would be provided or presentation[55].

1.132. Our qualitative consumer research found that the price comparison only option was the least well received by consumers and was given a positive rating by fewer than half of participants. In contrast, the variable standing charge proposal, RMR core and airline options proposals were rated favourably by more than two-thirds of participants. This finding should be treated with caution, however, because the table presented for the price comparison only option was visually more complex than those presented for the other options.

1.133. Our quantitative research found that the price comparison guide had a limited impact on the ability of non-E7 consumers to correctly identify the cheapest tariff. This result was found both when standing charges were uniform (85 per cent success rate with guide, 81 per cent without) and when they were different for each supplier (50 per cent success rate with guide, 44 per cent without). We note that the quantitative consumer research only focused on standard tariffs and so may not have identified the full benefit of a price comparison guide, given that different tariff structures would be permitted in the non-standard segment of the market.

1.134. There was, however, a significant impact when a price comparison guide was presented to E7 consumers. The success rate rose from 47 per cent to 70 per cent in the test with a common standing charge and from 19 per cent to 76 per cent in the test where standing charges differed by supplier. This highlights the importance of a price comparison guide to E7 consumers and also suggests that there is value in limiting the amount of information presented in comparison tables. The option with a common standing charge had one more column than did the table with varied standing charges and this may explain why the success rate was higher for the latter model.

Number of tariffs

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[55] Some suppliers are against the introduction of a price comparison guide, arguing that a more appropriate response would be to improve awareness and presentation of existing information.

1.135. The price comparison only proposal would not impact on the number of tariffs.

Consumer engagement

1.136. The price comparison only proposal would do nothing to simplify tariffs or to make them more transparent. It would, however, help consumers to compare tariff prices and this may encourage engagement with the retail market.

1.137. In our quantitative consumer research, 67 per cent of non-E7 participants stated that they would be more likely to switch supplier if suppliers were to set different standing charges and a price comparison guide was provided, compared to 59 per cent if a guide was not available. If standing charges were equal across suppliers, 74 per cent of non-E7 consumers stated that they would be more likely to switch if a price comparison guide was provided compared to 71 per cent if a guide was not available. This suggests that setting a common standing charge would do more to prompt consumer engagement than would providing a price comparison guide alone.

Consumer trust

1.138. The price comparison only proposal would not simplify the structure of energy tariffs and no component of tariffs would be set by Ofgem. Our qualitative consumer research found that consumers are confused by two-tier tariffs and that they would be reassured by an Ofgem-set standing charge. These findings suggest that consumer trust is unlikely to increase significantly under the price comparison only proposal.

Distributional impacts on consumers

1.139. The price comparison only proposal is likely to benefit proactive and reactive consumers who are currently on a non-standard evergreen contract. Many of these consumers are already able to navigate the energy market and the price comparison only proposal would make it easier for them to find the cheapest tariff while maintaining a significant amount of tariff choice. Standard tariffs would not be standardised or restricted in number and so disengaged and vulnerable consumers would not benefit from the 'ripple effect' would probably occur under the RMR core proposal. The price comparison only proposal is also unlikely to prompt passive and disengaged consumers to engage and so these consumers are unlikely to benefit.

1.140. Overall, we consider that the price comparison only proposal would be an improvement on the status quo but doesn't go far enough to address consumer disillusionment and concerns about the number and complexity of tariffs.

Airline options

Tariff comparability

1.141. The airline options proposal would allow suppliers to offer a wider range of standard tariffs, which would be appreciated by some consumers. However, compared to the RMR core proposal the additional options would increase complexity in the standard tariff market. Also, the larger range of standard tariffs may allow suppliers to move away from price competition through diversification of products. These effects would lead to reduced comparability of standard tariffs.

1.142. The airline options model was favoured by respondents in our qualitative research. However, this finding needs to be taken with some caution as the model was displayed using a different format to the other proposals under investigation. Due to complexities surrounding the presentation of the range of prices, key price information was removed from the tariff displays in the airline options model[56]. As a result, the presentation of the model turned out to be an oversimplification relative to the other models. Our research agency believes this played a large part in driving the preference for the airline options model over the others.

1.143. Our quantitative research found that only 54 per cent of participants (46 per cent in the vulnerable sample) felt that they understood the airline options proposal well and only 40 per cent (35 per cent in the vulnerable sample) would be likely to explore additional options to add to the standard tariff if this option were introduced. When asked to calculate the cheapest supplier, assuming that they want to manage their account online (and so receive a discount) and to have a green option (and so pay a premium), only 50 per cent of participants correctly identified the cheapest supplier. This compares with 85 per cent of non-E7 participants that identified the cheapest supplier when provided with a price comparison guide in the test with a common standing charge.

Number of tariffs

1.144. Under the airline options proposal, suppliers would be able to offer one standard tariff per payment method with a range of additional options associated with each tariff. The range of options would effectively increase the number of standard tariffs per supplier relative to RMR core.

1.145. If each supplier was allowed to offer one additional option, the effective number of standard tariffs per supplier would be two per payment method. If two additional options were permitted, the effective number of tariffs per payment method would be four per supplier and if three options were permitted the effective number of tariffs would be eight per supplier. This clearly indicates the significant complexity that the airline options proposal would create within the standard segment of the market. It also demonstrates that the greater the number of options permitted, the greater the number of standard tariffs. It is not inconceivable that the airline options proposal could lead to an increase in the effective number of standard tariffs available despite the apparent simplicity of one tariff per supplier.

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[56] The table did not show the unit rate for tariffs, only the estimated monthly cost of a medium user. The other tables showed unit rates and estimated monthly costs for low, medium and high users.

1.146. On this basis, we consider that the airline options proposal cannot achieve the goal of tariff simplicity and would do little to improve tariff comparability relative to the RMR core proposal.

Consumer engagement

1.147. The likely impact of the airline options proposal on engagement in the standard market is unclear. We expect that the standard segment of the market would be more attractive to engaged consumers under the airline options proposal than under RMR core and so they would engage in the standard market to a greater degree. However, this would result in fewer currently engaged consumers participating in the non-standard market than under RMR core. We expect the overall level of engagement by currently engaged consumers to be similar to that under RMR core.

1.148. However, the additional options would increase complexity in the standard tariff market and so we consider it unlikely that this proposal would prompt reactive and passive consumers to engage in the market more effectively. It is also possible that the greater complexity would lead a number of consumers to disengage. These effects mean that total engagement would be lower than under RMR core and may be no greater than it is at present.

1.149. The additional options would make it hard for the media or other organisations to publish standard tariff prices and so the information would be less accessible than under RMR core. The options would also blur the boundaries between the standard and non-standard market and could confuse consumers. Both of these factors could limit the extent to which the airline options proposal would promote consumer engagement.

Consumer trust

1.150. The airline options proposal is unlikely to promote consumer trust in the energy retail market. The range of additional options may be interpreted by consumers as a tactic employed by suppliers to hide the true tariff cost and so would do less to improve consumer trust than would RMR core.

1.151. It is also worth noting that the OFT is concerned with the 'drip pricing' strategies of airlines due to the lack of transparency in charges. It is possible that the airline options proposal could lead to similar forms of consumer detriment. If this were to occur, consumer trust in the energy retail market may be lower than it is at present. We also note that this is one of the issues that has led to new EU legislation (i.e. the consumer rights directive which will, from 2014, exempt consumers from being liable for hidden charges).

Distributional impacts on consumers

1.152. This proposal could benefit the most engaged consumers and those that are currently on non-standard evergreen tariffs. Many of these consumers value choice and so would appreciate the opportunity to design a bespoke standard tariff. However, given that these consumers are more likely to be comfortable with the non-standard market, the benefit of this option over the RMR core proposal is not clear.

1.153. The proposal is unlikely to benefit (and may confuse) many other consumers, including vulnerable consumers. This confusion could mean that these consumers would switch to tariffs that they would not choose if they had a full understanding of the tariff[57].

1.154. We expect that reactive and passive consumers would be less likely to engage in the market under the airline options proposals than under RMR core because it would remain relatively complex to compare standard tariffs. We note that our quantitative consumer research cannot provide firm support for this belief because consumers were not asked if they would be more likely to switch under the airline options proposal, only if they would be likely to explore the additional options. However, our research found that 63 per cent of participants found it easy to select the cheapest tariff under the airline options proposal compared with 85 per cent when standing charges were equal and a price comparison guide was provided. Assuming that likelihood of engagement is positively correlated with ease of use, consumers would be less likely to engage under the airline options proposal and so less likely to benefit from switching to a cheaper tariff.

1.155. The lower total engagement also means that the 'ripple effect' through which disengaged consumers can benefit indirectly from our proposals would be smaller than under RMR core.

Impacts on competition

1.156. The following section discusses the impact of a range of options on competition. This assessment is based on general principles of competition economics, qualitative analysis and results from consumer research. This analysis includes an assessment of the likely impact of our proposals on small suppliers.

RMR core

Standard tariffs

1.157. Our proposal to limit suppliers to just one standard tariff per payment method will lead to a reduction in the number of tariffs available that do not have a termination date. By reducing the range of offers and setting the same regional standing charge for all suppliers, it becomes easier to compare standard tariffs and should lead to increased consumer engagement in this segment of the market.

[57] A full discussion of the impact on vulnerable consumers is provided in the 'Impacts on sustainable development' section and in Chapter 5 of the consultation document.

Increased engagement should lead to increased competitive pressure on suppliers for three reasons.

1.158. First, standard tariffs would become increasingly similar as a result of our proposals. This may lead to suppliers competing on price rather than product differentiation in the standard segment of the market and, assuming suppliers do not collude or coordinate, this would put competitive pressure on prices to the benefit of the consumer. In accordance with standard game theory models, the more homogenous the products, the more intense this form of competition.

1.159. Second, by making it easier for consumers to compare tariffs in terms of price per unit, any premium charged will be more readily apparent and price competition will intensify further, to the benefit of the consumer.

1.160. Third, setting a common standing charge should increase the range of media in which tariff information can easily and clearly be presented. The proposal should therefore improve the accessibility of information and comparability of tariffs within the standard segment of the market. This would reduce the problem of imperfect information and improve consumers' bargaining power. This would, in turn, increase competitive pressure[58].

1.161. Competitive pressure on firms may be limited by coordinated supplier behaviour. While Ofgem's Probe and RMR found no evidence of cartel behaviour, simpler tariff structures and greater transparency of unit rates could facilitate coordinated effects[59]. The potential result would be standard tariff prices converging at uncompetitively high levels. However, given that this would be transparent:

- It is less likely to happen; and
- If it were to happen, Ofgem would be aware of it and would take remedial action where necessary.

1.162. Some consultation respondents raised concerns that tariff simplification would lead to price becoming the sole focus of competition. It was argued that suppliers may then follow a strategy of becoming and / or remaining the lowest cost

[58] In a perfect world, i.e. 'perfect competition', both consumers and suppliers have full information on anything that might influence their respective decision-making process, for example all suppliers' costs, products and prices. In an imperfect world, the party with better or more complete information has a competitive advantage over the other party, potentially leading to market failure. At present, suppliers are better informed than consumers, leaving the latter at a competitive disadvantage. By improving accessibility of information and comparability of tariffs, the proposal gives consumers the tools they need to more effectively engage in the market. If successful, consumers will be in a better bargaining position, and each will be better able to choose the supplier offering the most appropriate standard tariff.

[59] That is, coordination falling short of explicit collusion which is prohibited by Article 101 of the Treaty on the Functioning of the European Union and the Chapter I prohibition of the Competition Act 1998.

producer such that it could charge the lowest per unit price. Cost reduction may come at the expense of service quality, which would be detrimental to the consumer.

1.163. To mitigate these potential effects, we would require suppliers to compile a Tariff Information Label for each of its tariffs. This would provide consumers with wider information about the tariff and would facilitate competition on factors such as customer service quality in addition to price.

Non-standard tariffs

1.164. Suppliers would be free to set the structure of non-standard tariffs and to offer tariffs with a range of additional features (e.g. green tariffs, affinity deals, introductory offers etc.). This would allow suppliers to compete through product differentiation as well as on price and service quality. The price comparison guide would help consumers to compare the price of standard and non-standard tariffs while the Tariff Information Label would allow them to compare non-price features of tariffs.

1.165. We expect that non-standard tariffs would be attractive to engaged consumers and that switching rates among non-standard tariffs would be high. The fact that all non-standard tariffs must be fixed-term and that automatic rollovers to another fixed-term contract would not be permitted would lead to a high frequency of consumer engagement. This would create competitive pressure and so suppliers would seek to win additional customers though both price and non-price competition. As a result of product diversification, we consider that the likelihood of coordinated effects for non-standard tariffs is low.

1.166. Our proposal to ban auto-rollovers for non-standard tariffs would also create incentives for suppliers to promote consumer engagement if they wish to encourage consumers to agree another offer with them. We note, however, that this proposal may limit the options available to suppliers. Suppliers use fixed-term tariffs as a way to both reduce costs and better manage their hedging strategies. This can be particularly important for smaller suppliers, and for suppliers looking to invest in generation, including green technologies. Therefore, removing the ability for automatic contract rollovers to be enforced by suppliers could act as a barrier to entry or expansion. However, this potential effect would be mitigated by the fact that under the RMR core proposal customers will be able to expressly agree to a rollover towards the end of a fixed-term period.

Risk of two-tier market

1.167. Greater transparency of standard tariffs could result in the prices of these tariffs converging, depending on how suppliers react to our proposals. Our research tells us that consumers already think there is little difference between the suppliers and tariff price convergence could reinforce this perception. This may reduce switching among suppliers' standard tariffs. As a result, there is some risk that competition may become largely focused in the non-standard segment of the market and that the prices of standard and non-standard tariffs may diverge. This could result in consumers on standard tariffs paying more for their energy than those on non-standard tariffs. In this scenario, vulnerable and sticky customers would be disproportionately affected.

1.168. The development of a two-tier market would be an undesirable outcome but may be no worse than the status quo in which sticky consumers continue to pay more than non-sticky consumers. In any case, the emergence of a two-tier market would be immediately apparent as we would continually monitor prices. We would take action to address any concerns relating to the possibility of coordinated effects and any other unintended consequences arising from the tariff simplification remedies. This would limit the risk of the standard segment of the market becoming uncompetitive.

Innovation

1.169. The RMR core proposal allows suppliers great scope for innovation within the non-standard segment of the market. This would ensure that consumers have a wide range of tariffs and additional features to choose from and so would help to sustain effective competition over time. This would also allow suppliers to respond to technological developments and to offer innovative tariffs.

1.170. The RMR core proposal does not restrict the structure of tariffs within the non-standard segment of the market. It does not specify the manner in which discounts could be applied to non-standard tariffs and places no restriction on the type of additional features that could be offered within this segment of the market (e.g. loyalty points, boiler services, energy efficiency assessments etc.).

Differential impact across suppliers

1.171. There may be differential impacts across suppliers and this could affect the degree or nature of competition in the energy retail market. One concern would be if our proposals were to lead to a disproportionate impact on small suppliers or create a barrier to entry. However, our proposals might also provide an opportunity for small suppliers to more clearly differentiate their standard tariff from those of the Big 6 and so could provide greater incentives for suppliers to enter and remain in the market.

1.172. While we recognise that our proposals will impose financial costs on suppliers we consider that this is an inevitable consequence of radical reforms which are proportionate and necessary to protect the interests of consumers. The RMR core proposal would lead to one-off implementation costs for suppliers. The costs associated with creating new tariffs and migrating a proportion of customers to the standard options may be significant and will vary between suppliers. All suppliers would be required to publish tariff information in a specified format and so would incur system costs. Suppliers would also incur ongoing costs due to the requirements for enhanced communications with customers and for providing switching windows with no exit fee. We would welcome any evidence from stakeholders on how large the one-off and ongoing costs are likely to be.

1.173. The single regional standing charge may increase the risk faced by suppliers and could affect smaller suppliers more than larger suppliers. If an element of cost used to set the standing charge were to rise during the period for which the standing charge were fixed, it would be necessary for suppliers to finance the shortfall either from their cash / capital reserves or by raising the unit price of standard tariffs. As small suppliers tend to have smaller cash / capital reserves than large suppliers (as a proportion of revenue), they may be less able to absorb cost changes. However, there is no clear evidence that small suppliers change their prices more frequently than larger ones at present and so it seems that all suppliers have a similar response to changes in costs. It is not clear if this would change as a result of our proposals.

1.174. From our experience in the domestic retail market we know that some suppliers, particularly new entrants and smaller suppliers, may use fixed term tariffs to help manage their exposure to wholesale market risk. Having certainty over their customer base and the total amount of energy they need to purchase over a period of time can give suppliers increased certainty over their costs, which minimises the risk premium they need to build into their pricing. As such, they are able to pass the savings on to consumers and to remain competitive with larger suppliers who benefit from economies of scale. Our proposal to ban automatic rollovers may increase some suppliers' exposure to risk and could also impact their business models. However, we note that suppliers could mitigate any such risk by effective customer engagement. If such suppliers exit the market, this could cause a reduction in competitive pressures within the domestic retail market.

1.175. We also recognise that the 'no adverse unilateral variation' restriction on suppliers' non-standard tariffs could significantly impact the ability for all suppliers to pass through changes in network costs during the fixed-term. This would be an additional risk faced by suppliers and is again likely to affect smaller suppliers more than larger.

Variable standing charge

Standard tariffs

1.176. Relative to the RMR core proposal, the impact on competition in the standard segment of the market is likely to be limited. The fact that standing charges would differ between suppliers would make it more difficult for consumers to compare the cost of standard tariffs and this would limit the competitive effects that should arise from homogeneous products. This means that the price of standard tariffs may be higher under the variable standing charge proposal than under RMR core but also means that the risk of coordinated effects is lower.

