

**Testing domestic consumer take-up of
energy services: trial suspension of 28 day
rule**

Consultation document

January 2004

Summary

Energy efficiency is a keystone of the Government's sustainable energy policy. It has a vital role to play in reducing carbon emissions associated with energy supply to domestic premises, and it is also a crucial plank in the Government's policy to fight fuel poverty. Ofgem¹ is committed to supporting the promotion of domestic take-up of cost-effective energy efficiency measures.

Many stakeholders argue that energy suppliers are ideally placed to drive domestic take-up of energy efficiency measures. Ofgem has been working with suppliers, government, energywatch and other interested parties to explore how suppliers could be encouraged to offer "energy services" packages in the domestic sector, and how consumers could finance them. These offerings are packages that bundle energy efficiency advice and measures with energy supply. In these discussions suppliers have claimed that investment to develop energy services will not be viable without an assurance that the customers in question will not switch to another supplier.

To test this hypothesis, this document proposes a trial to explore whether suspending the "28 day rule" (which requires all energy supply contracts to be terminable on 28 days' notice) in limited circumstances will result in significantly increased up-take of energy services packages. It also consults on the parameters for this trial. The trial will also test whether consumer protection measures in the trial (which are in addition to existing statutory and licence protection) can be as effective as providing customers with a right to protect themselves by changing suppliers.

The trial parameters have been discussed in the forum of the Energy Services Working Group, whose creation was announced in the Government's Energy White Paper published in February 2003. The parameters discussed for consultation in this document include:

- size of trial
- definition of energy services
- contractual arrangements permitted in the trial, and
- consumer protection measures

¹ "Ofgem" and "the Gas and Electricity Markets Authority" are used interchangeably in this document.

Following consultation, the trial parameters will be incorporated into a derogation from the gas and electricity supply standard licences, in respect of customers purchasing an energy services package. Ofgem will not begin the trial until the industry has devised working arrangements for managing transfer objections within the context of the trial. A licence modification will be required to permit Ofgem to grant this derogation, and this consultation document also includes a draft of that modification. This modification will go to statutory consultation in February 2004, and a draft derogation will be published at the same time as that consultation.

This consultation also considers arrangements for evaluation of the trial.

Table of contents

1. Introduction.....	1
2. Timetable and responses.....	5
3. Legal position.....	8
4. Trial suspension of 28 day rule	13
5. Detail of trial design	18
6. Evaluation.....	31
Appendix 1 - Regulatory Impact Assessment.....	32
Appendix 2 – Draft licence modification.....	39
Appendix 3 - Accrediting Energy Savings from the pilots: technical information	41
Appendix 4 Energy Efficiency Assessment Questionnaire.....	43

1. Introduction

Potential role of energy services

- 1.1. Energy efficiency is a keystone of the Government's sustainable energy policy. Improved energy efficiency in households will be needed to meet the UK's carbon dioxide abatement targets, and is also a key means for reducing energy costs for fuel poor consumers.
- 1.2. A consumer's decision to make an investment flows from perceptions of the required investment and likely returns, but also from a number of other factors. These might include the priority a consumer gives to different calls on his or her money and/or credit, and a range of other more or less tangible factors relating to search and switching costs.
- 1.3. As regards consumers' purchases of measures to reduce the amount of energy supplied to their homes, it would appear that these "other factors" are a constraint on consumers' purchases of energy efficiency measures. Many consumers do not take up the opportunity to purchase such measures even when the costs would be paid back over a short period. It is widely recognised that lack of demand is a key barrier to take up of energy efficiency measures.
- 1.4. Some observers claim that the "energy services" approach can overcome these barriers, at least to some extent. Under the "energy services" approach suppliers are encouraged to offer packages to the domestic sector that bundle energy efficiency advice and energy efficiency measures with energy supply. This approach shifts the focus away from the sale of units of electricity or fuel to a focus on the services derived from the use of that energy, eg, the lowest cost of keeping warm, being well lit, etc. Such an approach has potential advantages for both supplier and consumer. An energy supplier can promote customer loyalty by selling multiple products, and promoting energy efficiency measures can help differentiate their product and strengthen their brand. For the consumer, a bundled "energy services" product can assist with access to capital and give more confidence about the supplier of the energy efficiency measure (since it is the same company that already supplies energy). In addition, the benefits to suppliers might lead to such bundles being actively marketed, so

overcoming some of consumers' search and switch costs. Its advocates believe that the energy services approach can develop a long-term relationship between the energy supplier and its customer, to potentially mutual advantage.

- 1.5. The potential of the energy services approach has been recognised in the design of the current Energy Efficiency Commitment (EEC). Under EEC suppliers can receive a 50 per cent uplift on energy efficiency measures where these are promoted through energy service activity. This uplift, however, is limited to 10 per cent of the supplier's EEC target. Many suppliers have indicated significant interest in this approach: of the six major suppliers with an EEC target three have submitted schemes that would take them to the 10 per cent threshold, while two other suppliers have indicated that they intend to make part use of the energy service uplift. (Currently around 5 per cent of the overall savings have been met via this route.) The energy service activity which is recognised under EEC is specifically defined in the Electricity and Gas (Energy Efficiency Obligations) Order 2001. It is anticipated that the energy services recognised for the purposes of this trial may encompass, but may extend beyond, the energy service activity recognised under the EEC.
- 1.6. It is clear that energy services cannot be the only approach if the Government's carbon reduction targets are to be met. Indeed, some observers suggest that it is not clear it can make a significant contribution to meeting these targets, since the margins available to energy suppliers to enter this new market are insufficient, given the high costs of marketing to uninterested customers. In addition, some argue that suppliers have an interest in seeing consumers use more energy, not less, and so are not natural partners in a drive for greater energy efficiency, at least in the short term.
- 1.7. Nevertheless, the energy services approach was considered sufficiently promising for the Government to have announced in the Energy White Paper the establishment of a Working Group, jointly chaired by DTI, Defra and Ofgem "to explore how to create an effective market in Energy Services ". The group met during 2003, and comprised all energy suppliers currently covered by the EEC, Ofgem, energywatch, the energy efficiency industry and relevant Government bodies. All working papers and minutes have been published on the DTI website.

28 day rule

- 1.8. The following was included in Energy White Paper (paragraph 3.35):
- “Energy services could help to overcome consumers’ reluctance to invest in energy efficiency improvements. However, since the energy markets were opened up to competition in the late 1990s, householders can switch supplier by simply giving 28 days’ notice. Energy suppliers have little incentive to offer energy service contracts if customers can switch at short notice. [The Working Group...] will address, among other issues, the barriers caused by the current 28 day notice period while maintaining adequate freedom of choice and consumer protection for customers.”
- 1.9. The “28 day rule” is the short-hand term applied to the supply licence rule that all domestic supply contracts must be terminable on 28 days’ notice (Standard Licence Condition (SLC) 46.1). (See Chapter 3 for more detail on the provisions of the domestic supply licence.) Some suppliers consider that the effect of the 28 day rule is effectively to forbid suppliers from locking domestic consumers into a bundled contract that could, for instance, spread the costs of an energy efficiency measure over a fairly long pay-off period. These suppliers say they are reluctant to provide energy services (eg, energy efficiency measures) to their customers without up-front payment if the latter can change energy supplier at 28 days’ notice and leave the original supplier collecting a debt for several years without a supply contract. Suppliers have claimed this is a major obstacle to the development of energy services, although they have not submitted to the Working Group the business case that would support this assertion.
- 1.10. In the absence of such evidence, Ofgem has remained sceptical about this argument. Ofgem has argued that the supply licence already permits fixed-term contracts, backed up by termination fees, which would have the same effect as a bundled lock-in contract. That suppliers are not experimenting with ways to enable energy service contracts (for example using fixed-term contracts with termination fees, or arrangements for assignment of contracts) tends to suggest that the 28 day rule is not the primary barrier to the provision of such offers. Moreover, the 28 day rule serves the important consumer-protection role of allowing customers, when unhappy with the price or service from their current supplier, to switch suppliers.