1.177. We note that tariff comparability would be assisted by the price comparison guide and Tariff Information Label. However, our quantitative consumer research found that the price comparison guide does relatively little to aid non-E7 consumers unless combined with a common standing charge. This suggests that engagement and switching in the standard market are likely to be lower under the variable standing charge proposal than under RMR core. Consequently, we would expect the impact of the variable standing charge proposal on competition in the standard segment of the market to be relatively limited.

Non-standard tariffs

1.178. The impact of the variable standing charge proposal on competition in the non-standard market is likely to be the same as for the RMR core proposal, given that the only difference between the options relates to standard tariffs.

Risk of a two-tier market

1.179. As the prices of standard tariffs would be less transparent under the variable standing charge proposal, the risk of price convergence for standard tariffs is lower than under RMR core. This means that it is less likely that competition would become solely focused on the non-standard market and so the risk of a two-tier market developing is lower under the variable standing charge proposal.

Innovation

1.180. The impact of the variable standing charge proposal on innovation would be the same as RMR core.

Differential impact across suppliers

1.181. While there will be a reasonably significant implementation cost for the variable standing charge proposal we note that there is a benefit for suppliers when compared to RMR core. With more freedom to set prices, suppliers will be able to design standard tariffs that more closely match the costs of their activities.

1.182. We would expect implementation costs to be of a very similar scale to RMR core and, subject to the previous paragraph, would expect the impact of the variable standing charge proposal on suppliers to be identical to the impact of RMR core.

Single tariff structure

Standard tariffs

1.183. The likely impact of the single tariff structure proposal on competition within the standard segment of the market is identical to that of RMR core. The impact of setting a common standing charge for standard tariffs is discussed above.

Non-standard tariffs

1.184. The single tariff structure proposal is likely to lead to a smaller increase in competition in the non-standard segment of the market than would RMR core.

1.185. Competition within the non-standard segment of the market may be less intensive under the single tariff structure proposal than under RMR core because of the smaller range of tariffs that would be available. This could lead to disengagement by some currently engaged consumers if they are no longer able to find a tariff that matches their preferences, or if the restrictions imposed by the single tariff structure proposal led to there being little difference between tariffs. Lower engagement and switching would result in less competitive pressure on suppliers and so non-standard tariff prices may not be subject to as much competitive pressure as under RMR core despite the greater simplicity of tariffs.

1.186. Under the RMR core proposal, competitive pressure on firms could be limited by coordinated supplier behaviour for standard tariffs[60]. As the single tariff structure proposal introduces a common standing charge and tariff structure to both standard and non-standard tariffs, there is an additional risk of coordinated effects in the non-standard segment. However, the risk of coordination may be limited by product differentiation in the non-standard segment of the market (e.g. through the application of discounts and additional features to these tariffs).

Risk of a two-tier market

1.187. At first glance, the single tariff structure proposal appears to make it easier for consumers to compare tariffs than does the RMR core proposal. However, given that suppliers would be free to apply discounts or other incentives to non-standard tariffs it would be necessary to use a price comparison guide to compare standard and non-standard tariffs. Therefore, it is not clear that tariff prices would actually be any clearer under the single tariff structure proposal than under RMR core. On this basis, we believe that the risk of a two-tier market developing is of a similar scale to the risk under RMR core. This risk was discussed above.

Innovation

1.188. The single tariff structure proposal would place significantly more restrictions on innovation than would RMR core because all tariffs would have the same structure and standing charge. Over time, this could lead to competition being less intensive than under RMR core because there would be less scope for suppliers to design tariffs that would attract consumers from their current supplier.

Differential impact across suppliers

1.189. The single tariff structure proposal would have substantially greater implementation costs for suppliers than would RMR core. It would require suppliers to introduce an element set by Ofgem to every one of their tariffs in the market. All consumers would need to be migrated onto a new tariff, whereas some existing

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[60] For the avoidance of doubt, we are not referring to forms of explicit collusion that would be caught by Article 101 of the Treaty on the Functioning of the European Union or the Chapter I prohibition of the Competition Act 1998.

tariffs may be permitted under RMR core. As discussed above, the implementation cost of RMR core is likely to be large and this cost would increase in line with the number of tariffs for which the format would need to be standardised. The single tariff structure proposal would also place a significant restriction on innovation by suppliers and consequently would restrict consumer choice.

1.190. The single tariff structure proposal may have a disproportionate adverse impact on small suppliers. The restriction of tariff structure and a common standing charge may enable small suppliers to more clearly demonstrate their price competitiveness. However, large suppliers may respond to the greater price transparency by seeking to cut costs and so exploit economies of scale.

1.191. The impact of the 'no adverse unilateral variation' restriction on suppliers' non-standard tariffs would be the same as under RMR core.

Price comparison only

1.192. The price comparison only proposal would have little direct impact on competition and suppliers. The proposal would not affect the range of tariffs available and so would not change the structure of the energy retail market. We expect only a modest increase in engagement to follow from the price comparison only proposal and so do not expect competition to intensify significantly. The proposal would neither create nor remove barriers to entry.

1.193. Suppliers would incur negligible implementation costs and we do not expect that the costs would be of a scale that would create a competitive disadvantage for small suppliers.

Airline options

Standard tariffs

1.194. Standard tariffs under the airline options model would be more attractive to engaged consumers than under RMR core because of the greater range of features available. This should lead to greater switching rates among standard tariffs and so the competitive forces necessary to keep energy prices at a competitive level may be present under the airline options model.

1.195. The ability for suppliers to compete through product diversification as well as through price would mean that coordinated effects would be less likely under this option. The airline options approach would lead to prices that are less transparent than under RMR core because the additional features would be priced separately. This would mean that suppliers would compete both on the unit price and the prices of the various additional features. Coordinating on each of these elements of the tariff would be a significantly more challenging task than would coordinating on the basis of unit price alone. We therefore consider that the risk of coordinated effects under the airline options approach is limited.

1.196. However, it is possible that the more complex structure of standard tariffs could make it difficult for consumers to assess the total tariff cost. Our quantitative consumer research found that it was more difficult for consumers to select the cheapest tariff under the airline options approach than under the other options tested. This confusion may allow the price of some tariffs with additional features to be maintained at a level above that which would obtain in a competitive market with well-informed consumers.

Non-standard tariffs

1.197. The impact of the airline options proposal on competition in the non-standard segment of the market would be similar to RMR core, but of a smaller scale.

1.198. We expect that engaged consumers would be more likely to select a standard tariff under the airline options model. Total consumer engagement would probably be lower than under RMR core because of the greater complexity of standard tariffs. Consequently, the intensity of competition in the non-standard segment of the market would be lower than under RMR core.

Risk of a two-tier market

1.199. As the prices of standard tariffs would be less transparent under the airline options proposal, the risk of price convergence for standard tariffs is lower than under RMR core. The additional options may mean that both standard and non-standard tariffs would appeal to proactive consumers under this proposal whereas only non-standard tariffs may appeal to them under RMR core. This means that it is less likely that competition would become solely focused on the non-standard market and so the risk of a two-tier market developing is lower under the airline options proposal.

Innovation

1.200. The scope for innovation in the non-standard segment of the market would be the same as under RMR core.

Differential impact across suppliers

1.201. The cost to suppliers of implementing the airline options is potentially significant. We expect the cost to small suppliers to be greater than under RMR core because it would be necessary for such suppliers to offer a wider range of tariffs. Under RMR core, small suppliers could offer just a single tariff (per payment method, per meter type) but this would not be possible under the airline options approach as all suppliers would be required to offer the full range of additional features. The Big 6 already offer a wide range of tariffs and we consider that the implementation cost of the airline options approach would be similar to RMR core for these suppliers, though still significant.

1.202. The difficulties resulting from the inability to pass through changes in network costs for non-standard tariffs would apply under the airline options proposal. The impact on suppliers would be the same as under RMR core.

Impacts on sustainable development

RMR core

Vulnerable consumers

1.203. Our quantitative research found that the vast majority of vulnerable consumers were able to select the cheapest tariff when a price comparison guide was provided and the standing charge was the same for all suppliers. This is encouraging and suggests that our proposals would directly benefit many vulnerable consumers. However, we note that a significant minority of vulnerable consumers would make an incorrect choice and so it may be necessary to introduce additional safeguards to protect these consumers.

1.204. Table 4 shows the success rate, speed of making a correct choice and ease of use for all non-E7 consumers, vulnerable consumers and sub-groups of vulnerable consumers that took part in our quantitative research. For vulnerable consumers as a whole the results of the quantitative research are encouraging. Given a price comparison guide and a uniform standing charge, 80 per cent of vulnerable consumers successfully identified the cheapest tariff which compares favourably with the 85 per cent success rate for all consumers. Vulnerable consumers took slightly longer to make a correct decision and rated the comparison guide slightly less easy to use than the average for all consumers, but the results are encouraging nonetheless.

1.205. Table 4 also shows that there is a small range of performance around the vulnerable average for vulnerable sub-groups. Those with no formal qualifications had the lowest success rate but, even within this group, nearly three-quarters made the correct choice.

1.206. Notwithstanding the overall encouraging results, we note that a significant minority of vulnerable consumers would make an incorrect choice of standard tariff even if standing charges were uniform and a price comparison guide was provided. It is possible that these would be the most vulnerable of vulnerable consumers but we cannot confirm this supposition from our consumer research.

Table 4: Vulnerable consumer analysis – non-E7

(Base)	**Correctly identify best deal (%)**	**Speed of making choice (mean secs)** Base: All identifying cheapest tariff	**Ease of use (% easy)** Base: All identifying cheapest tariff

All non-E7	(1,788)	85	41	82
Vulnerable (all non-E7)	(745)	80	43	78
Low income (up to £11,499 pa)	(439)	81	44	79
'Frail' elderly*	(27)	81	43	84
No formal qualifications	(260)	74	41	77
Literacy / numeracy difficulties	(50)	81	40	74
Disabled	(313)	79	43	77

**65+ and social grade E (state supported)*

Source: Ipsos MORI

1.207. Table 5 shows the breakdown of quantitative research results for vulnerable E7 consumers. The difference in success rate between vulnerable consumers and the average over all consumers is five percentage points – the same as for non-E7 consumers. However, each success rate is 15 percentage points lower for E7 consumers than for non-E7 consumers.

1.208. As for non-E7 consumers, there is a small range of performance around the vulnerable average for vulnerable sub-groups. Those with no formal qualifications and the frail elderly had the lowest success rate but, even within these groups, the majority made the correct choice. However, we note that a significant minority of vulnerable E7 consumers would make an incorrect tariff choice even with a fixed standing charge and price comparison guide. This suggests that it may be necessary to introduce additional safeguards for some consumers.

Table 5: Vulnerable consumer analysis – E7

	(Base)	**Correctly identify best deal (%)**	**Speed of making choice (mean secs)** Base: All identifying cheapest tariff	**Ease of use (% easy)** Base: All identifying cheapest tariff
All E7	(414)	70	48	64
Vulnerable (all E7)	(183)	65	49	65
Low income (up to £11,499 pa)	(107)	66	50	74
'Frail' elderly*	(13)	61	55	63
No formal qualifications	(69)	61	52	67

Literacy / numeracy difficulties	(23)	70	51	81
Disabled	(82)	63	46	64

**65+ and social grade E (state supported)* Source: Ipsos MORI

Fuel poverty

1.209. Any increase in tariff prices could increase the number of consumers in fuel poverty or aggravate the situation of those consumers already considered to be in fuel poverty. This could occur, for example, if standard tariff prices were to become uncompetitive due to coordinated effects or as a consequence of suppliers focusing competition on the non-standard segment. However, given that this would be transparent:

- It is much less likely to happen; and
- If it were to happen, Ofgem would be aware of it and would assess the impact on fuel poverty. We would take remedial action where necessary.

Environmental issues

1.210. The RMR core proposal may reduce the number of green tariffs offered, particularly in the standard segment of the market. Similarly, by clearly demonstrating the price premium of green tariffs in the standard segment, there is a chance that consumers would switch away from green standard tariffs. However, given that the majority of consumers on green tariffs have actively chosen these tariffs, we believe that tariff price is of secondary importance to these consumers compared to the generation mix. Therefore, we would expect the amount of switching away from green tariffs to be limited.

Variable standing charge

Vulnerable consumers

1.211. Vulnerable consumers found it significantly more difficult to select the cheapest tariff when standing charges differed between suppliers than when they were the same for all suppliers. Providing a price comparison guide helped some vulnerable consumers to correctly select the cheapest standard tariff but performance was significantly worse than where standing charges were equal. This suggests that it is the combination of remedies to the structure of energy tariffs and information remedies that would bring the greatest benefit to vulnerable consumers. In this regard, we conclude that RMR core is a better option than the variable standing charge proposal.

1.212. Table 6 shows the success rate, speed of making a correct choice and ease of use for the non-E7 tariff model in which standing charges differed by supplier and a price comparison guide was provided.

Table 6: Vulnerable consumer analysis – Non-E7

	(Base)	Correctly identify best deal (%)	Speed of making choice (mean secs) Base: All identifying cheapest tariff	Ease of use (% easy) Base: All identifying cheapest tariff
All Non-E7	(1,788)	50	58	61
Vulnerable (all non-E7)	(745)	45	61	57
Low income (up to £11,499 pa)	(439)	42	62	61
‘Frail’ elderly*	(27)	45	55	85
No formal qualifications	(260)	41	45	60
Literacy / numeracy difficulties	(50)	49	60	48
Disabled	(313)	47	63	50

**65+ and social grade E (state supported)* Source: Ipsos MORI

1.213. The success rate is relatively poor for all non-E7 consumers and indicates that half of consumers would make an incorrect tariff choice. Vulnerable consumers found it more difficult to select the cheapest tariff than did non-vulnerable consumers and the majority would not be able to select the cheapest standard tariff for their circumstances. This may result in vulnerable consumers switching to a more expensive tariff, which is likely to lead to future disengagement and a continuing lack of trust in the energy retail market.

1.214. There is a small range of performance around the vulnerable average for sub-groups of vulnerable consumers. Those with no formal qualifications had the lowest success rate and those with literacy / numeracy difficulties were the most successful. The time taken to make a correct choice was similar across all sub-groups except those with no formal qualifications.

1.215. Table 7 shows the breakdown of results for vulnerable E7 consumers. The success rate is significantly greater for E7 consumers (including vulnerable consumers) than it was for non-E7 consumers.

Table 7: Vulnerable consumer analysis – E7

	(Base)	Correctly identify best deal (%)	Speed of making choice (mean secs) Base: All identifying cheapest tariff	Ease of use (% easy) Base: All identifying cheapest tariff

All E7	(414)	76	58	59
Vulnerable (all E7)	(183)	68	72	63
Low income (up to £11,499 pa)	(107)	69	74	70
'Frail' elderly*	(13)	61	57	89
No formal qualifications	(69)	62	56	62
Literacy / numeracy difficulties	(23)	65	67	68
Disabled	(82)	62	88	62

**65+ and social grade E (state supported)*

Source: Ipsos MORI

1.216. On average, 68 per cent of vulnerable E7 consumers correctly selected the cheapest tariff for their circumstances compared with 76 per cent of all E7 consumers. This indicates that the success rate of non-vulnerable consumers would, on average, be somewhat above 76 per cent and hence the difference between the vulnerable and non-vulnerable groups is significant. The time taken to make a correct choice was significantly greater for vulnerable consumers.

1.217. The difference in performance is even more significant for certain groups of vulnerable consumers, including the frail elderly, those with no formal qualifications and those that consider themselves disabled. The results indicate that these groups would find it difficult to make the correct tariff choice and so could be adversely affected, though the small sample size of frail elderly means this result should be treated with caution. Given the disparate performance of vulnerable consumers there may be a need to introduce additional measures to protect some consumers under the variable standing charge proposal.

Environmental issues

1.218. The variable standing charge proposal may reduce the number of green tariffs offered, particularly in the standard segment of the market. However, the variable standing charge for standard tariffs would mean that the price premium of green tariffs in the standard market segment would be less clearly demonstrated than under RMR core because it could be split between the standing charge and unit rate. This means that the likelihood of consumers switching away from green standard tariffs may be lower than under RMR core. However, we do not believe that consumer confusion is a benefit of the variable standing charge proposal.

Fuel poverty

1.219. The risk of the variable standing charge proposal amplifying fuel poverty is lower than for RMR core because the risk of non-collusive price coordination, and so uncompetitively high prices, is lower. However, the potential for the variable standing charge proposal to intensify competition and thereby drive down prices and fuel poverty levels is also lower because fewer consumers would engage than under RMR core.

Single tariff structure

Vulnerable consumers

1.220. We presented the results of our vulnerable consumer quantitative research on the impact of setting a common standing charge earlier in this document. We would expect these results to apply to the single tariff structure proposal too. However, we noted above that the ripple effect is likely to be smaller under the single tariff structure proposal than under RMR core, meaning that the benefits to disengaged vulnerable consumers would also be lower.

Environmental issues

1.221. The single tariff structure proposal could lead to a reduction in the number of green standard tariffs due to the restriction on the number of tariffs in the standard segment of the market. In addition, restricting the format of non-standard tariffs is likely to result in a smaller number of green tariffs being available in this segment of the market than under RMR core.

1.222. Under the single tariff structure proposal, the price premium associated with green tariffs would be clearly visible to consumers in both the standard and non-standard market segments. Combined with the expected lower number of green tariffs, this could lead to a greater reduction in the take-up of green tariffs than would RMR core.

1.223. However, given that the majority of consumers on green tariffs have actively chosen these tariffs, we believe that price is of secondary importance to these consumers compared to the generation mix. On this basis we would expect the volume of switching away from green tariffs to be relatively limited, but greater than under RMR core.

Fuel poverty

1.224. Given that all tariffs would have the same structure under the single tariff structure proposal, non-collusive price coordination is a more serious risk than under RMR core because all tariffs and all consumers could potentially be affected. This means that the risks of uncompetitively high prices and an increase in fuel poverty is greater under this proposal.

Price comparison only

Vulnerable consumers

1.225. The price comparison only proposal would have a limited impact on vulnerable consumers. Given that the structure of the energy retail market would remain as today, the only way in which vulnerable consumers could be affected by the proposal would be through engagement, either by others or themselves. We do not expect the total increase in engagement as a result of the price comparison only proposal to be as great as under the RMR core proposal. This would mean that indirect benefits to these vulnerable consumers who do not engage through a 'ripple effect' would be lower under the price comparison only proposal. We also expect that engagement by vulnerable consumers would be lower under the price comparison only proposal than under RMR core.

1.226. Given that our quantitative research focused on standard tariffs, it is not possible to separate the results of the price comparison only approach from those of the variable standing charge proposal without an element of qualitative judgment. In either case, the results clearly demonstrate that providing only a price comparison guide would lead to a significant proportion of vulnerable consumers making incorrect tariff choices and is less likely to promote engagement by these consumers than if the standing charge was the same for all standard tariffs.

Environmental issues

1.227. The proposal would have little impact on green tariffs because the structure of the energy market would remain as it is today. It is possible that the price comparison guide might make the price premium associated with green tariffs clearer than it is at present, however, and so could lead to a small decrease in the take up of green tariffs.

Fuel poverty

1.228. The price comparison only proposal is unlikely to impact on fuel poverty. We expect only a modest increase in switching would arise from this proposal and so competition is unlikely to intensify and drive down prices to the benefit of those in fuel poverty. This proposal is unlikely to lead to coordinated effects and so we do not expect it to have an adverse effect on fuel poverty.

Airline options

Vulnerable consumers

1.229. Vulnerable consumers found it more difficult to identify the cheapest tariff under the airline options approach than under any of the other elements that were tested in our quantitative research. Under the airline options approach only 40 per cent of vulnerable consumers identified the cheapest tariff. We do not consider it appropriate to introduce a revised tariff structure that is so difficult for consumers to understand. Due to the difficulty of selecting the cheapest tariff, the proportion of vulnerable consumers that would suffer detriment is likely to be greater than under RMR core.

Table 8: **Vulnerable consumer analysis – non-E7**

	(Base)	**Correctly identify best deal (%)**	**Speed of making choice (mean secs)** Base: All identifying best deal	**Ease of use (% easy)** Base: All identifying best deal	**Likelihood of exploring options (% more likely)**
All non-E7	(1,788)	50	62	63	40
Vulnerable non-E7 (all)	(745)	41	62	60	35
Low income (up to £11,499 pa)	(439)	40	63	64	36
'Frail' elderly*	(27)	27	49	71	21
No formal qualifications	(260)	36	56	68	31
Literacy / numeracy difficulties	(50)	34	57	26	26
Disabled	(131)	42	61	54	35

**65+ and social grade E (state supported)*

Source: Ipsos MORI

1.230. Table 8 shows the success rate, speed of making a correct choice, ease of use and likelihood of exploring additional options for non-E7 respondents.

1.231. Vulnerable consumers find it more difficult to identify the cheapest tariff under this approach than do non-vulnerable consumers. Only 41 per cent of vulnerable non-E7 consumers identified the cheapest tariff. The frail elderly, those with literacy / numeracy difficulties and those with no formal qualifications found this task particularly difficult. To some extent, this finding is unsurprising given that it was necessary to use addition and subtraction in order to identify the cheapest tariff. These sub-groups would also be the least likely to explore the additional options. It should be noted, however, that the groups of frail elderly and literacy / numeracy difficulties were small and so these findings should be treated with caution. The remaining sub-groups of non-E7 vulnerable consumers were more successful in their decisions but fewer than half were correct in each case.

1.232. Table 9 shows that results are somewhat different for the E7 sample of vulnerable consumers. The proportion of these consumers that selected the cheapest deal is similar to the proportion of vulnerable non-E7 consumers. However, only those E7 consumers with literacy / numeracy difficulties appear to have found the challenge to be particularly challenging. The frail elderly and those with no formal qualifications had a success rate close to the average for all vulnerable consumers.

Table 9: Vulnerable consumer analysis – E7

	(Base)	Correctly identify best deal (%)	Speed of making choice (mean secs) Base: All identifying best deal	Ease of use (% easy) Base: All identifying best deal	Likelihood of exploring options (% more likely)
All E7	(414)	43	69	50	42
Vulnerable E7 (all)	(183)	39	70	51	41
Low income (up to £11,499 pa)	(107)	35	66	53	37
'Frail' elderly*	(13)	38	69	59	28
No formal qualifications	(69)	37	81	51	32
Literacy / numeracy difficulties	(23)	29	61	58	37
Disabled	(82)	44	60	46	43

**65+ and social grade E (state supported)*

Source: Ipsos MORI

Environmental issues

1.233. One of the additional features of standard tariffs available under the airline options model may be a green tariff. If so, this would enable all suppliers to offer a green standard tariff and so it is unlikely that this proposal would lead to a reduction in the number of green tariffs available.

1.234. However, the airline options approach would lead to the price premium associated with green tariffs being clearly visible as the additional features would be priced separately to the unit rate. This may cause some consumers to switch away from green tariffs but we would expect this effect to be relatively limited given that those currently on green tariffs have actively chosen to switch to that tariff in the past. We consider that price is of secondary concern to such consumers compared to the generation mix.

Fuel poverty

1.235. The airline options proposal may have an adverse impact on fuel poverty. Our quantitative consumer research demonstrated that consumers find it difficult to select the cheapest tariff under the airline options model. The research also found that the proportion of consumers who felt that the model was easy to use was greater than the proportion that correctly selected the cheapest tariff. This may mean that some consumers switch to a more expensive tariff because of an incorrect perception that the new tariff is cheaper than their existing tariff. This would be reinforced if suppliers were to aggressively market the additional options such that consumers selected features that they would not have chosen under other tariff models. Fuel poverty would be aggravated if some of those that that experienced a price increase through switching are currently close to the fuel poverty threshold.

Impacts on health and safety

1.236. We do not believe there are any significant impacts on health and safety arising from our proposals. However, we invite views on this issue.

Risks and unintended consequences

1.237. In earlier sections of this draft Impact Assessment we have discussed the likely impacts on consumers and competition of recommended options. This section discusses any risks and unintended consequences of the proposed options.

RMR core

Time-of-use tariffs

1.238. Time-of-use (ToU) tariffs are expected to become increasingly important as a way for consumers to manage their consumption. The smart metering roll out will make it easier for suppliers to offer ToU tariffs, and should increase the range of ToU tariffs on offer.

1.239. Our RMR proposals seek to promote competition and consumer engagement. This engagement will be vital if customers are to get the most out of innovative ToU tariffs and smart metering. Without improvements in the short term, consumers may not realise the full potential benefits of smart metering. Our RMR proposals will contribute to creating retail market conditions which maximise these consumer benefits. To preserve ToU tariffs currently in use, in the RMR core model we have proposed that a standard tariff would be available for consumers that are currently on E7 tariffs and that suppliers would be able to seek derogations for E10 and DTS tariffs.

1.240. Our proposals aim to preserve and stimulate opportunities to offer innovative products, including those associated with smart metering. At first, new ToU tariffs will only be available in the fixed-term market and we acknowledge that our proposals may restrict the number and permitted types of ToU tariffs. Nonetheless, new innovative ToU tariffs are likely in the short term to appeal only to the most engaged consumers, who we expect to consider tariffs in the non-standard segment of the market. We therefore think that, in the short term, our proposals will not adversely affect opportunities for consumers to take up new ToU tariffs.

1.241. We also note that the price comparison guide is less suitable for innovative ToU tariffs. More assumptions are needed to accommodate these tariffs within the guide than for other tariffs, such as applying an example load profile to the tariff. This increases scope for a price comparison guide to mislead consumers about the savings they could make. Furthermore, consumers could be expected to change their consumption profile in response to being on a ToU tariff, for example to take advantage of cheaper rates at off-peak times. Illustrating potential savings with the price comparison guide could further reduce its accuracy for individual consumers. Bad experiences amongst 'early adopters' could deter others, including those who could benefit from ToU tariffs.

1.242. As electricity usage changes in conjunction with the smart metering roll out, consumer appetite for ToU tariffs may increase. Recognising this, we will initiate work to analyse the regulatory arrangements around ToU tariffs. This will link with our wider Smarter Markets Strategy, on which we will be consulting. Our work on ToU tariffs will examine broader issues relating to new ToU tariffs, including tariff comparison, tariff complexity, the importance of consumer engagement for ToU tariffs and potential impacts on vulnerable customers. Further, we will examine how best to allow dynamic ToU tariffs to develop in light of our RMR proposals.

Other risks and unintended consequences

1.243. The elimination of dual fuel discounts in the standard segment of the market carries a risk of frustrating a significant number of consumers. Our qualitative consumer research found that people did not see the benefit of withdrawing the dual fuel option and this could attract a backlash from people who could blame Ofgem for increasing their bills. The reasons that we propose to remove the dual fuel option are discussed in the 'Additional Features' section below.

1.244. There is also a risk that because Ofgem would set the standing charge for tariffs in the standard segment of the market, we may be seen as favouring standard tariffs. This may result in consumers being drawn to standard tariffs because of a perception (albeit incorrect) that these tariffs are regulated by Ofgem and so 'safer' than non-standard tariffs. This would have the effect of distorting the market since some consumers may switch to standard tariffs because of the 'Ofgem-factor' when they would have chosen a non-standard tariff in the absence of this. We would work with suppliers and other stakeholders to clearly communicate our proposals and what they mean for consumers.

1.245. In order to avoid circumvention of our tariff simplification proposals through corporate groups holding multiple supply licences, we would ensure that the rules on one unit rate for each payment method apply to the total number of standard tariffs offered by all affiliated licence holders within the same corporate group (i.e. any legal entity connected by a subsidiary or holding company).

Variable standing charge

1.246. The risks and possible unintended consequences that could arise from the variable standing charge proposal are almost identical to those that could arise from

RMR core. These issues are discussed above. However, the risk of standard tariffs being mistakenly perceived as 'regulated' is lower under the variable standing charge proposal as Ofgem would not set the level of the standing charge.

Single tariff structure

1.247. Given the degree of intervention of the single tariff structure proposal, the possible unintended consequences are of a greater scale than those that could arise from the other options. However, the nature of the risks and unintended consequences are the same as those of RMR core, discussed above.

Price comparison only

1.248. The price comparison only proposal is the least interventionist option and we do not believe that the proposal has any significant risks or unintended consequences.

Airline options

1.249. It is conceivable that the airline options model would lead to an increase in tariff complexity relative to the status quo. This would not be in the best interests of consumers and would be contrary to the objectives of any intervention in the retail market. The likelihood of this unintended consequence is related to the number of options permitted – each additional option adds to the complexity of the standard segment of the market at an increasing rate (i.e. the additional complexity from allowing a fifth feature is greater than the additional complexity from allowing a fourth feature). It is possible that this could lead some consumers to disengage and so create an energy retail market that is less competitive than it would be if we chose not to intervene.

1.250. The other risks and unintended consequences are the same as those of RMR core, discussed earlier in this document.

Other impacts

RMR core

1.251. Ofgem would incur ongoing costs under the RMR core proposal. We would regularly review and amend the level at which standing charges are set in light of changes in relevant costs. This, and the process of communicating changes to suppliers, would create ongoing costs. The wider the standing charge, the greater would be the likely impact on our costs.

1.252. We would monitor the impact of the proposals on consumers, especially vulnerable groups, and would monitor how suppliers implemented the revised tariff structures and information remedies. We would investigate any potential breaches and would take enforcement action against any suppliers found to have breached relevant licence conditions. These processes would result in ongoing costs for Ofgem, but we expect these to be lowest with RMR core than with other options, given we believe the likelihood of us needing to take action is lowest with RMR core.

1.253. However, these costs would be mitigated by our proposed requirements for suppliers to have contractual terms which reflect relevant licence conditions and which will therefore help individual consumers to take action or seek redress in respect of their supplier.

Variable standing charge

1.254. Relative to RMR core, Ofgem would incur fewer ongoing costs under the variable standing charge proposal. It would not be necessary for us to set regional standing charges and so there would be no incremental cost arising from this.

1.255. However, we would need to monitor the impact of the proposals on consumers, especially vulnerable groups, and would monitor how suppliers implemented the revised tariff structures and information remedies. The cost impact would be the same as under RMR core.

Single tariff structure

1.256. We expect the single tariff structure proposal would have the same impact on Ofgem's costs as RMR core.

Price comparison only

1.257. Ofgem would incur a relatively small incremental cost if the price comparison only proposal were implemented. We would incur a one-off cost of designing the price comparison guide and would monitor suppliers' compliance with the requirement to publish a guide for each of its tariffs and to make these easily accessible to consumers. We expect that both one-off and ongoing costs would be lower than under any of the other proposals.

Airline options

1.258. Ofgem would incur ongoing costs under the airline options proposal. Costs associated with setting the standing charge would be of the same magnitude as under RMR core. The cost of monitoring the impact of the proposal on consumers would also be the same as under RMR core. However, we expect the costs of monitoring suppliers' response to the proposals would be greater under the airline options proposal than under RMR core due to the greater complexity in the standard segment of the market.

Post-implementation review

1.259. Following the implementation of our proposals we would monitor the impact of the proposals on consumers, especially vulnerable groups, and would monitor how suppliers implemented the revised tariff structures and information remedies. We would also monitor levels of engagement with the market and the how the price of standard tariffs evolved relative to prices of non-standard tariffs. The success of our remedies would be measured by the change in effective consumer engagement with the market.

1.260. As electricity usage changes and with the smart metering roll out, consumer appetite for ToU tariffs may increase. Recognising this, we will initiate work to analyse the regulatory arrangements around ToU tariffs. This will link with our wider Smarter Markets Strategy, on which we will be consulting. The work will examine broad issues relating to ToU tariffs, including tariff comparison, tariff complexity, the importance of consumer engagement for ToU tariffs and potential impacts on vulnerable customers. Further, we will examine how best to allow dynamic ToU tariffs to develop in light of our RMR proposals.

Additional features

1.261. We have considered a number of additional features that could be permitted for standard tariffs. These features could be associated with any of the tariff proposals and it is for this reason they have been treated separately.

1.262. We would like stakeholders to comment on two additional features in responses to this consultation and have chosen not to proceed with four other possibilities. The following sub-sections explain the reasons for our decisions.

Features that we are consulting on

Allow green standard tariffs?

1.263. One concern with the RMR core proposal, the variable standing charge proposal and the single tariff structure proposal is the potential adverse impact on the availability of standard green tariffs. In responses to the March RMR consultation, some stakeholders suggested that the proposals would preclude the provision of a green standard tariff and that this would not be in line with the broader green agenda.

1.264. We are minded not to allow suppliers to offer a green standard tariff in addition to an ‘ordinary’ standard tariff. However, we do not wish to undermine our sustainability objectives and we are therefore consulting on the issue.

1.265. We have discussed a number of options to allow suppliers a green standard tariff. We note that any dispensation for green standard tariffs would double the number of tariffs in the standard segment of the market. This would create significant complexity in the standard market and we do not consider that the benefits outweigh this additional complexity, for much the same reasons as discussed in the analysis of the airline options proposal.

1.266. Under the RMR core proposal there would be nothing to stop suppliers offering a green standard tariff rather than an 'ordinary' standard tariff. Some suppliers already focus on offering green / renewable energy tariffs and we would expect them to offer a green standard tariff under the RMR core proposal in any event without providing for a further exception. Suppliers would also be free to offer an unlimited number of green non-standard tariffs. Therefore, we expect that green standard tariffs would be available even if we were not to make an explicit exception.

Include a six month price guarantee for standard tariffs?

1.267. A six month price guarantee would give consumers the assurance that when they switched to a new tariff or supplier, their price would not change for the first six months. The price guarantee would be asymmetric, in that consumers would only be immune to price rises.

1.268. It is not clear if the benefits of the six-month price guarantee for standard tariffs would outweigh the costs, given that a 30-day price guarantee is already in place and would offer some protection for standard tariffs. Ofgem does not have a minded to position on this issue and welcomes stakeholder views.

1.269. Our qualitative consumer research tested a range of price guarantee periods, from one to six months. The majority of respondents said that a six month guarantee on prices would make them much more or somewhat more likely to switch supplier. Shorter periods would have limited impact on switching. One explanation for this finding might be that there is a transaction cost associated with switching. When considering whether or not to engage with the energy market, and potentially switch supplier, consumers will weigh up the potential benefits with the costs of switching. A six-month price guarantee would provide the consumer with confidence that their energy price would not increase for that period and so increase the expected benefit of switching, possibly to an extent such that the transaction cost is overcome.