- 1.11. Nevertheless, Ofgem is keen to stimulate the take-up of domestic energy efficiency measures, recognising this objective is of prime importance in government energy policy. Ofgem is also keen to understand to what extent the 28 day rule may be a barrier to innovation of various kinds in supply offerings.
- 1.12. Given the importance of this issue, Ofgem is prepared to test the proposition that removing the 28 day rule would significantly increase sales of such measures, by facilitating a trial. The trial will also serve to test whether adequate consumer protection can be assured by use of licence conditions and regulatory intervention, even when customers have (for the period of a fixed-term contract) lost the right to switch suppliers.

Regulatory impact assessment

- 1.13. Ofgem intends to subject the launch of the trial to a regulatory impact assessment. The first draft of this assessment is at Appendix I to this paper.

2. Timetable and responses

Timetable

2.1. The timetable for consideration of the trial is as follows:

13 February	Closing date for responses to this consultation
End February	Publication of a decision document and statutory consultation proposing modifications to the gas and electricity supply licences
	Publication for consultation of draft derogation
March	Modification of licences
April	Implement derogation

Views invited

Comments are invited on the proposals raised in this document. These should be sent to:

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The closing date for responses is 13 February 2004.

Contact

2.2 If you wish to discuss this consultation paper, please contact Iain Osborne at the address above.

Confidentiality

- 2.3 All responses will normally be published on the Ofgem website and held electronically in the Ofgem Research and Information Centre unless they are marked confidential. Respondents should try to confine confidential information to the appendices of their responses. Ofgem would prefer to receive non-confidential responses and to receive responses in an electronic form.

Issues for consultation

- 2.4 Ofgem would welcome comments on any matter addressed in this paper. However, responses are particularly sought to the questions italicised in Chapters 4 to 6 and Appendices 1 and 2, ie:

4.6 Respondents are asked to comment on Ofgem's proposal to conduct a trial suspension of the 28 day rule, and the proposed objectives.

4.10 Comments are invited on Ofgem's proposed approach to setting up the trial.

4.19 Comments are invited on the relevance of this trial to community energy schemes, and pre-payment meter customers, and what changes might be required to facilitate their inclusion.

5.7 Ofgem invites comments on its proposals for a 4 per cent/50,000 customer limit, and for a two-year trial.

5.9 Ofgem invites comments on the proposed definition of energy services, and in particular: whether the Energy Efficiency Partnership for Homes Code of Practice for Energy Efficiency Providers provisions on advice should be made mandatory; whether a 15 per cent threshold is sufficient to make "cherry picking" rules unnecessary; and how the reduction in supplied energy should be measured (in particular, whether the methodology as proposed is sufficient to allow the inclusion of alternative generation); the proposal that customers should save money as a result of the package, and what discount rate might be used to assess this; and the proposal to allow up to one-third of the total cost to be paid up-front by the householder.

5.10 *Comments are requested on the proposed duration.*

5.12.2 *Ofgem would welcome views on how indexation of prices for energy supplied should be applied, and how notification of price increases should be managed.*

5.12.6 *Ofgem would welcome views on the proposals for a written quote and an independent second opinion.*

5.12.8 *Ofgem invites views on its proposed approach to cooling off periods.*

5.12.9 *Ofgem would welcome comment on whether its proposed termination arrangements would be appropriate, and whether there are other situations in which a right to terminate would be appropriate.*

5.12.10 *Ofgem would welcome views on whether provision of product guarantees should be regulated.*

5.16 *Comments are requested on Ofgem's approach to enforcement and verification.*

5.21 *Ofgem would be interested if there is support for the creation of a national list of sites where a non-terminable contract is in force, and the practicalities of such an approach.*

5.25 *Taking all the design parameters together, Ofgem would welcome information from suppliers about the expected costs of participating in the trial.*

6.3 *Comments are requested on Ofgem's proposed approach to evaluation, and on the key priorities.*

Appendix 1 – comments on the draft RIA are requested.

Appendix 2 – comments are requested on the draft licence modification.

3. Legal position

- 3.1. This chapter outlines Ofgem’s objective and duties as they apply in this matter, and then describes the current licence rules, as well as relevant obligations in non-sectoral law.

Ofgem’s objectives and duties

- 3.2. Ofgem’s principal objective is laid down in the Electricity Act 1989 and Gas Act 1986 as amended by the Utilities Act 2000 (section 3A(1) of the Electricity Act, 4AA(1) of the Gas Act²):

“The principal objective of [Ofgem] in carrying out [its functions...] is to protect the interests of consumers... wherever appropriate by promoting effective competition”

- 3.3. The meaning of “consumer” in this objective “includes both existing and future consumers” (s3A(6)/4AA(6)).
- 3.4. Ofgem also has statutory obligations to have regard to a range of factors when carrying out its functions under the sectoral legislation referred to above. These functions include granting and amending licences, and also licence enforcement. The obligations relevant in this context include:
- s3A(3)/4AA(3): “have regard to the interests of: a) individuals who are disabled or chronically sick; b) individuals of pensionable age; c) individuals with low incomes; d) individuals residing in rural areas...”
 - s3A(5)/4AA(5): “carry out [its] functions in the manner best calculated a) to promote efficiency and economy in [the licensed activities]...”
 - s3A(5)/4AA(5): “have regard, in carrying out [its] functions, to the effect on the environment of activities connected with [licensed activities], and
 - s3B(2)/4AB(2): “have regard to any guidance issued [by the Secretary of State], about the marking by Ofgem of a contribution towards the attainment

² In this section references to s.3A relate to the Electricity Act, while references to s.4A relate to the Gas Act.

of any social or environmental policies set out or referred to in the guidance.”

- 3.5. With regard to the last of these, DTI laid before Parliament on 18 December 2003 revised Social and Environmental Guidance to Ofgem. Relevant sections include:

“[paragraph 2.1] The Government believes that [promoting efficient use of gas and electricity, and having regard to the effect of licensed activities on the environment are], through lower bills for consumers and a better environment, ...very much in the interests of consumers...”

“[Paragraph 2.4] The Government believes that energy efficiency... needs to play an increasingly important role, providing significant levels of carbon savings... The White Paper illustrates the contribution that energy efficiency might make to cutting carbon emissions in 2020 through domestic energy efficiency (4-6MtC).”

“[Paragraph 2.5] The Government expects the Authority to help secure these targets and aims and to ensure that, within their area of influence, barriers inhibiting progress are wherever possible removed.”

“[Paragraph 2.6] ... achievement of [Government] objectives may be dependent on a radical transformation of the energy system... This is likely to require... the development of energy services markets as a means of decoupling the use of gas and electricity and its environmental impact from the growth in demand for the services that energy provides.”

- 3.6. Under the sectoral legislation cited above, gas and electricity suppliers are required to hold a licence for these activities. The licences contain a range of obligations in licence conditions that can either be standard (SLCs) or company-specific (special licence conditions). Gas and electricity supply licences are divided into parts A to D, with the conditions in part C applying only to licensees supplying to domestic customers. The licence obligations discussed in

this document are all found in Part C of the licence, and so relate only to domestic customers.

What is the effect of the 28 day rule?