1.270. There are complications with a price guarantee of this duration. First, it would create an asymmetric risk on suppliers. Without the ability to pass through price rises to a proportion of their customers, suppliers would need to manage such an increase in risk. This is likely to come through amendments to their hedging strategies, which could turn out to be more costly than their current approach. This could lead to higher prices for all of their customers. While large suppliers are likely to be able to manage these risks, this may not be so for small suppliers.

1.271. A second problem with the price guarantee is that it would complicate the standard tariff segment of the market and potentially undermine the tariff simplification proposal. At any given time, different consumers on any single tariff could be facing several unit rates because of the price guarantee. While this would not affect the ease of price comparison for those looking to switch tariffs, it could complicate the assessment of potential savings (e.g. switching sites or sales agents may not take into account that a consumer is benefitting from a price guarantee when calculating the potential saving). This could mislead the consumer.

1.272. It is also worth noting that consumers that wished to have a longer price guarantee than the current 30 days could choose a non-standard tariff, for which the price throughout the fixed-term would be known in advance. However, some consumers may not be comfortable with switching to a tariff that has an exit fee.

Other features

Proposal to remove the restriction on unilateral contract variations in the non-standard market

1.273. The prohibition on the supplier increasing the price and making adverse unilateral variations in respect of other terms and conditions of non-standard tariffs will affect the types of tariff available in this segment of the market. If there were no exceptions to this rule, all non-standard tariffs would be fixed price. However, by way of exceptions which we consider are in line with general consumer protection law[61], we are proposing to allow suppliers to have tariffs that automatically provide for an increase in price in the following ways:

- The precise timing and amount of the price increase is expressly agreed in advance as part of the terms of the contract and is not in any way subject to the supplier's discretion[62]; and / or

- The contract provides that variations to the price will occur automatically only in a manner which is fully linked to fluctuations in a published and transparent stock exchange quotation or index or a financial market rate that the licensee does not control.

1.274. For the avoidance of doubt, these proposals will mean that suppliers would not be able to offer fixed-term, variable price tariffs that track increases in the supplier's standard tariff or other suppliers' tariffs. Given that these restrictions may result in suppliers seeking to mutually agree contractual variations with customers, we are also proposing rules to regulate how such mutual variations may be agreed in relation to both standard and non-standard tariffs.

1.275. There is a concern that limiting the non-standard market to a small number of tariff types would lead to higher prices for consumers. Without the ability to vary prices in the non-standard market, suppliers may find it difficult to, for example, set fixed prices without significantly increasing the risks of their activities. Suppliers may therefore enter more costly hedging strategies to manage the greater risk associated with tariffs that are less flexible.

1.276. Another concern is that consumers themselves would find the choice unappealing or the restriction too cumbersome. There may be some consumers who have a preference for a variable-price, non-standard tariff. We have looked closely at

[61] e.g. the Unfair Terms in Consumer Contracts Regulations 1999.
[62] This exception would include time-of-use tariffs such as E7.

the range of tariffs currently available. Other than green and online tariffs, we have not found a tariff type that is in high demand that may cause frustration if it was not available as a variable-priced tariff. We are consulting on a possible exemption for green tariffs and are committed to initiating work to analyse the regulatory arrangements around ToU tariffs, linking with our wider Smarter Markets Strategy. Therefore, we do not believe it necessary to make further dispensations for other variable-priced non-standard tariffs.

1.277. We also consider that permitting unilateral variations in the non-standard segment of the market would significantly restrict the impact of our proposals on consumer engagement. Our proposals are designed to prompt consumers to make active, conscious decisions in the non-standard part of the market. Permitting unilateral variations would mean that the terms and conditions of a consumer's tariff could change without them making an active choice. This would mean that our proposals would not be promoting consumer engagement in the market to as great an extent as if no adverse unilateral variations were permitted. On this basis, we maintain our March proposal to ban unilateral variations to non-standard tariffs.

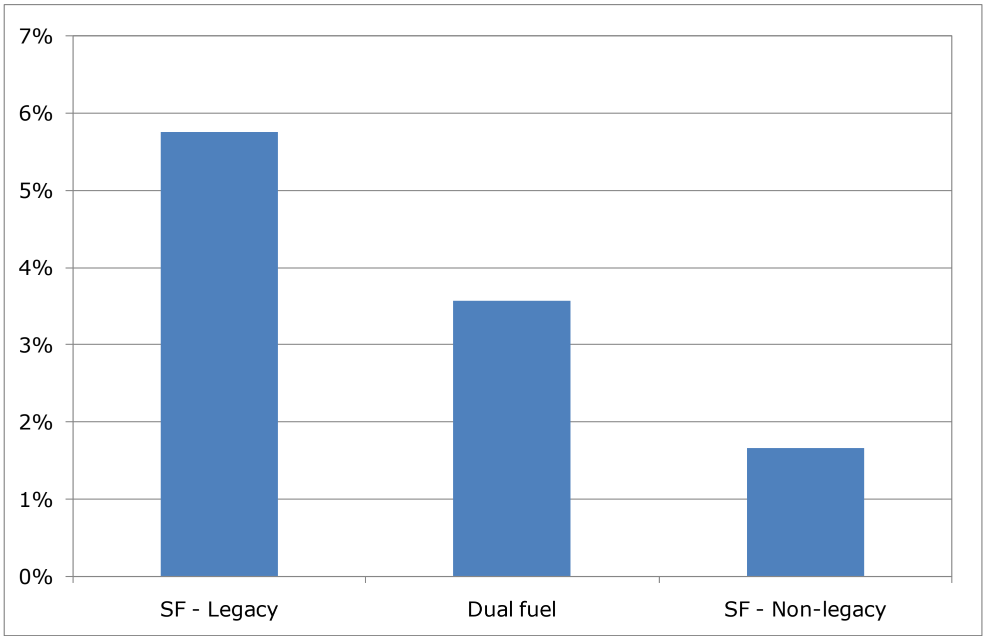
Proposal not to allow a dual fuel standard tariff or a dual fuel discount to standard tariffs

1.278. The RMR proposals presented in this paper are designed to apply to standard electricity and gas tariffs only. That is, suppliers would be required to have one standard gas tariff per payment type and one standard electricity tariff per payment type for each of E7 and non-E7 consumers. As a result, suppliers would no longer be able to offer standard variable dual fuel tariffs.

1.279. Concerns were raised by both suppliers and consumer groups that the RMR proposal would eliminate dual fuel tariffs and the discounts associated with them. The removal of dual fuel discounts may be perceived as Ofgem raising the price of energy to consumers and denying them a discount to which the consumer believes he should be entitled. Such a move would require explanation as part of our consumer engagement work to support the RMR.

1.280. However, Ofgem remains concerned that suppliers are using dual fuel discounts to cross-subsidise the prices of one fuel with the revenues from another. Figure 5 shows that, on average, suppliers make around three times the margin on their legacy fuels than on their non-legacy fuels. Dual fuel tariffs obscure the margin difference between legacy and non-legacy fuels and so remove a consumer's ability to tell whether their supplier is offering both the cheapest electricity and the cheapest gas in the market. Our own analysis, based on data from the energyshop.com, has shown that across the 14 ex-PES regions, consumers on dual fuel, direct debit tariffs could save up to £60 by switching to the lowest price supplier for both tariffs.

Figure 5: Estimated sales margins on legacy and non-legacy fuels



Source: Big 6 suppliers - request for information, Datamonitor

1.281. Given the above, we maintain our March proposal to remove dual fuel standard tariffs and require suppliers to compete on electricity and gas separately. Dual fuel tariffs may still be available in the non-standard segment of the market, if suppliers choose to offer them.

Proposal for opt-in auto-rollovers to non-standard tariffs

1.282. Some consultation respondents stated that an auto-rollover to a tariff with a termination fee could result in a customer paying less for their electricity or gas than if they were transferred, by default, to a suppliers' standard tariff. It was suggested that Ofgem should consider permitting auto-rollovers if it results in a saving to that customer, compared with being transferred to the suppliers' standard tariff.

1.283. We remain unconvinced by these arguments. We believe that any allowance for auto-rollovers in the non-standard market, would be a target for misuse by suppliers. We are also confident that a prohibition on auto-rollovers will increase competition among suppliers for customers on non-standard tariffs as it would create incentives for suppliers to promote consumer engagement if they wish to encourage consumers to agree to another offer with them. Suppliers would be required to notify consumers in advance of their fixed term tariff ending. This would remind them that they will default onto the supplier's standard tariff if they do not make an active choice to take another fixed-term tariff and so would prompt consumers to find a new tariff.

1.284. On this basis, we maintain our March position to prohibit suppliers from automatically rolling customers onto another non-standard tariff. However, we are minded to permit rollovers if the consumer gives their express consent close to the end of the contract term.

Proposal not to allow paperless billing, online or prompt pay discounts to standard tariffs

1.285. Paperless billing, online and prompt pay discounts may currently be applied by suppliers to reflect the lower cost of serving these consumers. The paperless billing and online discounts are likely to benefit engaged consumers that have actively chosen an online option and would not benefit those without internet access. The prompt pay discount is available to customers that pay by standard credit.

1.286. Allowing discounts to standard tariffs would create significant complexity in the standard segment of the market and would limit the number of consumers that would engage in the market more effectively due to this greater level of complexity. We do not consider that the benefits outweigh this additional complexity. The discounts would also make it harder for the media or other organisations to publish standard tariff prices and so the information would be less accessible.

1.287. On this basis we maintain our March position and will not allow paperless billing, online or prompt pay discounts to standard tariffs[63].

Backstop tariff

1.288. In the current environment of rising cost pressures, it is not an option to leave consumers without the protection of effective price restraint. Although we prefer to see this delivered through an effective market, we intend to monitor the impact of our proposals closely and to keep open the option of further interventions to protect consumers, including potentially a 'backstop' tariff.

1.289. A backstop tariff, for example priced relative to a basket of other tariffs available in the market, could co-exist with most of the proposals currently under consideration. It could be designed to target certain consumer groups, such as vulnerable consumers, as suggested by the Fuel Poverty Advisory Group for England (FPAG) in its response to the March consultation.

1.290. Alternatively, it could potentially be much wider and replace the standard tariff in our RMR core proposal, essentially acting as the backstop tariff to all non-standard tariffs. A wider backstop tariff would benefit those consumers that are unable to engage with the market, even following the RMR reforms, as it would be an alternative to participating in the competitive market.

[63] For the same reasons, the RMR core proposal would not permit any other discounts to standard tariffs and would not allow suppliers to link standard tariffs to contracts for other goods and services that don't directly relate to supply.

1.291. For the reasons described below, we do not propose to introduce a backstop tariff at this stage. However, we do not rule out the potential for additional protections for vulnerable groups. This could be a targeted backstop, a requirement for suppliers to offer the best tariff to vulnerable consumers or other measures. We will maintain dialogue with government on this issue and invite consultation respondents to suggest what additional measures can be put in place to protect vulnerable consumers within the context of our proposals.

Positives

1.292. A backstop tariff could help consumers if there was price divergence between the standard and non-standard segments of the market. For example, under the FPAG proposal, vulnerable consumers who had trouble engaging with the market would be protected from high prices in the standard market. Under a more general backstop, consumers who found it difficult to engage with the market would default onto the backstop tariff. It would also ensure that any consumer who did not engage at the end of a fixed-term contract would be placed onto a backstop tariff.

Negatives

1.293. By construction, a backstop tariff of the type described above, priced relative to a basket of other tariffs available in the market, would not be the cheapest available. This is likely to mean that the most vulnerable would always be paying more for their fuel than the most engaged consumers. In addition, the price of the tariff would vary more frequently than those of other tariffs (since the price would change whenever the price of any tariff in the basket was amended). Both of these features of the tariff may lead to consumer detriment in terms of perceived unfairness, confusion and frustration.

1.294. Such a backstop tariff could also be seen as at odds with the government’s fuel poverty initiative, which advocates lump-sum discounts through the Warm Home Discount. Further, it is only a possibility that prices between standard and non-standard tariffs would diverge. To consider the case for the introduction of a tariff to protect vulnerable consumers, it would seem prudent to monitor the impact of our proposals and review any evidence on the divergence between standard and non-standard tariff prices. Ofgem would closely monitor the impact of the RMR core proposal and would take further action if necessary.

1.295. There are also specific concerns with the FPAG proposal. It is highly interventionist and yet, if the tariff were targeted narrowly at certain vulnerable consumers, the intervention would have no positive impact on the wider market, and may have a negative impact if it discourages people from engaging. There would also be a need to define which consumers would be eligible for the tariff. One strategy to address this would be to follow the Warm Home Discount which identifies a specific core group of vulnerable consumers to receive rebates.

1.296. Our quantitative consumer research shows little difference in the average scores of vulnerable and non-vulnerable consumers in their abilities to select the cheapest tariffs. This implies that both vulnerable and non-vulnerable consumers will benefit from the introduction of our core tariff proposals. We acknowledge, however, that some vulnerable consumers would continue to find it difficult to engage with the market (e.g. to access tariff information) and so additional measures to protect such consumers may be necessary.

Conclusion

1.297. On balance, based on the evidence currently available and the analysis presented above, we consider that the likely benefits arising from the RMR core proposal are greater than the likely costs. We believe that the likely net benefit of this policy option exceeds that of the other options considered and that RMR core meets our objectives most effectively. Figure 6 summarises our assessment of the proposals against the policy objectives. It also includes an assessment of the likely scale of implementation costs and the risk of unintended consequences.

1.298. We consider that the RMR core proposal is a proportionate response to the problems with the retail market that were identified in the March RMR consultation document.

Figure 6: Assessment of the RMR tariff proposals

	Improve tariff comparability	Simplify tariff structure	Increase engagement	Facilitate innovation and choice	Improve decision-making	Low implementation cost	Low risk of unintended consequences
RMR core	✓ (green)	✓ (amber)	✓ (green)	✓ (amber)	✓ (amber)	✓ (amber)	✓ (amber)
Variable standing charge	✓ (amber)	✓ (amber)	✓ (amber)	✓ (amber)	✓ (red)	✓ (amber)	✓ (amber)
Single tariff structure	✓ (green)	✓ (green)	✓ (amber)	✓ (red)	✓ (green)	✓ (red)	✓ (red)
Price comparison only	✓ (amber)	✓ (red)	✓ (amber)	✓ (green)	✓ (red)	✓ (green)	✓ (green)
Airline options	✓ (red)	✓ (red)	✓ (red)	✓ (amber)	✓ (red)	✓ (amber)	✓ (amber)

Note: Green = high benefit, or low cost / risk, amber = medium benefit, or medium cost / risk and red = low benefit, or high cost / risk.

1.299. We acknowledge that there is an element of qualitative judgement in our view here. We have based this qualitative judgement on what economic theory and research / experience to date have been able to tell us. We expect the RMR core proposal to benefit the majority of proactive and reactive consumers. The majority of permanently disengaged consumers are unlikely to suffer detriment and would benefit through a 'ripple effect' if there is more effective engagement by consumers on standard tariffs. Ofgem will monitor the impact of its proposals on vulnerable groups.

Appendix 8 – Strengthen Probe Remedies – Domestic: Draft Impact Assessment

Executive summary

1.1. Proposal 3 of the Retail Market Review (RMR) March document[64] focuses on strengthening Probe remedies. We have designed proposed remedies that aim to ensure consumers receive simple and transparent information on bills, annual statements and unilateral variation notification letters. These communications can act as effective triggers for consumer engagement. Therefore, clarity of content as well as their ability to engage consumers and have a distinct impact are all vital. The current obligations regarding bills and annual statements are covered by the domestic supply licence conditions (SLC) 31A and unilateral variation notification letters are covered by SLC 23.[65]

1.2. Lack of clarity in suppliers' communications was a key concern identified in the RMR March document. Our research showed that consumers often find the information received from suppliers confusing and difficult to comprehend. This has led to low levels of consumer confidence and engagement. Therefore our proposed informational remedies are aimed at tackling this issue.

1.3. The proposed remedies have been designed taking account of a range of factors, including findings from the RMR March consultation, responses to that consultation, consumer research, consumer complaints received by Ofgem, a review of current supplier practices and consideration of the current legal framework. They have been further developed following testing in our most recent Consumer First Panel. In our view the net effect of our proposals would be reflected in enhanced consumer understanding of key tariff information and, ultimately, effective consumer engagement.

1.4. This draft Impact Assessment focuses on our analysis of the likely impact of our proposals on consumers, competition and other impacts. It also considers the potential impacts of other key options. We welcome responses to help inform our final assessment and to add further detail to our assumptions regarding benefits and costs.

1.5. With regard to SLC 31A (concerning information on bills and annual statements) we have considered the following options:

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[64] The Retail Market Review – Findings and initial proposals, March 2011, Reference: (34/11)
[65] See the accompanying Consultation Document for more detail on SLC 23 and unilateral variation notifications.

- **Option 1: ('Continue to use current arrangements'):** No change to the SLC 31A and publish guidance on how suppliers should interpret and implement the obligations;

- **Option 2: ('Introduce amendments to SLC 31A')**: Tighten the current drafting of the relevant licence conditions to clarify policy expectations; and

- **Option 3: ('Option 2 plus, introduce more prescriptive rules'):** Standardise certain elements of bills and annual statements as well as tightening the current drafting of the relevant licence conditions to clarify policy expectations.

1.6. Based on existing evidence from consumer research, an understanding of current supplier practices, views from language experts and consumer research we propose Option 3.

1.7. With regard to SLC 23 we have considered the following options:

- **Option 1 ('No change'):** Continue to monitor and enforce existing conditions;

- **Option 2 ('Additional information'):** Require suppliers to include additional information (without obligations on format);

- **Option 3 ('Additional information plus prescribed format'):** Require suppliers to include the additional information under Option 2, and also consult on a prescribed format for certain price increase information; and

- **Option 4 ('Tighten and clarify policy intent'):** Introduce amendments to SLC 23 to tighten the drafting and clarify policy intent.

1.8. We propose a combination of Option 3 ('Additional information plus prescribed format') and Option 4 ('Tighten and clarify policy intent'). For the avoidance of doubt, Option 3 ('Additional information plus prescribed format') includes all of the additional information requirements contained in Option 2 ('Additional information') along with the proposal to present price increase information in a prescribed format.

1.9. On the basis of this draft Impact Assessment, we believe that the combination of options we recommend would secure the best outcome for consumers and enhance competition. We are mindful that systems changes associated with our proposals could result in costs for the industry and, ultimately, consumers but consider that any potential negative effects will be outweighed by the benefits to consumers. These proposals will work in conjunction with the wider package of remedies proposed through the RMR.

Key issues and objectives

1.10. As part of the internal research and analysis of the RMR we have found evidence of low consumer engagement, which manifests in symptoms such as low switching rates and poor quality of switching decisions. Through our research, including our Consumer First Panel[66], we also know that consumers do not find their bills, annual statements and unilateral variation notification letters user-friendly or easy to understand.

1.11. Responses to the RMR March consultation generally agreed that the lack of clarity and transparency regarding information currently provided by suppliers does not facilitate consumer engagement in the desired way. In addition, Ofgem's Consumer First Panellists felt that standardisation of some terms and formats in these documents would improve clarity across the industry and help consumers to recognise and understand key information more easily.

1.12. Our package of proposals will improve the quality of information consumers receive and to enhance customer engagement. We are currently minded to propose standardising certain elements of bills, annual statements and unilateral variation notification letters as well as tightening the current drafting of relevant licence conditions to clarify policy expectations. The broad objectives of our proposals are as follows:

- Improve the quality of information suppliers provide to consumers;
- Facilitate greater consumer engagement in the market; and
- Enable consumers to make well-informed decisions regarding their choice of energy tariff.

1.13. We believe this approach will work in conjunction with other RMR proposals to aid effective consumer engagement.

1.14. These proposals are consistent with our statutory objectives. We have considered our principal objective[67], set out in legislation, which is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. We have also had appropriate regard to all relevant general statutory duties.

[66] Ofgem's Consumer First Panel is a deliberative forum made up of around 100 consumers recruited across England, Scotland and Wales, chosen to be broadly representative of consumers. The Panel meets regularly to discuss key issues impacting on their participation in the energy market and panellist change every year.
[67] As well as our general objectives under the gas and electricity directives of "ensuring that customers benefit through the efficient functioning of their national market, promoting effective competition and helping to ensure consumer protection".

Bills and annual statements

Options

1.15. As discussed in the main consultation document (Chapter 3) we examined several possible policy options to address our concerns with the quantity and quality of information suppliers provide to their consumers in bills and annual statements. These options are briefly outlined below.

Option 1 (Continue to use current arrangements)

1.16. Under this option SLC 31A will remain unchanged and we would publish Guidance on how suppliers should interpret and implement the obligations set in the licence.

Option 2 (Introduce amendments to SLC 31A)

1.17. This option would introduce amendments to SLC 31A to tighten the drafting and clarify our policy intent.

Option 3 (Option 2 plus, introduce more prescriptive rules)

1.18. With this option we would introduce requirements for suppliers to use consistent and standardised terminology and to provide more standardised information on consumer bills and annual statements. This will also include tightening of the current drafting of the relevant licence conditions to clarify policy expectations. The proposed level of standardisation varies between the two documents.

1.19. Considering the benefits and drawbacks of the options discussed in the main consultation document and the impacts of each on consumers, competition and other factors, we propose implementation of Option 3.

Research findings

1.20. Through our research, particularly our Consumer First Panel, we know that consumers do not find their bills particularly user-friendly or easy to understand[68]. Consumers like information about how to assess home energy use and related costs accurately. Bills are perceived as being unnecessarily complicated and many

[68] Ofgem Consumer First Panel, 'Research findings from first event', January 2009

consumers are confused by the content of their bills, and other communication from suppliers.

1.21. Research by Consumer Focus[69] confirms this, noting that consumer's overall understanding of their energy bills is relatively poor. It found that 35% of consumers did not understand their energy bills. This lack of understanding can reduce consumer confidence and trust in suppliers and stop consumers from engaging with the market.

1.22. Our recent Consumer First Panellists[70] also saw details Ofgem had selected to be highlighted as key information on bills and/or annual statements (i.e. tariff name, payment method, annual consumption and an illustrative projection of annual spend in £) as broadly correct. Their view was that this is information they would be most likely to need in order get a quotation from another supplier. However, it is not clear that the provision of this extra information on the bill on its own has much of an impact on consumer engagement. Important consideration will be needed to devise the best way to present this information to ensure consumers were able to find and understand key details. In addition, it is important that any such information would not add to confusion regarding how information is presented on bills. We tested presentational elements with the November 2011 Consumer First Panel, and intend to carry out further testing and seek expert input regarding how this could best be achieved.

1.23. These findings are also confirmed by research commissioned by DECC[71], which showed that consumers did not tend to engage with their bill in its present form and only checked the document to see how much they have paid, or have to pay, and to confirm the accuracy of meter readings.

1.24. Ipsos Mori's survey[72] conducted following implementation of remedies under the Probe shows that just under half of all energy consumers are aware they have received clearer information on the name of their tariff, any changes to it, or the projected cost of their energy consumption over the coming year[73].

1.25. Our research also shows that most consumers are not aware they have received an annual statement. Ofgem's switching omnibus[74] found that just under half of all energy consumers were aware of receiving one. Consumer Focus' survey found that under half (46%) of consumers were aware of receiving their annual

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[69] Consumer Focus, 'Informing choices – consumer views of energy bills', October 2010.
[70] Consumer First Panel, November 2011.
[71] Ipsos MORI, 'Empowering Households - Research on presenting energy consumption benchmarks on energy bills', June 2011.
[72] Ipsos MORI, 'Customer Engagement with the Energy market - Tracking Survey', January 2011.
[73] However, this report noted that as annual statements, which include all of this information, became required only from July 1st 2010 the figures are probably not fully representative of all customers' response to them, as many may not yet have received one by January 2011.
[74] Ipsos MORI, 'Customer Engagement with the Energy market - Tracking Survey', January 2011.

statement and just over half (54%) said they had definitely not been sent one. We also note that many Ofgem's Consumer First Panellists did not recognise they had received the information as part of an annual statement and, where they were aware of it, were generally unsure what to do with the information provided. In addition to this, the Panellists[75] felt that standardisation of some terms on annual statements would help them to recognise the information more easily.

1.26. The language report[76] noted that annual statements need to be differentiated from bills and labelled clearly to help consumers understand the information presented. This report also identified that consistent use of terminology and formatting across a range of different consumer communications can aid consumers' engagement. For example, in some documents the words 'tariff', 'contract', 'plan' and 'package' are used interchangeably as are 'bill', 'account', 'summary' and statement. Consistency allows consumers to become more familiar with such information and makes it easier for them to understand, and use, the details provided.

1.27. The same report also found where suppliers fail to meet certain principles of communication in their annual statements. This related to the language and terms used, disorganised and scattered presentation of information and the prominence given to the switching reminder. For example, within annual statements individual pieces of information including tariff names and principle contract terms are sometimes presented as disconnected details. Therefore, consumers do not necessarily understand how given pieces of information may relate to other items on a given page or relevant information elsewhere in a piece of correspondence.

1.28. It is unlikely that such practices are in line with absolute requirements of SLC 31.A.5 (a) to provide that information in a manner that is clear and easy to understand, does not mislead the customer and which is fair in terms of its content and how it is presented. It is possible for suppliers to make changes unilaterally to improve current practice. However, it may be beyond any one supplier's ability to address this issue fully, as an industry-wide approach is needed. Our research clearly shows that consumers would benefit from the use of consistent formats and terminology across the industry to allow consumers to more easily understand and compare tariffs.

1.29. Currently it would appear that the information customers need in annual statements is often unclear and potentially presented in a way that does not provide consumers with an opportunity to easily understand the information. For example, the annual statement may or may not be provided within a customer's energy bill and some information that customers need to allow engagement is fully integrated into sections of the bill and therefore loses prominence. The location of and timing regarding how and when relevant information is presented is unreliable as sometimes it appears on a half-yearly statement but is not then repeated on an annual statement. Consumers are presented with a multiplicity of documents with

[75] Consumer First Panel, November 2011.
[76] Lawes Consulting, 'Energy bills, annual statements and price rise notifications: advice on the use of language', November 2011.

titles such as 'summary', 'statement', 'summary statement', 'annual statement', 'annual summary', 'key terms', etc. This makes the phrase 'annual statement' almost meaningless: it denotes nothing specific as there are far too many other documents in circulation with overlapping names and functions. It also means that an 'annual statement' has no clear or consistent meaning for consumers. Similarly, information about principal terms is highly confusing, has no common language and some sections show almost the same level of complexity as the Harvard Law Review.

1.30. The Consumer First Panellists[77] felt that standardisation of some terms on annual statements would help them recognise key information more easily. Many consumers did not recognise they received the information as a part of annual statement and were generally unsure what to do with the information provided. Some stand-alone drafts of annual statements generated by Ofgem were well received by the Panellists and were seen as clear and concise. Formats that clearly grouped key information and provided relevant context helped consumers understand key details, and how they could use this information. Less engaged Panellists in particular liked that the first paragraph clearly stated their right to switch. Details of material presented to Panellists will be published shortly, alongside results of that research.

1.31. Feedback from our language research suggests that if annual statements were standardised across suppliers and charges presented in simpler formats, consumers would better be able to compare suppliers and tariffs on a like-for-like basis. This could in turn aid their prospects of finding a better deal and possibly switching[78]. This is also confirmed by the results from the latest Consumer First Panel.

1.32. In addition to the research, we also reviewed relevant information that suppliers provide to domestic customers on bills and annual statements, as part of our general market monitoring activity into Licensees' compliance with SLC 31A. This review shows that many suppliers are not acting in line with our expectations concerning requirements. With regard to annual statements we have particular concerns with the prominence and content of a switching reminder, the provision of principal terms of contract, clarity regarding the premium/discount tariffs, consumption comparison information and general clarity and layout of annual statements. We are also concerned with general clarity and layout of both, bills and annual statements. We have asked suppliers to review their bills and annual statements and make the required amendments. Alongside this, we have provided suppliers with timelines by when we would like to see this happen so that consumers can benefit from such a clarification. However, research has shown that changes to existing licence conditions are needed to provide increased clarity and promote consumer engagement.

[77] Consumer First Panel results, November 2011.
[78] Ofgem Consumer First Panel, Research Findings from the Second Events – Billing Information and Price Metrics', March 2009.

1.33. Responses to the Retail Market Review[79] show strong support for clearer information on bills and annual statements. Whilst suppliers were generally less supportive than consumer groups, they did recognise the need for greater standardisation.

Impacts on consumers

Option 1 (Continue to use current arrangements)

1.34. We believe this option will not be sufficient to ensure that consumers can understand and engage with their bills and annual statements.

1.35. If we were to continue to use current arrangements, there is potential that a large proportion of consumers would remain unaware they had key information that could help them engage with the market. This can lead to poor switching decisions or, more commonly, consumers not feeing confident they have the knowledge they need to engage with the market. In addition to the direct benefits to consumer engagement, we anticipate greater transparency can produce indirect benefits as well. Over time, greater clarity and transparency may increase consumers' trust in suppliers, which may further reduce barriers to consumer engagement and allow consumers to benefit from increased levels of competition in the market.

1.36. The main advantage of this option include that it would be quick to implement and likely to result in limited costs implications for the industry, and ultimately for consumers.

1.37. Providing more Guidance in respect of the application of SLC 31A may address some concerns surrounding clarity of bills and annual statement. However, there are other areas of concern this option would not address. For example, with this option consumers will not be provided with a record of the name of their current tariff, their current payment method, and their annual energy consumption (where available) in one place. In addition, not having standardised language or formats would reduce the potential for understanding of, and familiarity with, key information.

Option 2 (Introduce amendments to SLC 31A)

1.38. This option would improve clarity for consumers and help ensure that consumers who wish to search for a better deal have the information they need to make accurate comparison, thereby getting closer to our original policy intent in the Probe. The language report suggests that separating annual statements from the bill may help ensure that key details within annual statement do not get lost among other information. This is particularly relevant where details provided to help

[79] All non-confidential responses are available from Ofgem's website at www.ofgem.gov.uk.

customers easily find and use the relevant information may be scattered around the document.

1.39. We consider this option would go further in achieving our objectives than Option 1, but it would still not go far enough to improve current practice and ensure consumers have the information they need, and are able to engage with the market.

1.40. In addition, a lack of clarity with annual statement is also likely to result in a missed opportunity for an additional trigger point to nudge consumer engagement. Even where annual statements can be distinguished from bills, there is no guarantee that consumers know why they are being sent a statement or what they are supposed to do with it.

Option 3 (Option 2 plus, introduce more prescriptive rules)

1.41. Based on the consumer research and other evidence we believe this option addresses consumer concerns most effectively. It will directly promote increased clarity and transparency of key information, and will also help consumers to know how they can use the information to help them explore their options.

1.42. By having more standardised information on annual statements, consumers will have all the relevant information they need to compare deals from all suppliers on one piece of paper, making engagement easier. This may be of particular benefit to vulnerable consumers.

1.43. Research results from our language expert indicate that consumers may be better able to understand the information provided and engage with the market if it is clearly labelled and self explanatory. The language report identified that providing consumers with information may not be helpful if they don't know why they are being given it, and what to do with it. Option 3 would allow us to require suppliers to state what the purpose of the annual statement and how the information can be used, overcoming this barrier to engagement.

Impacts on competition

Option 1 (Continue to use current arrangements)

1.44. With this option there would be no change to the current regulatory obligations for existing or prospective suppliers. The advantage of this option is that there would be no change to industry practices and therefore no implementation costs. Therefore, the short run impact of this measure on competition would be neutral. We would expect little or no near term impact on supplier business models, or the type of offers they make available if we pursued this option.

1.45. However, over time this may lead to a reduction in competitive pressures within the market as this measure is less likely to achieve our aim to increase the levels of consumer engagement and competition within the market.

Option 2 (Introduce amendments to SLC 31A)

1.46. This option could have some positive impacts on competition. It would help provide consumers with key information presented in a way that is easier to understand and facilitates their engagement with the market. In turn, consumers who are more engaged are better able to exert competitive pressures on suppliers. However, evidence shows that such minor amendments to the licence are unlikely to address the issues we have identified.

1.47. We are aware that suppliers may face additional costs associated with the introduction of this option. They are likely take the form of direct costs in IT systems, and the costs associated with sending annual statements separately from bills for suppliers that do not already send them separately. However, we believe the actual impact of such costs would not pose a burden that outweighs the benefits of the proposal.

Option 3 (Option 2 plus, introduce more prescriptive rules)

1.48. We consider that suppliers' incentives to compete vigorously would be increased by option 3. They will lead to the increase in consumers' trust in the energy industry, encourage consumer engagement and give consumers the information they need to feel confident about switching and engaging with the energy market. We believe that this enhanced competitive pressure from suppliers' customer base will result in a sharpening of incentives for suppliers to compete. These effects are difficult to quantify as it is not known how many customers will become more active as a result of improved information measures.

1.49. We are aware that systems and design changes associated with this proposal could result in costs for the industry to be higher than they would be with the two other options discussed. The costs are likely to cover potential up-front system changes that are required including IT staff costs, re-design of annual statements and other relevant administrative costs. There may also be some additional ongoing cost associate with sending annual statements as a separate mailing to bills, for suppliers that do not already do this. However, we have not seen evidence to suggest that variation in these costs would be sufficient to distort materially the sector to the advantage or disadvantage of any particular supplier. These costs would be shared by other policies that also require changes to bills and would be implemented at the same time[80].

[80] We also note that Government has been working with suppliers on a voluntary basis to consider what information should be provided to consumers on bills to help them understand their energy costs by ensuring that energy bills provide information on how to move to the cheapest tariff offered by their supplier, and how each consumer's energy usage compares to similar consumers in the area. In time for this winter they have agreed that suppliers would send out a message with general switching reminder to all consumers and that this would include.

1.50. In their responses to the March RMR consultation, suppliers stated that the adoption of a more prescriptive approach to bills and annual statements may impact innovation and their ability to differentiate their service offerings and compete with their rivals. We note that it is possible that the provision of more standardised information on bills and annual statements may limit suppliers' ability to differentiate and increase incentives on them to compete principally on price, rather than other product differences. However, we do not consider that this conflicts with consumer interests. Our research suggests that saving money is the principal motivation for changing suppliers for the vast majority of consumers.

1.51. Overall, these changes are designed to trigger consumer engagement and increase confidence in supplier communications. Clear, standardised, self explanatory and comprehensive information can prompt and aid engagement. It can also help to build trust, and boost levels of competition in the market.

Impacts on sustainable development

Protecting vulnerable consumers and the fuel poor

1.52. Having all the information required to engage with the market in one area of the bill and annual statement, in a 'Summary box' and 'Tariff Information Label' respectively, is likely to help to improve consumers' ability to engage as well as the quality of switching decision they.

1.53. Standardised communications, using familiar language can help to build trust of suppliers and encourage engagement by all consumers, including the vulnerable and fuel poor. Fuel poor consumers are more likely to be on lower incomes and so may have the most to benefit from engaging with the market. However, we note some vulnerable consumers such as those with limited numeracy and literacy may still consider this information to be complex.