- 3.7. The terms of contracts are regulated by the licence in a number of ways. The rules discussed by the ESWG are contained in SLCs 46 and 47 of both the Electricity Supply Licence and the Gas Suppliers Licence. The provisions of these SLCs were drafted to embody a compromise between two desirable goals. On the one hand it is desirable that, in the short term, customers have choices between a range of contract types. On the other, it is essential for the long-term interest of customers to prevent incumbents from hampering new market entry by locking up large sections of the market, and to ensure that customers are not locked into arrangements that are to their detriment (even though exiting them may be at a price).
- 3.8. This compromise is effected by licence rules that set out the following:
- all energy supply contracts (whether fixed-term or rolling) must contain provision for them to be terminated on no more than 28 days' notice (SLC 46.1)
 - energy supply contracts can be for a fixed term period (see SLC 31.1), and if the contract is for a fixed term that is more than 12 months a reasonable termination fee can also be demanded³ (SLC 46.5)
 - all energy supply contracts must be able to be terminated where the customer ceases to own or occupy the premises, without payment of a termination fee even during a fixed term period (SLC 46.5), and
 - energy suppliers may bundle other goods and services into the same contract with energy supply, and the contractual provisions governing these goods and services may be different. The licence provides that where the energy

³ Other than where the customer is terminating under the provisions of SLC 47 (ie, on moving house, or during the first five days of a fixed term contract) (SLC 46.5(a)), or where the termination does not take place during the fixed term period (SLC 46.5(b)), or where the supplier has unilaterally changed its terms (SLC 46.5(c)), or where the customer was not told about the termination fee (SLC 46.5(d)).

part of the contract is terminated, the supplier may require “reasonable security” with regard to the goods and services (SLC 47.4).

Objections to customer transfers

- 3.9. The licence also includes rules that allow a supplier, in some circumstances, to require a network operator not to carry out a request for the customer to change suppliers. These rules are written out in SLC 30 of the gas supply licence. In electricity they are contained in Clause 16 of the Master Registration Agreement (MRA), membership of and compliance with which are obligations under SLC 20 of the electricity supply licence.
- 3.10. The situations in which objections are permitted for domestic customers are as follows:
- where the customer has failed to pay charges that have been demanded in writing and remained unpaid for 28 days after the demand
 - where the customer has requested the objection on the grounds that he has not signed a contract with a new supplier (i.e., the request for a transfer is erroneous)
 - where the suppliers agree on an objection (generally for customer service reasons), and
 - in electricity, where the transfer request relates to a Meter Point Administration Number (MPAN) linked to another MPAN that is not the subject of the request.

Other consumer protection

- 3.11. Consumers are also protected under a range of non-sectoral consumer protection regulations enforced by Ofgem⁴. These include:
- Distance Selling Regulations (eg, identification of supplier is required prior to conclusion of contract; information about contract, including cancellation

⁴ In general Ofgem enforces these measures concurrently with the Office of Fair Trading and Trading Standards Officers. Consumers also have recourse to the courts.

rights, must be provided in good time; cancellation right for services is 7 days after contract is concluded, for goods is 7 days after goods are provided)

- Cancellation of Contracts Concluded Away from Business Premises Regulations (e.g., notice of contract must be provided within 7 days; 7-day cancellation period from making of contract)
- Control of Misleading Advertising Regulations (broadly, prohibit misleading advertising and govern comparative advertisements), and
- Unfair Terms in Consumer Contracts Regulations (broadly, require fairness and balance in impact of contract terms on consumer and supplier).

3.12. Finally, it should be noted that Ofgem has concurrent powers with the Office of Fair Trading to enforce the Competition Act 1998 in the energy sector. This prohibits abuse of a dominant position in GB markets and anti-competitive agreements other than in certain circumstances. From May 2004 Ofgem will also have concurrent powers directly to enforce EU competition law within the GB energy sector.

4. Trial suspension of 28 day rule

- 4.1. This chapter sets out for consultation Ofgem's reasons for establishing a trial suspension of the 28 day rule, discusses the mechanism for establishing the trial, and puts forward initial proposals on the parameters of the trial.

Ofgem's reasons for establishing a trial

- 4.2. As described in the introduction to this document, Ofgem recognises the importance of increasing the take-up of energy efficiency measures by domestic consumers. A range of stakeholders consider that the 28 day rule is a key barrier to increased marketing of energy services packages, and hence to domestic take-up of energy efficiency measures. Ofgem does not share this view. However, the matter is of sufficient importance that Ofgem wishes to gather further empirical evidence.
- 4.3. Ofgem has considered whether such evidence could be gathered by other means. Barriers to energy efficiency have been examined before through consultancy studies. However, the proposition to be evaluated is that companies would behave differently in a different regulatory environment, and it has in the past proven difficult to validate this essentially subjective contention through a paper study. There has also been some difficulty in gathering objective information about the cost-base of this activity, as suppliers have been unwilling to release internal business cases as a result of confidentiality concerns.
- 4.4. These discussions led Ofgem to propose a trial so as to gather reliable information about the actual (not predicted) reaction of companies to a change in their regulatory environment. It is not possible to be certain whether the trial will generate a net benefit to customers. However, as described in the Regulatory Impact Assessment at Appendix I, it appears that a trial suspension of the 28 day rule is the best way to unlock the potential benefits, and that the potential detriments can be largely mitigated by trial design (in particular, keeping it on a limited scale until the effects are more fully understood).

4.5. Ofgem notes the recent publication by the Government Chief Social Researcher's Office of a report on a review of Government pilots⁵. This review underlines the value of pilots in policy making. This discusses good practice, and Ofgem has sought to reflect its approach in developing this trial. Key points include:

- "a pilot should be undertaken in a spirit of experimentation"
- "the precise purpose(s) of a policy trial must be made explicit in advance"
- "independence is critical. Pilots must be free from real or perceived pressure to deliver "good news""
- "methods matter. A poorly conceived or poorly specified pilot may be worse than no pilot at all. To ensure that the methodology of a pilot is as bullet-proof as possible, expert internal and external advice should be drawn on early, and appropriate resources made available," and
- "a pilot that reveals a policy to be flawed or ineffective should be viewed as a success rather than a failure."

4.6. In this spirit, the proposed objectives for the trial will be:

- to test the proposition that removing the 28 day rule would significantly increase sales of energy services packages by boosting their promotion by suppliers, and so save customers money, and
- to test whether adequate consumer protection can be assured by use of licence conditions and regulatory intervention, even when customers have (for the period of a fixed-term contract) lost the right to switch suppliers.

Respondents are asked to comment on Ofgem's proposal to conduct a trial suspension of the 28 day rule, and the proposed objectives.

4.7. Ofgem's position on the 28 day rule's wider role in energy supply markets remains unchanged, which is that the rule plays an important role, and the case

⁵ "Trying it out: The role of "pilots" in policy-making", by Professor Roger Jowell, Cabinet Office Strategy Unit, December 2003

has not been made that customers would benefit from its removal. Ofgem will continue to enforce vigorously SLC 46 and 47 as they apply outside the trial.

The mechanism for establishing the trial

- 4.8. As discussed in the previous chapter, the 28 day rule is directly enshrined in the licence, and therefore its suspension will require a licence amendment. The same is true of any change to the objections rules (and these may also require a change to the MRA).
- 4.9. It is in the nature of a trial that the changes involved may later be modified or reversed. It is also important that the trial is specified in a level of detail adequate to ensure it is clear what is being tested. For both these reasons, it appears sensible not to attempt to enshrine the details of the trial directly in a licence condition.
- 4.10. Instead Ofgem proposes to insert into licences an enabling power, under which Ofgem can grant a derogation from the relevant provisions, and lay down the conditions in which this derogation is to apply. Appendix II to this paper includes provisional drafting for the licence amendments themselves. This consultation will lead into drafting of the derogation, which as outlined in Chapter 2 will be published in draft at the same time as the statutory consultation on the licence modification.

Comments are invited on this approach to setting up the trial.

Market research

- 4.11. The ESWG is arranging market research with customers to assist in elaboration of the trial. The results of this research will be taken into account as they become available.

Details of the trial

- 4.12. The ESWG asked Ofgem to develop in more detail the specification of the trial. The next chapter includes this detail. However, Ofgem is keen that suppliers understand clearly what they must do in order to participate in the trial, and that

this is not over-complex. In this chapter we have therefore summarised the trial rules, which reduce to the following:

4.13. **Number of customers.** The supplier must not recruit more than 4 per cent of its customers onto the trial (or 50,000 customers, if this is larger).

4.14. **Customer benefit.** The supplier's offering must be of substantive benefit to customers. That is:

- the package must be bespoke, designed after a personal energy efficiency audit of the consumer's home
- provide advice based on the audit, listing energy efficiency measures that are suitable to install and advice on other ways the consumer could save energy
- the package must include the installation of substantial energy efficiency measures (which will reduce the household's estimated energy demanded from the grid by at least 15 per cent. This will be assessed in the same way as EEC, as described in Appendix 3). It should be noted that measures provided within the trial are eligible to be counted against a supplier's EEC targets where they also meet the requirements of the Electricity and Gas (Energy Efficiency Obligations) Order 2001
- the package must be expected to save the consumer money, all other things being equal, and
- suppliers cannot lock in the customer if they are only providing advice or arranging installation. The fundamental rationale for the energy services concept implies a long-term relationship, with the supplier lending a substantial part of the cost of the energy efficiency measures to the consumer.

4.15. **Duration.** Although the trial runs only for two years, energy services contracts can be struck for up to five years.

4.16. **Consumer protection.** Contracts within the trial must provide a specified range of consumer protection measures, over and above the normal licence protection:

- price certainty;

- bills that state separately charges for energy, charges for energy efficiency measures, and finance charges;
 - a written quote in advance, and access to an independent second opinion;
 - fair termination arrangements (on house move, or when the customer chooses to pay off the credit, or if the supplier breaches the terms of the trial).
- 4.17. **Verification.** Suppliers will be asked to make regular data returns to Ofgem, as well as a six-monthly board-level statement of compliance. Initially, these returns will assist with evaluation of the trial, but they are also intended as permanent should the trial lead to a permanent removal of the 28 day rule for energy service offerings.
- 4.18. **Objections.** Suppliers will be able to object to the transfer away of a customer participating in the trial on grounds of non-termination of the contract.
- 4.19. **Scope.** Ofgem believes that these arrangements, as described in more detail below, will be sufficient for the generality of customers. However, we are keen that no groups of customers should be excluded accidentally. Ofgem would therefore particularly welcome comments on:
- *What changes might be needed to ensure suppliers are able to tailor offerings suitable for community energy schemes?*
 - *To what extent suppliers expect to make offerings to customers using pre-payment meters (PPMs), and whether this would be desirable.* Ofgem is aware that legislative change could allow energy efficiency charges to be collected through these meters. However, we are also aware that many users of PPMs are eligible for substantial financial assistance for energy efficiency measures, and so it is not clear to Ofgem whether it will be viable for suppliers to tailor offerings for this customer group.

5. Detail of trial design

5.1. This chapter discusses in more detail how the trial parameters outlined in the previous chapter are to be applied.

Size and duration of trial

5.2. Given the objectives above, it seems clear that any trial needs to give suppliers a clear incentive to make a serious effort to promote energy services. This means, for example, that the size and duration of the trial must be such as to give suppliers prospect of a reasonable return on their investment in developing energy service bundles, and that consumer protection measures should not be so costly as to remove such a return. It remains to be seen whether an “affordable” package of consumer protection measures can be effective – evaluating this is one objective of the trial.

5.3. The size and duration of the trial have been discussed at the ESWG, as well as informally with suppliers. From these discussions, Ofgem understands that a trial within the following parameters would offer a fair test:

- Suppliers may recruit up to 4 per cent of each supply licensee’s customers onto a non-28 day rule contract; and
- Such recruitment to run over two years, before the final evaluation of the trial. This would run from spring 2004 to spring 2006.

5.4. There are around 20 million households in Great Britain that use gas and electricity, and an additional 5 million electricity-only customers. The 4 per cent limit therefore suggests that up to around 1 million customers may be within the coverage of the trial.

5.5. Ofgem recognises that the 4 per cent limit will bear disproportionately on smaller suppliers, and therefore also proposes an alternative limit of 50,000 customers (if that is higher). This 50,000 limit would be applied collectively to all the affiliated suppliers within a corporate group.

5.6. Ofgem would welcome views on whether the 4 per cent limit should also be applied collectively across a corporate group. Ofgem recognises this may

facilitate suppliers' administration (eg, where their customers are spread across multiple supply licences), but has some concerns that this might complicate verification and enforcement.

- 5.7. Suppliers should note that Ofgem would regard it as potentially anti-competitive for a former Public Electricity Supplier to focus its energy services marketing disproportionately on regions where it is the former monopolist.

Ofgem invites comments on its proposals for a 4 per cent/50,000 customer limit, and for a two-year trial.

Link to energy services

- 5.8. The rationale for the trial is to assess the scope for regulatory change so as to underpin government policy on energy efficiency. Therefore the suspension of the 28 day rule will only apply to contracts that bundle energy supply and a substantive energy efficiency package. This requires a view on what constitutes a substantive package, a question that has been discussed in the ESWG. The Working Group proposed to define an eligible package in terms that required a personalised audit of energy saving options for the home in question, achieved a "minimum reduction" in supplied energy, and included an offer of credit.
- 5.9. Building on this work, Ofgem proposes that the definition of an eligible package should include the following elements:
- 5.9.1. It would include provision of advice based on an assessment of the customer's home. ESWG recognised that there would be some cost implications of such an approach for suppliers, but from its inception recognised that personalised advice was a core element of energy services. A 'personalised' energy efficiency audit must be tailored to the individual circumstances of the consumer's home. The audit would be expected to be carried out in the home, but could exceptionally be carried out over the telephone or by post using a detailed questionnaire – an example is contained in Appendix 4. It should assess the efficiency of the heating system, the efficiency of insulation, the performance of the appliances and the lighting of the household, and outline the energy saving opportunities (ie, energy efficiency measures, opportunities for lower-carbon generation and zero cost ways to save energy).

5.9.2. It is fundamental that the customer be given sound and practical advice about the full range of opportunities in his or her home. One supplier has told Ofgem that it would welcome specific guidance about what should be included in the audit. Suppliers already have a licence obligation with regards to advice, and Ofgem has encouraged all the major suppliers to join the Energy Efficiency Partnership for Homes Code of Practice for Energy Efficiency Providers, which sets standards for the provision of quality advice. We would welcome views as to whether the terms of the Code of Practice should be made mandatory for energy services contracts.

5.9.3. The customer must then be offered an energy services package that offers the consumer sufficient energy saving benefits to justify giving up his or her right to switch. As proof of this, the measures offered, installed and included in financing arrangements⁶ must be expected to reduce the amount of energy the household demands from the grid (as defined in paragraph 5.9.8) by at least an amount that exceeds a defined savings threshold.

5.9.4. The ESWG was keen to avoid suppliers “cherry picking” measures that could see the customer give away his or her right to switch in exchange for only a few of the possible energy efficiency measures. ESWG also proposed that the energy saving threshold should be set between 10 and 15 per cent. Ofgem considers that there is a close link between the level of the threshold and any additional provisions necessary to avoid “cherry picking”. If the threshold is set high, such additional provisions will not be necessary. If the threshold is set lower, while suppliers might sell more packages, there is significant risk that suppliers will only install a sub-set of the measures that would benefit each consumer. This would not be in the interests of the individual consumers, nor would it produce maximum support for the Government’s policy of reducing carbon emissions.

5.9.5. Ofgem therefore considers that a lower threshold should be accompanied by a system where the offering to the customer would have

⁶ As noted, Ofgem expects the audit should identify all relevant energy efficiency measures, including those for zero cost. However, only measures with a cost should be included in assessment of whether the savings threshold is met.

to include all of the most common measures, if specified in the home audit as relevant to the customer (for example, cavity wall insulation, boiler replacement, loft insulation...), while leaving suppliers free to offer other, more innovative measures in addition. However, such rules are likely to be inflexible and Ofgem would prefer market forces to determine the most favoured measures.