Promoting energy savings

1.54. In advance of the national roll out of smart metering and in-home displays, consumers often struggle to understand how much energy they consume. This was apparent in our Consumer First Panel (March 2009) and in the qualitative tariff work we commissioned[81]. We believe that our minded to proposal can improve consumers awareness of key energy information and promote overall engagement, which can help encourage consumers to save energy.

[81] Tariff Comparability Models, Volume 1 - Consumer qualitative research findings, Creative Research, October 2011.

1.55. Our research shows that many consumers struggle to understand what a kWh is. Providing clearer information on energy consumption and tangible examples of kWh can help to improve energy literacy and may further encourage energy saving. We welcome views on how this may best be achieved.

Supporting improved environmental performance

1.56. We do not believe there would be any significant impact on improving environmental performance. No respondents to our consultation raised concerns about significant impacts on incentives to save energy.

Managing the transition to a low carbon economy

1.57. We believe that our proposed licence conditions would not have a significant impact on the transition to a low carbon economy. We did not receive any consultation responses that suggested otherwise.

Ensuring a secure and reliable gas and electricity supply

1.58. We believe our proposals would not have a significant impact on any factors that ensure a secure and reliable gas and electricity supply.

Impacts on health and safety

1.59. We do not believe that any of our proposals would lead to a significant impact on health and safety.

Risks and unintended consequences

1.60. In their responses to consultation some suppliers raised concern that the adoption of a more prescriptive approach on bills and annual statements may impact innovation and their ability to differentiate their service offerings.

1.61. However, we are only proposing to standardise a number of elements within annual statements and some elements of bills, which we believe is necessary for consumers to engage with energy market. Subject to fairness requirements, suppliers will still have some freedom to consider the best way of displaying all other information on bills and annual statements.

1.62. Consumers are generally disengaged from the energy market. There is a risk that improved information will not be a sufficient prompt widespread engagement. However, we note that these proposals form one part of the broader RMR package, which should increase the likely impact of this proposal.

1.63. We invite respondents to highlight other potential risks and unintended consequences.

Other impacts, costs and benefits

1.64. One of the Big 6 suppliers suggested that that our proposals will result in them incurring £1.3m costs for system build and test, £1.4m for software development and £1.1m annually on additional call handling. While we agree that suppliers will need to make investments in their systems to generate the information required for the bills and annual statements we are not convinced that suppliers will incur sustained ongoing costs for additional call handling. We would also note that we identified improving consumer communications as a priority in the Probe documentation and would therefore expect that some suppliers will have already improved their systems such that any prescriptive rules we set may have only a limited impact.

1.65. We are more convinced that by providing consumers with clear, useful and comparable information in one place may actually decrease the volume of contacts and complaints regarding billing and, therefore, could lower operational costs to handle those contacts. This is particularly relevant in long term as over time consumers will become increasingly familiar with the new format of bills and annual statements.

1.66. We recognise requirements, to send the annual statement separately from bills will incur additional ongoing operational costs. However, on the basis of the data available to us we consider that these costs will not outweigh the benefits.

1.67. We feel that, on balance, our minded to proposal represent a proportionate approach to solve concerns regarding the level of consumer engagement in the energy market, and improve the quality of information consumers receive in order to make well-informed decision about their energy supply.

Post-implementation review

1.68. We would continue to monitor suppliers' practice closely including the review of bills and annual statements they send to customers. We also propose to carry out research that will help us monitor the impacts of our proposals. This could include using our Consumer First Panel.

1.69. The indicators of success of these proposals will be measured by in an increase in consumer awareness of key information on their bills and annual statements and better awareness of how this information can be used. Ultimately, we would be looking to see an increase in the number of consumers engaging with the market.

Conclusion

1.70. This draft Impact Assessment outlines a range of potential impacts, costs and benefits of our proposed standardisation of some elements of bills and a number of aspects of annual statements.

1.71. Clear, standardised, self explanatory and comprehensive information can aid, and may prompt, consumer engagement. It can also help to build trust in the energy market. These measures are, therefore, likely to lead to more effective levels of competition.

1.72. We do not believe that Options 1 and 2 would achieve our policy goals. They are likely to result in continued consumer harm (due to poor information, low engagement and reduced trust) and diminished competitive intensity in the market (due to limited engagement). We are mindful that systems changes associated with our proposals could result in costs for the industry and, ultimately, consumers but we consider that any potential negative effects will be outweighed by the benefits to consumers.

1.73. On the basis of this draft Impact Assessment, we believe that our proposal would help to empower consumers and enhance competition. We believe that our proposed measures are a proportionate response to the problems they seek to tackle.

Proposals on Price Increase Notifications and other variations subject to SLC 23 Options

1.74. On the basis of our evidence[82] we have identified a number of concerns with suppliers' unilateral variation notifications (including price increase notifications) and other issues related to SLC 23. Broadly there are a range of potential options available for addressing these issues as presented in the diagram below.

Range of potential options

No change	Redraft existing conditions	Strengthen existing conditions	Introduce new measures
Monitor and enforce existing conditions	Clarify our intent	• Require additional information • Consult on prescribed format	

1.75. The options discussed below propose a combination of revisions to the existing condition to clarify and strengthen it. They introduce improvements that are within the spirit of the current licence condition as well as amendments required to deliver some of the benefits of the wider RMR package of proposals.

1.76. These options are summarised briefly in the table below, and are also described in more detail in the accompanying Consultation Document.

[82] The proposed options have been developed based on the review of suppliers' communications, responses to the RMR March consultation document, complaints information and the relevant legal framework. In addition to this, we commissioned the following pieces of consumer research:

(i) A review of the language and presentation of price increase notifications (as well as bills and annual statements) by language experts Lawes Consulting.

(ii) Feedback and testing in our Consumer First Panel sessions.

Table 9: High level summary of options for SLC 23

Option	Summary
Option 1 ('No change') Continue to monitor and enforce existing conditions	SLC 23 would remain as currently drafted and our ongoing monitoring and enforcement activity would reflect that
Option 2 ('Additional information') Require suppliers to include additional information (without format obligations)	• Suppliers would have to provide additional information setting out their changes and how they would impact the consumer • Suppliers would have a degree of freedom regarding presentation and format
Option 3 ('Additional information plus prescribed format') Require suppliers to include the additional information under Option 2, and also consult on a prescribed format for price increase information	• Additional information required would be as for Option 2 • Suppliers would be required to present price increase information in a prescribed format[83] (see Appendix 3)
Option 4 ('Tighten and clarify policy intent') Amend SLC23 to tighten the drafting and clarify policy intent	• SLC 23 drafting would make our policy intent and expectation clearer • Suppliers would be required to provide information in plain and intelligible language

1.77. Option 1 ('No change') is the baseline against which we assess the impact of other options. Options 2 ('Additional information') and 3 ('Additional information plus prescribed format') each represent incremental strengthening of the licence condition. We acknowledge that Option 3 ('Additional information plus prescribed format') is stronger, as it incorporates the changes proposed under Option 2 alongside an additional measure. However, we have come across practices by some suppliers that reflect some of the improvements that we propose. In our view the proposed information and formatting requirements would not be a fundamental change from existing requirements. Finally, Option 4 ('Tighten and clarify policy intent') would clarify policy expectations.

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[83] Advice from language consultants (Lawes Consulting) highlighted the importance of grouping together key pieces of information, and of using consistent terms and language. Both of these would be enabled by this option. Furthermore the findings from our consumer testing through the Consumer First Panel also broadly support this form of presentation of price increase information.

1.78. The following sections discuss our assessment of Option 1 to 4 in terms of their relative impacts on consumers and competition. A very high level summary of these impacts is presented in Table 10 below.

Table 10: Summary assessment of Option 1 to 4

SLC Feature	Current SLC 23	Draft modifications to SLC 23 - Minded to position	Impact on consumers	Impact on competition
Information on Terms & Conditions	Consumers must be notified of key Terms & Conditions before a contract is entered into	Clarity about the application to mutual variations and that information must be communicated in plain and intelligible language	Easier to understand Terms & Conditions before committing	None
Information on increase in charges	Covered in the licence condition – but not subject to prominence or clarity requirements	Clarity that all price increases made by a supplier (i.e. at their discretion) are covered (subject to exceptions)	Can be confident any discretionary change in prices is covered	None
	Suppliers required to provide specific price increase information for each customer but there are no restrictions on the content of notifications	Suppliers must provide: • Comparison of old and new charges and monthly/annual estimates of the cost • The date of and reason(s) for changes All information provided must be personalised (additional information about average price increase for customer will not be permitted)	Budgeting and switching decisions can be made based on more useful, personalised information	Competitive intensity should increase as consumers become better-informed and more engaged
Information on customers' rights	Suppliers must tell consumers they can: • Obtain impartial advice about switching • End their contract by switching supplier (unless there are outstanding charges) • Take steps to switch supplier and avoid the increase	Suppliers must also: • Explain that the customer may also enter into a new contract with his existing supplier • Provide a statement to consider switching supplier • Provide clearer information on how to take steps to avoid the increase and any termination fees	Easier to understand switching rights	Consumers will be able to make better switching decisions, increasing competitive pressure on suppliers
Format and display of information	Not covered (but prominence and clarity requirements)	Ofgem may issue directions to ensure presentation is clear	Can be confident information will be presented in a way that is easy to understand	Competitive intensity should increase as consumers become better-informed and more engaged

Exceptions to the licence condition	Suppliers must follow the licence condition unless directed not to by Ofgem	Subject to information transparency requirements, suppliers do not need to notify customers if: • Charges change automatically due to fluctuations in a published and transparent external benchmark that the supplier does not control; and • The contract precisely sets out in advance when the price will increase and by how much (and the increase is not in any way subject to the discretion of the supplier)	This change clarifies our original intention	This change clarifies our original policy intention
Contract Terms & Conditions	Not covered	Suppliers must: • Ensure Terms & Conditions in the contract reflect the requirements, e.g. as to notice and avoiding the variation • Not enforce Terms & Conditions that do not meet these requirements	Empowered to take their own action against suppliers (based on contract) rather than relying only on Ofgem action	None

Impacts on consumers

1.79. Our proposed options would enhance our ability to ensure suppliers fully comply with letter and the spirit of SLC 23 and make improvements where appropriate. We anticipate that these measures would have similar impacts to those identified as part of our February 2011 decision of modifying SLC 23 to require suppliers to provide at least 30 days advance notice of unilateral variations[84]. These would include the following potential benefits to consumers:

- Ability to make better budgeting decisions;
- Increased comparability of price increase information across domestic suppliers;
- Enhanced consumer understanding of the impact of the price increase including other changes/variations captured by SLC 23;
- Requirement regarding contract Terms and Conditions reflecting the same information and standards as for notifications will enhance individual consumers' ability to get their grievances redressed speedily;
- Improved decision making regarding switching; and
- Greater confidence in the market.

1.80. In addition, the cost of producing notifications could change, and this change may be passed on (in whole or in part) to consumers.

1.81. We set out the impacts for each option separately below.

Option 1 ('No change')

1.82. Our evidence suggests that under this option consumers will continue to lack confidence in suppliers as the concerns identified with supplier practices would continue. Price increase notifications will often fail to act as a trigger to engagement, and those customers who do try to engage may struggle if key information is not in an accessible format. As noted in the section on key issues above, our recent research shows that price increases by suppliers often has the effect of disengaging consumers give the lack of clarity around price increases.

1.83. We acknowledge that these issues should improve as a result of other elements of the RMR package. For the most active consumers – who are already confident switchers – these other elements may be sufficient. However, this option would fail to inform and nudge the majority of consumers, and would not protect vulnerable groups.

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[84] Proposed modifications of Standard Licence Condition 23 (SLC 23) of the gas and electricity domestic supply licences and consequential proposals- Ref: 14a/11- http://www.ofgem.gov.uk/Markets/RetMkts/Compl/pricechange/Documents1/Final%20Impact Assessment.pdf.

Option 2 ('Additional information')

1.84. Under this option, suppliers would be required to include information that is more relevant to consumers in their decision-making. In particular, we would require them to present a comparison of rates before and after the change, and an estimation of the overall impact on monthly/annual bills.

1.85. In our view and based on feedback from consumer research and testing, the proposed pieces of information are considered very important by consumers. Such information would help customers understand the likely effect of price changes. This should help customers decide how best to respond – whether by budgeting for higher bills, adjusting consumption or switching to a new tariff or supplier. We would not prescribe the format for presentation of this information. Therefore, suppliers would have some flexibility in the way they present the required information (subject to our prominence requirements and standards of conduct).

1.86. However, the language report also concludes that the language and layout used is vital to the effect of supplier communications. This message was also reflected in the consumer testing that we recently concluded as part of the Ofgem Consumer First Panel. Our overall view based on RMR research is that suppliers have often failed to present key information effectively to consumers. As a result, we have significant concerns that the language and layout used may continue to be sub-optimal. The impact of this option may, therefore, be limited.

1.87. This option is arguably more likely than others to result in small increases in cost to serve, which as one respondent to our March RMR consultation noted are typically passed on to consumers. Suppliers would need to incorporate more information into their price increase notifications, and would need to develop formats to absorb this. However, our initial view is that such increases should be low, given this option would impose no restrictions on layout or format. In addition, the information that would be required should be simpler to provide following the full introduction of smart meters.

Option 3 ('Additional information plus prescribed format')

1.88. Under this option, as well as requiring the additional information under Option 2 ('Additional information'), we would be able to ensure specific pieces of price increase information are presented using accessible language and a clear prescribed format. These proposed formats are presented in Appendix 3.

1.89. Our Consumer First Panel sessions at the start of 2011[85] identified a need for greater predictability and reliability of prices and offers; a "fair" system would give consumers greater confidence in difficult economic times. We have tested the

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[85]Please see the following link: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Ofgem_OpinionLeader_Tariff_Report_Final.pdf.

proposed format with our latest Consumer First Panel. The format was broadly well-received, and clearly presents information that consumers consider to be important.

1.90. Based on input from our language experts, this option should significantly improve the transparency of notifications. It will also increase the comparability of tariffs across domestic suppliers, a point that our Panellists appreciated. Information using accessible language and a clear format is easier for consumers to use for budgeting and for making switching decisions. Comparing old and new prices directly, and providing estimated bill impacts, will make the information in notifications more tangible to consumers and provide the basis for effective customer engagement.

1.91. It is difficult to quantify this benefit. However, our latest Consumer First Panel suggests that many consumers feel helpless in the face of price increases, and see no value in switching supplier. In our view, improved price increase communications have the potential to trigger re-engagement among these consumers, enabling them to make better decisions.

1.92. There will be little room for interpretation by suppliers. In particular, we anticipate consumers will benefit from receiving key information in a consistent, familiar format across all notifications from suppliers.

1.93. Overall costs to consumers are likely to fall. We acknowledge there will be one-off development and systems costs, but we expect these to be very low, and a common template avoids suppliers spending money in parallel with one another on redevelopment in the future. As for Option 2 (‘Additional information’), we note that the information that would be required should be simpler to provide following the full introduction of smart meters.

Option 4 (Tighten and clarify policy intent)

1.94. As for Options 2 (Additional information) and 3 (‘Additional information plus prescribed format’), under this option consumers would be provided with improved information. In particular, under this option they will see prominent, clear and easy to understand information on their switching rights as well as other relevant information. This will help customers to decide whether to respond to the price increase by switching to a new tariff or supplier.

1.95. Our language experts conclude that while information is important to consumers, it is of equal importance that they understand what action to take with it. Our January 2010 Consumer First Panellists reported that in price rise notifications consumers’ rights (and responsibilities) in relation to switching supplier are often poorly-presented. Clear guidance on this should therefore support better switching decisions on the part of consumers.

1.96. There may also be a modest increase in consumer confidence if clearer presentation is perceived to be more honest. We note, however, that this option alone is likely to deliver only relatively narrow benefits based on the level of clarity of a small number of specific pieces of information.

1.97. Increasing clarity of and familiarity with this information is designed to help a broad range of consumers. However, we note that some vulnerable groups such as the frail elderly or those with limited numeracy and literacy abilities may continue to struggle to engage with this information.

1.98. The proposed amendments would prohibit suppliers from providing additional material (such as marketing material) together with the price increase notification. This is likely to reduce the overall volume of marketing material provided to consumers. Some consumers may therefore find that they receive a lower volume of useful information through the marketing channel. Our Consumer First Panellists have told us that supplier communications are generally not well regarded, and that such material is often treated as superfluous and left unread. Therefore, there may be very little cost to consumers associated with a reduction in marketing material. Our overall view is that clarifying the key message of a price increase notification would be the primary objective.

1.99. This option would provide a series of further clarifications regarding Terms and Conditions. Consumers would be notified in advance of changes to Terms and Conditions, which would make it easier for them to understand and therefore facilitate engagement in the market, for example by prompting them to consider switching supplier. Suppliers will also be required to ensure that contract Terms and Conditions properly reflect the requirements for price increase and other variation notifications. This will empower consumers to take action against suppliers where they have failed to meet the requirements of SLC 23 based on their contract.

1.100. This option is unlikely to result in any significant additional costs passed on by suppliers related to development of notification materials.

Impacts on competition

1.101. Our proposed options are measures to enhance our ability to ensure suppliers comply with the intent of SLC 23. We anticipate that these measures would have similar impacts to those identified as part of our February 2011 decision on modifying SLC 23. These would include the following potential impacts on competition:

- Increased consumer engagement will increase the proportion of consumers who actively compare and switch between suppliers, which may heighten the intensity of competition between them; and
- Constraints on format (and therefore innovation) may impinge on the ability of suppliers to differentiate themselves in this way.