5.9.6. Ofgem's current view is therefore that the savings threshold should be set higher, but without detailed "cherry picking" rules. We therefore propose to set it at 15 per cent. We welcome views on this proposal, and also on what might be the impact on the typical installed package of setting the threshold lower or higher.

5.9.7. The package must be expected to save money for the consumer, all other things being equal. This means that the benefits from lower fuel bills will outweigh the costs of the installed energy efficiency measures. This should be assessed over a reasonable period (perhaps the expected life of the installed measures), and by a discounted cash-flow approach using a discount rate that approximates to an average consumer's cost of capital. Ofgem does not particularly expect that suppliers will discuss this rather complex assessment with customers – it is up to each supplier how it persuades a customer that this is a good deal. Rather, Ofgem expects each supplier would be able to demonstrate on request that it has in place procedures to verify that each customer is in fact saving money.

5.9.8. It is proposed that the assessment of reduction in supplied energy should be measured in kWh avoided (both in terms of increased comfort and energy saving). It is also proposed that energy savings should be weighted according to the carbon intensity of the fuels. In this way the output of the trial packages would be measured in exactly the same way as energy savings are calculated for the EEC. See Appendix 3 for full details of how the calculations would be made. However, Ofgem would be interested to hear arguments for measuring carbon emissions avoided instead of kWh avoided. It is intended that within the trial it should be possible to include alternative generation such as micro-CHP within energy service packages. Ofgem is interested to hear if respondents have concerns about this not being possible within the methodology as described.

5.9.9. The measures must be installed without most of the cost being paid up-front by the householder. Ofgem proposes that contracts within the trial should involve up-front deposits of no more than one-third of the initial cost (ie, the cost of installed energy efficiency measures, but not including the cost of credit), with the balance spread broadly equally over the repayment period (unless the consumer chooses to pay off the balance during the contract period). This would ensure that customers receive a real benefit from the surrender of their right to change energy supplier. Ofgem recognises that the consumer benefit from energy efficiency is not reduced if the consumer funds the energy efficiency measure him- or herself, and indeed that a consumer-funded package will have required the supplier to make some investment in advice and co-ordinating installation. However, it appears that the provision of credit is by far the most substantial supplier contribution that promotes consumer take-up of energy service packages. Therefore, if substantive credit is not being provided, the supplier does not in Ofgem's view have adequate justification for asking the consumer to surrender the right to switch.

Ofgem invites comments on the proposed definition of energy services, and in particular: whether the Energy Efficiency Partnership for Homes Code of Practice for Energy Efficiency Providers provisions on advice should be made mandatory; whether a 15 per cent threshold is sufficient to make "cherry picking" rules unnecessary; and how the reduction in supplied energy should be measured; the proposal that customers should save money as a result of the package, and what discount rate might be used to assess this; and the proposal to allow up to one-third of the total cost to be paid up-front by the householder.

Duration of contracts

5.10. Some energy efficiency measures could be relatively high-cost, and consumers are likely to wish to pay for these over an extended period. Ofgem therefore proposes that contracts lasting up to five years should be permitted under the trial, with the consumer unable to terminate while the costs of the energy efficiency measures are being recovered (other than in specified circumstances, as set out below).

Comments are requested on the proposed duration.

Consumer protection

- 5.11. At present, all domestic energy consumers can react to poor service or over-charging by their supplier by switching away. Suspension of the 28 day rule will remove this right from customers who enter a lock-in contract. A key objective of the trial is to assess whether regulated consumer protection can provide a level of protection for consumers comparable with the right to switch energy supplier. This must be achieved without becoming so onerous as to make it impossible for suppliers to earn a return in providing energy services. This is never an easy balance to strike, and it remains to be seen whether it is possible. In this light, Ofgem is particularly keen to receive views on the proposals below.
- 5.12. The ESWG discussed consumer protection, and proposed a package including the elements discussed below. Ofgem's proposals build on the Working Group ideas.

Licence protection

- 5.12.1. Suppliers should note that the protections to be incorporated into the trial are over and above those provided by other measures: the consumer protection requirements listed in chapter 3, and other licence conditions. In particular, the marketing and sale of energy services packages will be covered by SLC 48. This applies to all marketing activities in respect of energy supply, which means "any activity... directed at or incidental to the identification of and communication with customers supplied or to be supplied... and includes entering into domestic supply contracts". This evidently includes communication with a supplier's existing or former customers.

Price certainty

- 5.12.2. The Working Group considered it important to ensure consumers unable to switch supplier should be protected from over-charging. It therefore proposed changes in the price of energy should be restricted in energy service contracts, in one of three ways:

- prices may be fixed
- prices be capped (ie, they may fall but they cannot rise above a specified price), or
- prices may be indexed to wider changes in prices. The value of indexation clearly depends on to what prices are being linked – for example, a link to wholesale prices would expose customers to undue volatility. Ofgem therefore proposes that increases in unit gas and electricity prices in eligible packages should not exceed increases in the relevant retail energy index published by DTI quarterly⁷. Since this is published each year in arrears, the relevant price rise would presumably be that in the previous year. Alternatively, it might be possible for a robust index to be made available more frequently.

If prices are not fixed (and so may rise), suppliers will need to bear in mind the effect of SLC 44.6. This provides that, except where the Authority has approved otherwise, when suppliers increase prices they should write to the customer informing him/her of the variation and of the customer's right to terminate the contract. Under the trial, the customer's rights to terminate will not be applicable, but Ofgem sees continuing value in the customer being notified of price increases. Comments are requested as to how suppliers will wish to manage this licence obligation.

Ofgem would welcome views on how indexation of prices for energy supplied should be applied, and how notification of price increases should be managed.

Unbundled bills

5.12.3. The current licence rules require bills to set out charges for energy separately from charges for any bundled goods or services. Some have argued there would be some advantages in presenting these in a single figure. However, this proposal was not acceptable to the majority of

⁷ These are currently published on-line by DTI:
http://www.dti.gov.uk/energy/inform/energy_prices/index.shtml
 Testing consumer take-up of energy services: Trial suspension of 28 day rule
 Office of Gas and Electricity Markets

members of the Working Group. Ofgem therefore does not propose any change to the current rules requiring separate presentation of charges.

Written quote, second opinion

5.12.4. The Working Group considered it essential that customers be given a written quote in advance of signing an energy service contract, and have access to an independent second opinion.

5.12.5. It is proposed that the written quote should include:

- the energy efficiency measures proposed, and the total cost of these;
- credit terms, including the APR to be applied;
- the unit charge and the “price certainty” approach that will be applied (including details of any indexation);
- the consumption assumptions underlying the quote;
- expected supplied energy reduction, and the consequent notional carbon saving;
- expected financial savings over the customer’s current service;
- termination provisions; and
- the total monthly charge for the package.

5.12.6. Suppliers will be expected to make available an independent second opinion with no up-front cost (although the cost may be rolled into the overall package). This should be provided from a reputable and expert source (for example, from the EEACs). This need not replicate the initial audit in its level of detail, but rather should confirm that the initial assessment of the proposed measures’ impact is reasonable. If impact assessment uses well-understood EEC methodologies, this may consist of little more than checking the calculations.

Ofgem would welcome views on these proposals for a written quote and an independent second opinion.

Cooling off

5.12.7. Current rules provide a range of cooling off periods (depending on circumstances) from five days to two weeks. The Working Group proposed that eligible contracts should provide a cooling off period of three weeks. This was on the assumption that a longer cooling off period would offer greater protection of the consumer. However, it is not clear to Ofgem that this assumption is correct. Experience from the energy supply market suggests that the majority of customers who wish to cancel a signed contract do so fairly quickly. Moreover, some energy services offerings will incorporate “distress” purchases, for instance a boiler installation to replace a boiler that has broken down. It would not be in consumers’ interest to bar suppliers from installing a boiler in that situation. Finally, Ofgem observes that customers sign consumer credit agreements, sometimes for sums that will be larger than are likely to be involved in an energy services contract, with a normal two-week cooling off period.

5.12.8. Ofgem therefore proposes to rely on the cooling off periods required under existing consumer protection provisions.

Ofgem invites views on this proposal.

Termination

5.12.9. Although at the heart of the trial is suspension of a consumer’s right to terminate their contract, some termination provisions will nevertheless be necessary. For instance, when a customer moves into a property, the new occupant (whether owner or tenant) cannot be bound by any previous energy services contract relating to that property as energy supplied to the new tenant will be under a different (deemed) contract. Therefore, eligible contracts should be terminable on change of tenancy. (This will also simplify handling of the right to object, since the “change of tenancy” flag on industry systems can be used⁸.) Ofgem also expects that the customer should have the right to pay off outstanding debts under the contract, plus a reasonable charge to cover administration and the costs of a supplier’s

⁸ Note that for gas, although a change to Transco’s Network Code has been agreed, this functionality has yet

hedging arrangements, and so terminate the contract and switch supplier. (The right to pay off credit is already enshrined in the Consumer Credit Act.) Ofgem also proposes that the customer should have a right to terminate where the supplier's contract does not comply with the terms of the supply licence (for example, with the terms of the derogation setting up the trial). This would ensure that, if suppliers fail to honour their contract, consumers are not obliged to rely on regulatory enforcement or court action to protect themselves.

Ofgem would welcome comment on whether these termination arrangements would be appropriate, and whether there are other situations in which a right to terminate would be appropriate.

Guarantees

5.12.10. The Working Group considered that product guarantees should be offered to cover installed energy efficiency measures where appropriate. These would presumably be expected to run for at least the period of the energy service contract. However, it is arguable that this is a dimension of the offering that could reasonably be left to competitive forces.

Ofgem would welcome views on this issue.

Enforcement and verification

5.13. The next chapter reviews how the trial is to be evaluated. However, the objective of the trial is to set in place arrangements that could be made permanent, if evaluation suggested this was in consumers' interest. Thought is therefore required as to how suppliers' compliance with their obligations in the trial is to be monitored, with such enforcement and verification arrangements being potentially durable beyond the lifetime of the trial.

5.14. Ofgem maintains a standing capability to monitor suppliers' compliance with regulatory obligations. However, we have some concerns that the complexity of energy services may mean such routine monitoring would be inadequate. Each energy services package is itself complex, and each will be somewhat different.

Therefore Ofgem and energywatch cannot necessarily expect to spot systematic problems from individual consumer cases.

5.15. Ofgem therefore proposes that suppliers should be required to report to Ofgem regularly. These reports will take two forms:

- regular reports on issues such as how many contracts have been signed, where, and of what nature, what measures are being installed, how much energy saved, etc. Where possible this return will be at the same time as returns for EEC monitoring purposes (where the packages form part of a supplier's EEC activity the normal approval of schemes will continue alongside the requirements for monitoring the trial set out here), and
- suppliers will be asked to provide regularly a statement of compliance, approved at board-level. During the trial this will be required six-monthly, although should the trial suggest these arrangements are beneficial to consumers, this might be made only an annual requirement.

5.16. The trial is expected to run until April 2006. Within the trial, contracts may be signed that do not expire for five years, i.e., until April 2011. As the trial closes Ofgem will consider whether these reporting arrangements can be relaxed. However, suppliers should expect that to a significant extent they will remain in force so long as non-terminable contracts remain.

Comments are requested on this approach to enforcement and verification.

Objections

5.17. Until October 2003, suppliers could object to the transfer away of a customer solely because the customer had not provided a contract termination notice. However, the industry recognised that these arrangements were not in consumers' interests, nor beneficial to suppliers who had to manage the flow of termination notices. The right to object for non-termination of contract has therefore been removed from the domestic sector.

5.18. However, this creates a situation where a customer who has signed a contract within the trial could nevertheless switch away. This would leave the energy services supplier in the position of having to seek to enforce a customer contract

through legal means or debt collection. It appeared to the Working Group that this possibility could undermine the viability of the trial, and Ofgem therefore proposes to continue (for the duration of the trial) the right to object for non-termination of a non-terminable contract. This special regime is to apply only to contracts that meet the terms of the derogation.

- 5.19. This proposal raises a number of complex practical questions about how the industry is going to manage the objections process in this area. There is a legitimate concern that objection may be used by suppliers to retain customers other than in support of the trial. It may therefore be desirable for a new supplier to be informed of the reason for an objection where that reason is that the customer has agreed to an energy service contract. Ensuring that this happened would require industry procedures to be changed. Alternatively, the new supplier could rely on the old supplier writing to the customer explaining the reason for the objection, and the customer informing the new supplier.
- 5.20. A “change of tenancy” flag signals to an old supplier that an objection may not be made. It was suggested above that where a customer with a fixed-term contract has left the premises where the relevant energy efficiency measures were installed, the contract should be terminable and any outstanding debt could be paid off. In any case, the new tenant in that property (who may well have paid more to buy or rent the property because of its energy efficiency) is free to switch and the new supplier may be unaware of the energy services installation. Therefore the “change of tenancy” flag can still be used to signal that an objection should not be made.
- 5.21. New suppliers may wish to avoid marketing to customers who are committed to long-term contracts. *Ofgem would be interested to hear if there is support for the creation of a national list of sites where a non-terminable contract is in force. Those suppliers interested in such a development are asked to comment on how data protection issues might be addressed, and how the list would be kept up to date.*
- 5.22. Ofgem has raised these issues with an industry working group that was already considering issues relating to objections and erroneous transfers. All large suppliers are represented on this group. Ofgem expects the industry to have developed the necessary protocols on treatment of objections, communications

between suppliers, communications with customers, etc., before the trial begins. Ofgem does not currently believe changes to core industry documents (MRA, Network Code) will be required, but if they are, Ofgem will expect them to have been approved. However, Ofgem recognises that implementation of such arrangements takes time, and we do not expect all suppliers to have completed implementation of these arrangements before the trial goes live.

5.23. Ofgem will also expect suppliers' arrangements to include creation of an audit trail that will enable verification that customer transfers have only been blocked in appropriate circumstances (similar, for example, to the arrangements for customer requested objections).

5.24. Ofgem will wish to be satisfied that suppliers are going to be able to manage the objections process without consumer detriment, before we will put into effect the derogation that will begin the trial.

Costs

5.25. Taking all the design parameters together, Ofgem would welcome information from suppliers about the expected costs of participating in the trial

6. Evaluation

- 6.1. Clearly, any trial is only as good as its evaluation. Ofgem proposes to carry out a substantial programme of evaluation work. Our initial view is that the objectives of this programme might encompass evaluation of:
- the consumer benefits from the take up of energy service products promoted by the suppliers
 - the additional energy savings as a result of the energy service activity
 - consumer problems arising, and how the consumer protection measures dealt with these, and
 - benefits to suppliers from the trial.
- 6.2. These multiple objectives are likely to lead to a work-programme including multiple approaches:
- regular data returns from suppliers covering issues like the number and type of contracts and measures taken up by customers
 - supplier interviews to gather information on different approaches to the market
 - customer surveys to research the effectiveness of consumer protection, and
 - before-and-after meter reads from a sample of homes.
- 6.3. Ofgem expects to carry out as much as possible of this work internally, so as to minimise costs. However, this would be done in collaboration with a steering group of interested parties.

Comments are requested on this approach, and on the key priorities for evaluation.