1.102. We set out the impacts for each option separately below.

Option 1 (‘No change’)

1.103. The intensity of competition would, in our view, remain constrained by lack of engagement. Suppliers would retain some freedom to innovate – although we note that they would remain subject to SLC 23 as it is currently drafted.

Option 2 ('Additional information')

1.104. The potential impact on competition is positive but secondary to the direct benefits to consumers. The additional information would help consumers to make better individual budgeting decisions, which could indirectly promote intensity of competition. However, this option does not directly address comparability between suppliers, which we would see as the primary driver of increased intensity.

Option 3 ('Additional information plus prescribed format')

1.105. A prescribed price increase notification format would enhance competition. If consumers understand, trust and respond more positively to the resulting format, it could increase consumer engagement. This should encourage consumers to compare tariffs more effectively, feeding into increased competitive intensity. It will also improve switching decisions by ensuring that relevant information is available in a familiar and accessible format.

1.106. We acknowledge that this option is more restrictive than others in terms of suppliers' ability to present information. It would not permit any substantial design innovation regarding presentation of price increase information. Arguably there is likely to be an opposite effect that limits the ability of suppliers to compete based on price change notification design. However we do not consider this to be a substantial issue.

Option 4 ('Tighten and clarify policy intent')

1.107. This option is more focused on competition than Options 2 ('Additional information') and 3 ('Additional information plus prescribed format'). Improved presentation of switching rights, in particular, should increase the intensity of competition. Evidence from our January 2010 Consumer First Panel and feedback from our more recent consumer research suggests that consumers' switching rights are not always clearly displayed. In our view price rise notifications potentially represent a key entry point into the competitive marketplace for consumers, and greater clarity should help a significant number of consumers to engage with the market.

1.108. The restrictions this option imposes should not stifle innovation. Based on examples from suppliers we are confident that our proposal is not onerous.

Other impacts

Implementation costs

1.109. Each of the proposed options would potentially result in implementation costs to suppliers. However, we expect these would be low in each case, and would be absorbed into suppliers' regular development costs for notifications. As noted in the section on 'Impacts on consumers', under Option 3 ('Additional information plus prescribed format') the development of a common format is likely to reduce costs for suppliers in the long run.

1.110. Under Option 3 ('Additional information plus prescribed format'), the resource requirements for Ofgem would increase, although as noted in the section 'Impacts on consumers' we expect that the decreased costs to suppliers discussed above would more than offset this. In the short-term, resources would be required to consult on and develop the prescribed format. There would also be a need to monitor the effectiveness of the standardised price increase template, which could be absorbed into our routine monitoring activity. These costs would be offset by our proposal for suppliers to incorporate contractual terms that reflect the licence condition. This will facilitate consumers seeking their own redress for non-compliance.

Impacts on sustainable development

Protecting vulnerable customers including the fuel poor

1.111. We have discussed the likely impacts of our proposals on consumers in the section on consumer impacts above. It is our view that our proposed policy options will enable consumers to budget more effectively.

1.112. Fuel poor consumers are more likely to be on lower incomes and so have the most to benefit from engaging with the market. Our research on vulnerable consumers suggests that advance information is particularly important for budgeting for low income groups.

1.113. Standardised communications using familiar language can help to build trust in suppliers and encourage all consumers to engage, including the vulnerable and fuel poor. However, some vulnerable consumers such as those with limited numeracy and literacy may still consider this information to be complex.

1.114. None of the proposed options target fuel poverty or other vulnerable consumers to a greater extent than the others. Hence we do not expect that the specific impact on such consumers will be a deciding factor between the proposed options.

Supporting improved environmental performance

1.115. We do not believe there would be any significant impact on incentives to invest in improving environmental performance. Respondents to our March RMR consultation did not provide any views or data on any potential implication of our proposals on environmental performance.

Impacts on health and safety

1.116. We do not believe that any of our proposals would lead to a significant impact on health and safety.

Risks and unintended consequences

1.117. There are a number of generic risks with trying to address issues through amendments or additions to a licence condition:

- We may impose a one size fits all outcome that may not be appropriate for all consumers;
- Additional conditions may stifle innovation and make the licence less future-proof; or
- Our additional requirements could result in information overload for consumers.

1.118. In addition, we note that existing consumer disengagement and mistrust may present a barrier to the effectiveness of our proposals. The benefits we have identified depend to some extent on notifications from suppliers being used by consumers as a key source of information (and potentially a trigger for considering whether to switch supplier). These benefits have been assessed taking into account the findings of our consumer testing. Based on our Consumer First Panel, however, we are aware that for disengaged consumers this is not currently the case.

1.119. These risks apply to some extent to Options 2 (Additional information), 3 (Additional information plus prescribed format) and 4 (Tighten and clarify policy intent). There are also some more specific risks.

1.120. Option 2 ('Additional information') does not directly address the problems we have identified in the course of the RMR analysis. To a significant extent issues have arisen when suppliers fail to act within the spirit of existing licence conditions – for example in relation to prominence requirements. Given the flexibility afforded to suppliers under this option, there is a risk that suppliers will act contrary to the spirit of the new, strengthened licence condition. The benefits to consumers may therefore be less than could be achieved through other options.

1.121. We recognise, however, that although Option 3 ('Additional information plus prescribed format') goes further to deliver these benefits, it also represents a chance to get it right. It would not allow suppliers to refine and develop their own versions over time. However, in our view this risk is outweighed by our RMR finding that innovation alone has not delivered a useful format consistently to all consumers.

1.122. A stronger licence condition, as proposed in Option 3 ('Additional information plus prescribed format'), carries a particular risk of unintended consequences for supplier behaviour. It could result in suppliers simply ensuring they meet our requirements rather than finding out what customers want. This is an inherent risk of a more prescriptive approach.

1.123. Under Option 4 ('Tighten and clarify policy intent'), suppliers might judge that the prohibition of additional marketing materials would need to be offset by increased marketing activity elsewhere. Consumers may face additional costs related to this additional activity.

Post implementation review

1.124. We will measure the success of the proposed option(s) based on industry reputation and consumer engagement. We will draw on data sources including consumer research, feedback from stakeholders such as industry representatives and consumer groups, complaints data, quantity and quality of switching, and press coverage.

1.125. Option 3 ('Additional information plus prescribed format'), in particular, will require periodic review to ensure the required format for price increase information remains up to date.

Conclusion

1.126. We do not believe that the 'No change' scenario is viable. It is likely to result in continued consumer harm (due to constrained decision-making) and diminished competitive intensity (due to limited engagement). Option 1 ('No change') is therefore included here only as a baseline. Our view is that there should be scope to deliver improved outcomes.

1.127. In particular, our proposals seek to provide consumers with clearer and more relevant information. This resonates with our consumer research into the views of the Panellist on price increase notifications. In our opinion this would help significant numbers of consumers to engage with the market and make better switching decisions. Our view is that the relatively prescriptive approach of Option 3 (Additional information plus prescribed format) would deliver significant benefits to consumers. There is a limited risk of a negative impact on competition (suppliers will be less able to compete on notification design). Indeed, lack of effective competition in this area represents our motivation for intervention.

1.128. Under Option 2 ('Additional information'), there is a greater risk that consumers will see little or no benefit if suppliers exploit the inherent flexibility of this option. We acknowledge that this flexibility would allow suppliers to innovate to a greater extent, and may be more future-proof. However, in our view this flexibility does not outweigh the greater benefits that we expect under Option 3 ('Additional information plus prescribed format').

1.129. Option 4 ('Tighten and clarify policy intent') would address a significant imbalance we have identified regarding price increase notifications. There is a tendency for some suppliers to treat price change notifications as a marketing opportunity. This option would bring the focus back towards providing clear information to consumers – in line with the spirit and original intentions of SLC 23. We therefore consider it would deliver significant benefits to consumers.

1.130. Our minded to position is a combination of Options 3 ('Additional information plus prescribed format') and 4 ('Tighten and clarify policy intent'). This approach will address some of the poor supplier practices that we have observed and will help deliver benefits to consumers. These proposals will enhance our ability to take more effective enforcement action if needed. They will help inspire consumer confidence and will enhance consumer engagement. As well as delivering the optimal overall impact, this approach should also offer useful synergies with other proposals under the RMR package.

Appendix 9 – Proposals on Switching Sites: Draft Impact Assessment

Introduction and RMR Consultation

1.1. In June this year the department for Business, Innovation and Skills (BIS) published its consultation on institutional changes to the GB consumer landscape which included the continuation of the Consumer Confidence code (a voluntary code of practice for domestic online price comparison sites) after the proposed abolition of Consumer Focus in 2013. The Confidence Code is currently administered by Consumer Focus. This code sets standards for the operation of domestic online price comparison sites. There is also an accreditation mark which can provide consumers with assurances about the service. Accredited websites must commit to provide an independent, comprehensive and accurate service, and their service is subject to an annual audit. BIS recently concluded its Consumer Landscape consultation and is considering responses.

1.2. We considered the issue of consumer trust in switching sites in our RMR March 2011 consultation document. Our evidence shows that consumer engagement in the industry has declined, driven in part by mistrust of suppliers. This manifests in a high proportion of "sticky" consumers, who rarely or never switch suppliers. In this context, we consider independent price comparison websites have an important role to play.

1.3. Independent price comparison websites are an integral part of the process for many of those consumers who do switch supplier. Data from the January 2011 MORI survey (a key input into the RMR) shows that such sites are the second most important source of information for consumers about the deals on offer from suppliers[86]. However, there are indications that these sites are not delivering their full potential. Over 20 per cent of consumers use switching sites to research deals and 16% go on to use those sites to switch. Supplier sales contacts (both doorstep sellers and call centre staff) are more popular options. We note that some suppliers have been withdrawing their face-to-face sales teams recently.

Consultation responses

1.4. We have considered a range of suggestion based on responses to the RMR March 2011 consultation. In this document, we had sought views on what more needs to be done to improve consumer trust and use of switching sites.

[86] Customer Engagement with the Energy Market – Tracking Survey, Ipsos Mori, January 2011, (The Retail Market Review – Findings and Initial Proposals associated document)

1.5. The table below summarises the broad suggestions in response to this question, and gives an indicative view of their likely implications.

Table 11: Switching site response summary

Suggestions	Potential implications
Ofgem provision of a Price Comparison Website (PCW)	• May be incompatible with our remit and may raise potential competition concerns
New Ofgem PCW accreditation scheme or industry standards	• May result in duplicating work already done to develop existing Confidence Code
Ofgem to administer/ revise Confidence Code	• Code could benefit from improved customer perception of independence given Ofgem branding • Provides an opportunity to address existing shortfalls • The code would be helpful in implementing the wider RMR package including future changes necessary as part of the smart metering programme • May require additional monitoring resources
Ofgem to drive operational improvements to existing PCWs or provide thought leadership	• Could encourage synergies with other RMR proposals – e.g. tariff simplification • Our role in driving improvements is not necessarily clear without a formal remit • Would not necessarily be precluded by other options
New independent PCW	• Not clear which consumer body would be responsible for this • Would not be precluded by other options

Our Proposals

1.6. The provision of information to consumers in order to support their engagement in the market and decision-making is a key theme of the RMR. Given the falling consumer confidence in the energy industry, independent sites can play an important role in providing independent and impartial information to customers, thereby enhancing customer engagement. In our view it is essential that information at these sites is provided in a clear and easy to comprehend manner. Our tariff proposals will go some way to help this, however we feel more can be done to improve these sites. This may include the transparency of commission arrangements between suppliers and switching sites. It could also include the use of consistent language and terms, as proposed for supplier's communications, to aid familiarity and understanding.

1.7. Taking into account the key themes emerging from the responses to this issue in response the RMR March consultation we considered that taking responsibility of the confidence code will provide us a key tool to implement some the suggestions emerging from stakeholders. Therefore in our official response to BIS, we have proposed taking over the responsibility for the Confidence Code. We would look to review the code to enable us to influence and improve the domestic switching site services market thereby inspiring consumer trust in the market. We also stated our intention to take over the Confidence Code in a recent press release[87]. We note that BIS is considering who should take over the Confidence Code.

1.8. More proactive options – such as our own provision of a new price comparison website or a new accreditation scheme, or licensing of existing sites – would result in unwarranted additional costs or duplication of resources. Many of the less intrusive proposals reflect operational improvements that we would be better able to consider as administrators of the Code. Our tariff proposals are intended to make standard tariffs in particular, much more transparent and therefore a broader range of stakeholders will be able to access and publish this information.

1.9. Our proposals for binding Standards of Conduct (SOCs) would make suppliers accountable for the conduct of switching sites they have a direct or indirect relationship with. In this context the Confidence Code will be a method of helping suppliers comply, as well as a mechanism to cover independent switching sites without any relationship with suppliers. We also acknowledge that consumer protection law gives us an existing avenue to take action against price comparison websites. This is adequate for cases where sites have broken such laws. However, it does not give us a mechanism to enhance the reputation of sites for independence or to influence or drive operational improvements.

1.10. The following sections briefly summarise the impacts of our proposal.

Impact on consumers

1.11. Consumers should benefit from improved decision-making based on switching sites. This could arise if consumers have greater trust in regulator-accredited sites, leading to increased uptake. It could also result from any operational improvements that we identify. Respondents to our March RMR consultation suggested that both of these would be possible.

1.12. Our recommended approach would also bring synergies with other RMR elements. In particular, it would enable us to harmonise the presentation of information on switching sites with that presented elsewhere. Consumers would benefit from a consistent approach.

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[87] Please see the following link: http://www.ofgem.gov.uk/Media/PressRel/Documents1/RMR%20Oct.pdf.

Impact on competition

1.13. We consider that increased consumer usage of switching sites would bring benefits to competition provided consumers can trust the information presented on these sites. Switching sites can enable better-quality switching decisions by consumers, a key driver of competitive intensity. The provision of price information also supports competitive new entrants. To the extent that our administration of the Confidence Code drives increased usage, there should be a benefit to competition.

1.14. By contrast, poor quality switching sites could stifle competition – for example, by providing only partial coverage of the market. We could reduce the incidence of such sites by implementing operational improvements suggested to us by stakeholders, should the evidence support such an approach.

Impacts on sustainable development

Protecting vulnerable consumers and the fuel poor

1.15. This proposal does not directly target vulnerable consumers and the fuel poor.

1.16. Fuel poor consumers are more likely to be on lower incomes and so have the most to benefit from engaging with the market. Some vulnerable consumers such as those with limited numeracy and literacy may benefit most from the ability of price comparison websites to process information for them. Conversely they may still struggle with this information. Vulnerable consumers are less likely to have access to the internet and so may not have access to switching sites. However, some switching sites offer a telephone service. If an Ofgem-administered Confidence Code is more effective, these consumers in particular may benefit. Whilst this is the case, we acknowledge that vulnerable consumers including the fuel poor may be less likely than other consumer groups to have (internet) access to switching sites.

Promoting energy savings

1.17. We do not believe there would be any significant impact on promoting energy savings.

Supporting improved environmental performance

1.18. We do not believe there would be any significant impact on improving environmental performance.

Managing the transition to a low carbon economy

1.19. We believe that our proposed licence conditions would not have a significant impact on the transition to a low carbon economy.

Ensuring a secure and reliable gas and electricity supply

1.20. We believe our proposals would not have a significant impact on any factors that ensure a secure and reliable gas and electricity supply.

Impacts on health and safety

1.21. We do not believe that any of our proposals would lead to a significant impact on health and safety.

Risks and unintended consequences

1.22. Our research shows that a large segment of the consumer base are generally disengaged from the energy market. There is a risk that an Ofgem-administered Confidence Code will not be a sufficient prompt to engage. However, we note that this proposal forms one part of the broader RMR package of remedies.

1.23. Further risks are limited at this stage, but could materialise in relation to any changes we subsequently propose. If we propose changes to the Confidence Code, there is a possibility they would not deliver the intended benefits or that they would be overly restrictive on switching sites. We would expect to take full account of such issues as part of a process for amending the Confidence Code.

Other impacts, costs and benefits

1.24. As noted in the section on risks and unintended consequences above, at this stage we are not proposing any specific changes to the Confidence Code. We therefore do not anticipate any other impacts. If we subsequently propose changes, we would expect to take full account of other impacts such as costs to switching sites.

Post-implementation review

1.25. If and when we take over the administration of the Confidence Code, we will carry out a review. This will look at the coverage of the Code and its remit, and will identify areas that may need to be strengthened.

Conclusion

1.26. We conclude that there is a strong rationale for us to administer the Confidence Code. There is likely to be scope for improved take-up of and operational improvements in switching sites if we administer the Confidence Code. Consumers would be likely to benefit from improved decision-making as a result of this and the consistency we would be able to introduce between the Confidence Code and our wider RMR proposals. To the extent that usage of switching sites increases as a result, we also anticipate heightened competition between suppliers.

Appendix 10 – Standards of Conduct: Draft Impact Assessment

Overview

1.27. This draft Impact Assessment represents our view of the benefits and risks of our proposed options around the Standards of Conduct presented in the associated consultation document, these options are also briefly outlined below. For the purpose of this draft Impact Assessment we have focused on policy options around the SOCs as they relate to the domestic supply market.[88] We welcome views on our assessment, including further information regarding benefits, risks and costs.