Appendix 1 - Regulatory Impact Assessment

Introduction

- 1.1 This appendix is Ofgem's initial regulatory impact assessment (RIA) of the proposed trial to assess customer take-up of energy services in the light of suspending the 28-day rule. If Ofgem proceeds to a licence modification, a final RIA will be presented accompanying the statutory consultation for a s11A modification to the standard gas and electricity supply licences.

Objective

- 1.2 The objective of the trial is to assess the removal of the 28-day rule as an approach to boosting suppliers' efforts to promote uptake of energy efficiency measures by domestic consumers, and assess whether alternative consumer protection measures can be as effective.

Overview of key issues

- 1.3 Some argue that energy suppliers are ideally placed to drive domestic take-up of energy efficiency measures by marketing energy services packages. The trial will help suppliers to market fixed-term contracts, so as to help suppliers finance such measures. It is not yet clear if this approach will increase take-up of energy services, or whether consumers who cannot switch energy supplier can nevertheless be adequately protected.

Options

- 1.4 Ofgem has participated in the Energy Services Working Group, which has discussed a number of approaches to boosting take-up of energy services:
- "level playing field" - which would not rely on energy suppliers to drive energy efficiency take-up. It has been noted that financial incentives to energy suppliers may make it less likely that non-suppliers will enter the energy efficiency market. This option has the attraction that it does not rely on a group of companies whose apparent incentive is to see more energy

consumed, not less. However, there has been little sign of interest in this market from prospective entrants

- “termination fees” – this option would seek to improve the attractiveness of energy services to energy suppliers by building longer-term relationships between suppliers and customers. Such relationships would be built through wider use of contracts that require customers to pay a termination fee. This option has the attraction that it could be implemented without change to the licence, and without removing any customer’s right to change suppliers. However, suppliers expect that customers would be resistant to termination fees, and the fees would be difficult to collect, and
- “non-terminable contracts” – this option involves suspending the 28 day rule for energy service contracts.

Costs and benefits of change

- 1.5 There are potential benefits to both suppliers and consumers from wider take-up of energy services packages. However, both the “termination fees” and “non-terminable contracts” options involve the creation of barriers for customers who wish to change energy suppliers, and this may act against the interests of customers who have signed such contracts.

Consumers

Benefits:

- Customers could see lower bills. Energy service packages will be expected to generate at least a 15 per cent saving in supplied energy. This might not create lower bills during the lifetime of the energy services contract, when bills would be held steady and the surplus used to pay for the energy efficiency measure. However, once the contract has come to an end the consumer will be free to ensure his or her bills reflect lower consumption. The exact relationship between saved energy and bill-reduction will depend on the household’s fuel mix. However, for the average consumer a 15 per cent reduction in energy bills would represent around £90 per participating

household⁹. The design of the trial ensures that customers will save money over the longer-term from energy service packages.

- These benefits are available to most energy customers. However, because statute currently forbids the collection through pre-payment meters (PPMs) of charges for other goods and services, it is unclear how customers with PPMs could participate in the energy services market. Should legislative change make this a possibility, Ofgem will be looking for industry proposals that ensure that these customers derive genuine benefit, taking into account that a large proportion of PPM customers will be eligible for the various subsidy schemes to help the most vulnerable customers install energy efficiency measures.
- Innovation in energy services might see the integration of previously separate measures, and the bringing of new measures to the market. It is not possible to quantify this effect, but it should not be ignored.
- These benefits arise progressively, the more effectively energy services are promoted. Suppliers have argued strongly that the “termination fees” option would not significantly increase their level of activity. This option is already open to them, but has produced relatively little activity. The “level playing field” option has not been tried (to the extent that the EEC and before it the EESoP schemes have always focused on energy suppliers). However, the ESWG’s work has not established that there are any major non-supplier players looking to enter this market. Ofgem therefore tentatively concludes that the “non-terminable contracts” option is more likely than any other to deliver the consumer benefits of energy service packages.

Costs:

- Individual customers might find themselves wishing to switch away from their energy supplier as a result of poor customer service, or if they become aware of substantially better offers. This would remain possible under the “termination fees” option (the customer would pay a termination fee that was

⁹ Given the average household gas bill of around £340 pa, and the average electricity bill around £250.
Testing consumer take-up of energy services: Trial suspension of 28 day rule

reasonably related to the supplier's costs), but not under the "non-terminable contracts" option.

- In terms of the price disadvantage that might arise from being unable to switch, customers can currently save an average of £70-£120 (depending on locality) from switching both fuels for the first time. The saving from switching away from an energy services contract might be less or more, depending on the pricing of this contract.
- The detriment to the customer of staying with a supplier with which he or she is dissatisfied is hard to estimate. Resolving customer service problems can take up an inordinate amount of customer time (especially where supplier call centres are not responsive). On any reasonable estimate of the cost of a customer's time, this detriment can therefore amount to many tens of pounds. In addition, some consumers experience disputes with energy suppliers as upsetting, a factor that is hard to quantify.
- There is also some risk that the added complexity of energy service packages will lead to consumers over-paying for the energy efficiency measure component. This risk can also be mitigated to a significant extent through trial design.
- In conclusion, we might say that for some customers there is potential for significant costs from the "termination fee" or "non-terminable contracts" options. However, most customers do not experience serious customer service problems (customer satisfaction with energy suppliers remains high) and the design of a trial has the potential to limit the down-side, through indexation of prices to prevent over-charging and, above all, through keeping the trial to a limited number of customers.

1.6 Suppliers

Costs:

- The costs incurred by suppliers from any of the three options listed above are not in themselves costs arising from regulation. Rather, they would be marketing costs that the companies had chosen to incur (and could have chosen to keep to zero by not marketing this kind of contract).

Benefits:

- Benefits would accrue to suppliers from guaranteed revenue streams that would arise under the “termination fee” or “non-terminable contracts” options. Under the latter, suppliers could be sure of a customer’s energy supply revenue for years into the future. Under the former, that revenue might be replaced by a one-off payment. However, there is some doubt about how easily and cost-effectively termination fees would be payable. Introducing large-scale debt-collection into these arrangements might not be beneficial to either consumers or suppliers.

Competition

- 1.7 Competition relies on companies believing that customers can and will switch suppliers. Both the “termination fee” or “non-terminable contracts” options reduce this willingness and ability, and to that extent have potentially negative implications for competition.
- 1.8 The prevalence of “non-switching” customers is also important for the willingness of new entrants to address the market. (This includes the willingness of ex-PES suppliers to market in one another’s incumbent areas, and of electricity companies to address the domestic gas market.) The economics of direct selling are heavily influenced by the “hit rate”, and if sales agents were to begin finding that a significant proportion of their potential targets were unable to switch, a proportion of marketing activity would become uneconomic. This impact would be even greater if customers were unable to inform sales agents that they were tied into a contract, so that suppliers would have to unpick a contractual dispute after the event.
- 1.9 These implications are of particular importance with regard to the legacy customer bases of the former monopolies, since the business case for new entrant is normally already less profitable than the incumbent’s.
- 1.10 These risks are more significant, the more customers are unwilling to switch (owing to non-terminable contracts or termination fees), and the more geographically concentrated these customers are in certain regions.

- 1.11 It is, however, possible that competition could benefit from the trial, should it be proven that a wider range of contract structures are possible, consistent with high levels of consumer protection.

Environment

- 1.12 Increasing domestic take-up of energy efficiency measures is a key plank of government energy policy. The government is committed to emissions reductions in households of around 3.5 MtC per annum by 2010 (additional beyond those envisaged in the UK Climate Change Programme), and a further 4 – 6 MtC by 2020.
- 1.13 Energy services may play a part in delivering this increase in domestic take-up of energy efficiency measures. However, as with the benefits to customers these benefits arise progressively, the more effectively energy services are promoted. The benefits to the environment will only be additional if the energy services approach leads (through market transformation) to energy efficiency measures being installed over and above EEC activity.