1.28. In March 2011 we published the initial findings of our Retail Market Review (RMR). This work follows our 2008 Retail Probe ("the Probe") and provided an update on competition in the market. It also assessed the impact of rules we introduced as part of the Probe. Our objective throughout both the Probe and the RMR has been to address issues that may reduce the effectiveness of competition in the market, and to improve the experience of retail energy consumers. The RMR found that further action was needed to make retail energy markets in GB work more effectively for both domestic and non-domestic consumers. Our initial RMR findings document included a range of measures to strengthen Probe remedies. Within this we considered giving greater force to the Standards of Conduct (SOCs).

1.29. We propose to modify the existing SOCs to make them applicable to all interactions between suppliers (including their representatives[89]) and consumers, and to take a more principles-based approach where the SOCs are concerned. This reflects our concern that the scope of the existing SOCs – both in terms of behaviours and interactions covered – is too narrow. The proposed new, broader SOCs are listed in Figure 6 of the accompanying Consultation Document. The current standards of conduct apply to all domestic and micro business consumers. We propose the new SOCs would apply to the whole of the domestic and non-domestic markets, but as noted above, we have focused this assessment on the domestic market.

1.30. There are a number of different ways in which we could give practical effect to the new SOCs. The options below discuss the potential legal status and compliance incentives of the new SOCs:

[88] We discussed policy options as they relate to the non-domestic supply market in our non-domestic Consultation Document and Impact Assessment (see list of associated documents).
[89] For these purposes a representative would include a person that is directly or indirectly authorised to represent the supplier, including, for example, any person that is paid a commission by a supplier.

- **Option 1 ('Legally binding via an overarching licence condition') – Binding SOCs in the licence.** We would recast the SOCs as high level principles and apply them to all interactions between suppliers (including their representatives) and consumers, by making changes to their wording and coverage. Under this option, we would incorporate them into an overarching licence condition. We would be able to enforce supplier adherence directly;

- **Option 2 ('Non-binding + industry commitment') – Non-binding SOCs with strong voluntary commitment.** As per Option 1 ('Legally binding via an overarching licence condition'), we would recast the SOCs and apply them to all interactions between suppliers and consumers. In addition, suppliers would make a public commitment to uphold them. We would monitor their performance against this commitment and would move to licence conditions if it was unsatisfactory; and

- **Option 3 ('Non-binding') – Non-binding SOCs.** As per Option 1 ('Legally binding via an overarching licence condition'), we would recast the SOCs and apply them to all interactions between suppliers and consumers. However, they would retain their current, non-binding status and we would not be able to enforce them directly.

1.31. Within this draft Impact Assessment we consider the proposed options as well as a 'no change' scenario where the existing, relatively narrow and non-binding SOCs would remain.

1.32. As noted in our consultation document, **we propose implementing Option 1** ('Legally binding via an overarching licence condition'). Our RMR evidence shows that low consumer trust in suppliers and low engagement with the market need to be addressed. A key mechanism for improving the situation is supplier conduct. We consider that stronger, broader SOCs will support improvements in conduct and give consumers more confidence in suppliers. They would also help to ensure that other customer related licence conditions (including those proposed under the RMR) are interpreted and applied consistently with the SOCs.

1.33. We are concerned that a purely reputational incentive to adhere to the SOCs, as is the case with other options considered in this Impact Assessment, would not deliver such improvements. This concern is based on experience to date – the RMR found that the non-binding SOCs introduced following the Probe have not resulted in the desired outcomes. In our view the proposed SOCs formalise what we expect a competitive supplier should do as a matter of course; therefore, we do not anticipate this proposal would be disproportionate.

Impact on consumers

'No change'

1.34. By definition this option will not result in any impact relative to the baseline.

1.35. With this option we would continue to lack the ability to directly enforce the SOCs, although we are able to have regard to them in relation to determining consumer detriment and prioritising enforcement activity. As a result, we do not anticipate an improvement in supplier conduct. Indeed, consumers' views of suppliers may continue to worsen over time, and their willingness to engage in the market may fall further.

Introduction of new SOCs

1.36. Expanding the scope of the SOCs to include all interactions between consumers and suppliers (including their representatives) will mean that universal expectations around clear communication, fairness and transparency will exist for a broad range of activities. Consumers could, therefore, expect improved conduct in all interactions with suppliers – including areas such as billing and metering, which are currently subject to limited regulation within current licence conditions and are not covered by existing SOCs.

1.37. This could result in improved outcomes for all consumers. Evidence from consumer research shows that poor supplier practice is one reason customers do not trust energy suppliers, and this lack of trust leads many not to engage with the energy markets. Therefore, improved supplier practices could lead to increased levels of consumer engagement in the market, and greater transparency may also improve the effectiveness of such engagement.

1.38. The principles-based nature of the proposed SOCs should mean suppliers are better-equipped to deliver benefits to consumers in the context of technological, and other, change. For example, they may be more likely than prescriptive measures to retain their relevance as we roll out smart metering. The SOCs would not inhibit innovation with regard to both products and services valued by consumers.

1.39. A principles-based approach also means suppliers have a degree of flexibility with regard to how they meet the SOCs. Therefore, we expect that the additional cost required for a competitive supplier to meet our standards – which would ultimately be borne by consumers – would be low. In particular, our view is that this cost would be lower than an alternative scenario in which we relied on more detailed rules, and that any costs incurred would be outweighed by consumer benefit.

Option 1 ('Legally binding via an overarching licence condition')

1.40. We see the key factor that separates this from other options is that suppliers would be under a legal obligation to adhere to the SOCs (and to ensure their representatives adhere) with this proposal. In our view, making the SOCs legally binding is fundamental to improving supplier conduct and addressing consumer mistrust. If the SOCs are part of an overarching, enforceable licence condition suppliers could face financial penalties or enforcement orders if they do not adhere. The likelihood of adherence is, therefore, significantly greater with this option. As a result, we believe this option is most likely to deliver the intended direct benefits to consumers.

1.41. We recognise that suppliers will need to put in place reviews and potentially system changes to ensure compliance, and the cost of this will ultimately be passed on to consumers. However, arguably those suppliers who already seek to achieve high standards will need to do less. We do not believe it is unreasonable to expect suppliers to invest in improving their customer relations. In addition, the proposed SOCs are principles-based, which would allow suppliers a degree of flexibility over time when delivering the required outcomes. This would, therefore, limit the overall regulatory burden that would be faced by suppliers.

Option 2 ('Non-binding + industry commitment')

1.42. With this option these measures would, ultimately, be voluntary. Although we could report publicly on suppliers' adherence to the SOCs, we note that Ofgem would still lack formal enforcement powers (see further discussion in Risks section). In our view this significantly limits the potential impacts of this option. Given the prevailing degree of mistrust among consumers, it is also unlikely that a voluntary (albeit public) commitment from suppliers to adhere to the SOCs will result in an immediate improvement in consumers' trust in suppliers.

1.43. We recognise that this would expand the scope of the SOCs compared to their current status, resulting in the costs outlined above. However, there would be no direct regulatory burden on suppliers, since the SOCs would not be incorporated into a licence condition.

Option 3 ('Non-binding')

1.44. The extent to which the proposed SOCs deliver impacts for consumers ultimately depends on supplier adherence. Under this option, the new SOCs would not be legally binding. Therefore, we would not be able to enforce adherence to the SOCs. In our view this significantly limits the potential positive impact of this option for consumers. Our evidence suggests that the existing SOCs have not delivered the intended higher levels of consumer trust in suppliers and engagement in the domestic market.

1.45. As with Option 2 ('Non-binding + industry commitment'), we recognise that this would expand the scope of the SOCs compared to their current status, resulting in the costs outlined earlier in this document. However, there would be no direct regulatory burden on suppliers, since the SOCs would not be incorporated into a licence condition.

Impact on competition

'No change'

1.46. By definition this option will not result in any impact relative to the baseline. However, consumers' views of suppliers may continue to worsen over time, and their willingness to engage in the market may fall further, which could have a negative long-term impact on competition.

Introduction of new SOCs

1.47. Improving competition within the market is one of the key goals of this proposal, and we anticipate the new SOCs would have a positive impact on competition. The direct benefits to consumers regarding greater clarity and fair treatment should help to improve the reputation of individual suppliers, and the industry as a whole. Increased levels of trust in energy suppliers will help facilitate consumer engagement and, ultimately, greater levels of competitive pressure within the market.

1.48. The proposed SOCs should not inhibit the ability of suppliers to innovate or differentiate themselves. We are aware that any new requirement has the potential to impose a burden on licensees, including smaller suppliers and new entrants; however, we anticipate the negative impacts on competition due to the introduction of proposed SOCs would be negligible. On the contrary, current and future suppliers would benefit from increased competition within the market, and increased opportunities to win customers. The proposed SOCs formalise what we expect a competitive supplier should do as a matter of course, so we do not anticipate this proposal creates unreasonable or overly burdensome costs for suppliers.

Option 1 ('Legally binding via an overarching licence condition')

1.49. As discussed in the section on consumer impacts, making the SOCs legally binding is fundamental to improving supplier behaviour and addressing consumer mistrust. We therefore anticipate an increase in competitive intensity driven by improvements in suppliers' interactions with consumers, and increased consumer engagement levels.

1.50. Of the proposed options, Option 1 ('Legally binding via an overarching licence condition') should maximise the long-term benefits resulting from increased competitive intensity. These benefits could be realised sooner than would be possible under Option 2 ('Non-binding + industry commitment') or Option 3 ('Non-binding'). If there is consumer mistrust of suppliers, an initial voluntary public commitment from suppliers may contribute little to increasing consumer engagement. Under this option, the SOCs would be backed by an overarching, enforceable licence condition. Moreover, wider awareness of these rules could result in an immediate increase in trust and engagement, if consumers anticipate improved supplier conduct.

Option 2 ('Non-binding + industry commitment')

1.51. There is potential for this option to have a positive impact on competition; however, the extent to which this would materialise would depend on supplier adherence. Suppliers may have an added incentive to adhere to the SOCs if they give a verbal commitment; however, the new SOCs would not be legally binding. We would, therefore, not be able to enforce adherence to the SOCs. In our view this significantly limits the potential positive impact on competition under this option.

1.52. If suppliers do adhere, we would anticipate an increase in trust in the market would help to drive consumer engagement and increased levels of competition. While this mistrust should diminish if suppliers' conduct improves, we would not expect such an outcome if some suppliers do not adhere to the SOCs. Given the prevailing degree of mistrust, it is unlikely that a voluntary (albeit public) commitment from suppliers to adhere to the SOCs will result in an immediate impact.

Option 3 ('Non-binding')

1.53. As with Option 2, the extent to which this option would positively impact on competition depends on levels of supplier adherence. Under this option, the new SOCs would not be legally binding. We would not be able to enforce adherence to the SOCs. Again, in our view this significantly limits the likely positive impact of this option on competition.

Impacts on sustainable development

Eradicating fuel poverty and protecting vulnerable consumers

1.54. These factors are not a focus of the proposals. The proposed SOCs do not make specific provision to ameliorate fuel poverty or include specific protection for vulnerable customers. They should benefit all consumers. However, some categories of vulnerable consumers may be disproportionately represented amongst those currently least able to engage effectively in the market, for example because they are more likely to find tariffs confusing. To this extent, the SOCs arguably benefit vulnerable consumers in particular.

Supporting improved environmental performance

1.55. We do not believe there would be any significant negative impact on incentives to invest in improving environmental performance.

1.56. Indeed, if better treatment of consumers and information helps to promote trust and increase levels of consumer engagement, this may support sustainable development goals. For example, engaged consumers may be better placed to participate actively in demand reduction activities in response to supplier communications. They may also be more likely to sign up to smart tariffs (following the introduction of smart meters), which could encourage energy and carbon savings.

Other impacts and post implementation review

Impacts on health and safety

1.57. We do not believe that any of our proposals would lead to a significant impact on health and safety.

Cost of implementation

1.58. Under our preferred approach (incorporating the SOCs into the licence via an overarching licence condition), we recognise that suppliers may face increased compliance costs, at least in the short term. However, these costs are more limited over the longer term as the principles-based nature of the proposed SOCs will allow more flexibility as the market evolves. Arguably, the benefits to consumers and to competition may be seen to outweigh these costs. As noted earlier in this chapter, the proposed SOCs formalise what we expect a competitive supplier should do as a matter of course, and so we do not anticipate this proposal would be unreasonable or overly burdensome. Due to this, we do not anticipate significant compliance and enforcement costs.

Risks and unintended consequences

1.59. The high level objectives based approach will cover a wide range of behaviour, which may include, but is not limited to: billing; meter reading; any written or oral communications with consumers; any sales and marketing activities; the exercise of Rights of Entry; the exercise of disconnection powers; and debt recovery. In some circumstances, suppliers may need guidance to understand our interpretation of the SOCs, which we intend to provide where appropriate. We will also consider how to align our enforcement approach with the requirements of principles-based regulation. In any case, we will continue to consider the facts and circumstances of a particular case when considering enforcement priorities, and action.

1.60. As with any policy proposals, there is a risk that the proposed measures may not be as effective as indented. If suppliers do not adhere to the SOCs then, as noted, consumers' trust in suppliers and engagement in the market is likely to remain low (and could even fall). This could require us to implement more prescriptive measures in the future. This risk applies in particular to Options 2 ('Non-binding + industry commitment') and 3 ('Non-binding'), where adherence to the SOCs would be voluntary on the part of suppliers.

1.61. There is also a risk that the proposed measures do not have the intended impact in the short-term; particularly if consumers' current lack of engagement and mistrust of suppliers means they are initially sceptical of any improvements in interactions with suppliers. In this instance we may be able to take some action to help consumers understand the intended impact of our proposal and to monitor supplier compliance.

Better Regulation

1.62. As part of its general statutory duties, Ofgem is required to have regard to the following principles of Better Regulation:

- 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; and
- Targeting – Regulation should be focused on the problem and minimise side effects.

1.63. Our proposed SOCs are consistent with these principles. They impose the minimum burden needed to secure the desired level of treatment for consumers. Our research suggested that consumers' lack of trust in suppliers is due to their experience with them in a wide range of circumstances. Research also shows that current experience has negatively impacted consumers' willingness to engage with the market, and ultimately decreased competitive pressures in the market. Therefore, the proposed SOCs target interactions between suppliers and consumers, but do not reach beyond this. Moreover, the principles-based approach allows these issues to be addressed, while allowing suppliers a degree of flexibility with regard to how they meet the standards. We, therefore, consider this to be a proportionate response. We believe the proposed SOCs are consistent with what would be expected of a reasonable, supplier within a competitive market.

1.64. In addition to the principles outlined above, we are required to have regard to any other principles that may appear to represent best regulatory practice. The proposed SOCs may enable further improvements in regulation, in line with Ofgem's shift towards a more principles–based approach. In the future we may be able to rely increasingly on relatively simple and flexible principles such as the proposed SOCs, reducing the need for more onerous forms of regulation such as prescriptive licence conditions.

Post implementation review

1.65. There are different scenarios for post implementation review depending on the proposals adopted:

- Option 1 ('Legally binding via an overarching licence condition') would require both enhanced monitoring and, where appropriate, enhanced enforcement;
- Option 2 ('Non-binding + industry commitment') would require enhanced monitoring activity with some reporting needs; and
- The 'no change' scenario and Option 3 ('Non-binding') would represent a continuation of the status quo from a monitoring perspective. We would continue to monitor industry data and gather information from consumer feedback.

1.66. We will measure the success of the proposed SOCs based on industry actions, consumer views of the industry, consumer feedback on experiences within the market and consumer engagement levels. We will draw on data and information sources including samples of suppliers' communication with consumers, consumer research, feedback from stakeholders such as industry representatives and consumer groups, and media coverage.

1.67. We recognise that it may be difficult to isolate the impact of our proposed SOCs given that we would intend to introduce it as part of a broad package of RMR measures. However, we note that we see this measures working in tandem with other proposals. Also, there are areas that are not targeted by other RMR proposals that would be covered under our SOCs proposal, and it would be possible to consider the impact on these areas along with other data and information.

Conclusions

1.68. We do not consider the status quo is viable, in terms of either the current drafting or scope of application of the existing SOCs. These SOCs have not had the impact we envisaged when they were introduced, and in the RMR we have identified areas where supplier behaviour has been poor. Our proposed options are designed to address this.

1.69. Our preferred approach is Option 1 ('Legally binding via an overarching licence condition'). A key mechanism for meeting our objectives is improving supplier conduct and levels of competition within the market. We consider that stronger, broader SOCs will support improvements in conduct, give consumers more confidence in suppliers and promote consumer engagement. They would also help ensure that other consumer-related licence conditions (including those proposed under the RMR) are applied and interpreted in a way that is consistent with the new SOCs.

1.70. We are concerned that a reputational incentive would not deliver such impacts. Option 2 ('Non-binding + industry commitment') may offer a greater incentive for adherence than a pure voluntary approach. However, based on suppliers' adherence to the spirit of current SOCs, and general compliance with Probe remedies, to be successful the proposed SOCs would need to be backed by clear rules and the ability for Ofgem to take enforcement action if needed. Given existing low levels of consumer engagement and trust, our view is that this option would deliver limited benefits. Similarly, we would continue to have significant concerns regarding supplier adherence under Option 3 ('Non-binding') on the grounds that suppliers would have limited incentive to adhere to the SOCs.

1.71. In our view the proposed SOCs formalise what we expect a competitive supplier should do as a matter of course, and so we do not anticipate that this proposal creates unreasonable or overly burdensome compliance costs. Moreover, any costs generated under Option 1 ('Legally binding via an overarching licence condition') would be outweighed by the benefits to consumers and competition.