Security of supply

- 1.14 It is not expected that these proposals will lead to an additional improvement in security of supply, unless energy services are sold over and above EEC activity.

Distributional effects

- 1.15 Improving the energy efficiency of the homes of the fuel poor is a key objective of government policy. To the extent that suppliers target energy services on the full range of consumers, the fuel poor will benefit like others. However, energy services packages are likely to be high-value, relatively complex arrangements that will appeal only to households that are financially literate and have good credit ratings. If suppliers concentrate their marketing of energy efficiency at these households, it may result in less resources being made available to fuel poor households. In addition, fuel poor customers can get measures for free under the Warm Front programme in England and the equivalent programmes in Scotland and Wales, and can obtain assistance under the priority group proportion of EEC. It therefore seems much less likely that these customers will look to purchase measures through an energy services package.

Costs and benefits of proposed trial parameters

- 1.16 Ofgem does not yet have sufficient information about the impact of its proposed parameters to assess their costs and benefits in detail. Collecting such information is one objective of this consultation document.

Conclusion

- 1.17 Ofgem recognises that the scope for significant benefit or detriment to customers and the environment both arise from the extent of take-up of contracts covered by one of the options under discussion. The extent of the benefits of each option is proportional to the extent to which they increase the take-up of energy services packages. Ofgem therefore concludes that on the available evidence:
- the “level playing field” option is not entirely realistic, owing to the absence of non-suppliers seeking to enter the energy services market
 - the “termination fees” option is possible under the current regulatory rules, and there has been a marked supplier reluctance to take up this option, and
 - the “non-terminable contracts” option is therefore more likely to lead to wider take-up.
- 1.18 The benefits and detriments to consumers and to competition (which is itself the best protector of consumer interests) are potentially significant. The risk of detriment can be substantially mitigated, for example by keeping the trial on a limited scale until the actual effect can be better assessed, and by requiring price certainty.

Appendix 2 – Draft licence modification

Electricity Supply Licence: Standard Conditions

SLC 46

Insert:

8. The Authority may issue a direction relieving the licensee of its obligations under paragraph 1 to such extent and subject to such terms and conditions as may be specified in the direction.
9. Paragraph 8 shall cease to have effect on 1 April 2006 (the “termination date”) unless prior to the termination date the Authority issues a direction providing for the continuing effect of paragraph 8. Any direction issued by the Authority under this paragraph may be subject to such terms and conditions as the Authority considers appropriate.

[N.b. permission to object to the transfer away of customers within the trial will need to sit in electricity in the MRA, not in the licence]

Gas Supply Licence: Standard Conditions

SLC 46

Insert:

8. (d) the customer is bound by the provisions of a contract with the licensee for the supply of gas at those premises which will neither expire nor, to the knowledge of the licensee, be terminated on or before the date of the proposed transfer, and that contract is of a kind specified in a direction issued by the Authority.
11. The Authority may issue a direction relieving the licensee of its obligations under paragraph 1 to such extent and subject to such terms and conditions as may be specified in the direction.

12. Paragraphs 8(d) and 11 shall cease to have effect on 1 April 2006 (the “termination date”) unless prior to the termination date the Authority issues a direction providing for the continuing effect of paragraphs 8(d) and 11. Any direction issued by the Authority under this paragraph may be subject to such terms and conditions as the Authority considers appropriate.

Appendix 3 - Accrediting Energy Savings from the pilots: technical information

- 3.1 It is proposed that the suppliers' energy service activity in the pilots will be measured in the same format as the Energy Efficiency Commitment. This will ensure that there is a consistent approach across the two programmes and that additional administration costs to the suppliers will be minimised.
- 3.2 For the suppliers to reduce each consumer's estimated energy consumption by 15 per cent the supplier will need to know the household energy consumption and the energy savings made by each of the measures installed in the house. Suppliers cannot be expected to do a detailed monitoring of the energy consumption by each household, primarily because most households do not have accurate billing data. However, Ofgem has an array of energy savings already calculated for the main measures that suppliers use in their EEC schemes and it is intended to use these for the energy service pilots. These figures are derived from standard occupancy patterns and usage patterns for the main energy saving measures in a home. Total household energy consumption will be based on the same standard occupancy and usage patterns and calculated using the same models.
- 3.3 The energy savings for each of the standard measures come from a variety of sources. The energy savings from insulation and heating measures are taken from BREDEM. The assumptions used to calculate the energy saving values are summarised in the Appendix of Ofgem's 'Energy Efficiency Commitment 2002-2005 Technical Guidance Manual', http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/125_oct2002.pdf. The energy savings for appliances and lighting have been derived by the EST. The savings for appliances are based on the difference in the energy consumption between the installed unit compared to the market average unit. Energy savings for the installation of different CFL wattages are based on the difference between the energy consumption of the CFL and the GLS equivalent.
- 3.4 It should be noted that suppliers will not be able to claim the uplift for appliance schemes nor the uplift for EEC energy service activity in their energy service pilots in calculating the 15 per cent.

3.5 Because saving a unit of the different forms of fossil fuels and electricity has a different impact on the environment, in terms of carbon mitigated, it is intended to use the same system used in the EEC to standardise the energy savings from each of the measures. The coefficients used in the EEC are:

Electricity	0.8
Coal	0.56
Oil	0.46
LPG	0.43
Gas	0.35

3.6 The estimate for total household energy consumption will be multiplied by the relevant coefficients in the table above and then summed. The energy saving from BREDEM of the measures the supplier proposes to install based on the survey of the house will also be multiplied by these coefficients and summed. If the value of the sum of the standardised energy savings is at least 15 per cent of the standardised household energy consumption then the offering would qualify for the trial.

3.7 It is important to note that both the household consumption and the energy saving data will change for EEC 2. However, the changes are likely to be consistent across the insulation measures and the householder's energy demand (as this will result from a change to the average boiler efficiency used in the calculations). It is also worth noting that the energy saving suppliers will be accredited with for boilers will change significantly in the change from EEC 1 to EEC 2. This will result from a change to the Building Regulations.

Appendix 4 Energy Efficiency Assessment Questionnaire

A. CUSTOMER DETAILS

A1. Title: Mr Mrs Ms Miss
Other

A2. First Name / Initial:

A3. Surname:

A4. Address:

A5. Postcode:

A6. Contact tel. no:

● **A7. In what year was your house built? (Mark one.)**

Before 1900	<input type="checkbox"/>	1966 – 1975	<input type="checkbox"/>
1900 – 1918	<input type="checkbox"/>	1976	<input type="checkbox"/>
1919 – 1929	<input type="checkbox"/>	1977 – 1980	<input type="checkbox"/>
1930 – 1944	<input type="checkbox"/>	1981	<input type="checkbox"/>
1945 – 1949	<input type="checkbox"/>	1982 – 1990	<input type="checkbox"/>
1950 – 1964	<input type="checkbox"/>	1991 – 1995	<input type="checkbox"/>
1965	<input type="checkbox"/>	1996 or later	<input type="checkbox"/>

● **A8. Property type? (Mark one.)**

Detached	<input type="checkbox"/>	Mid terrace with passage	<input type="checkbox"/>
Semi-detached	<input type="checkbox"/>	Top floor flat	<input type="checkbox"/>
End terrace	<input type="checkbox"/>	Middle floor flat	<input type="checkbox"/>
Mid terrace	<input type="checkbox"/>	Ground floor flat	<input type="checkbox"/>

● **A9. Do you own your home or do you rent?**

Own / buying on mortgage
Renting from council
Renting from housing association
Renting privately
Tied house / other

B. PROPERTY DETAILS

IF YOU LIVE IN A FLAT

B1a. What type of building is it in?

Tower block (six or more storeys)
Custom block (five or less storeys)
Above shop or office
Divided house

B1b. Is there a roof directly above your flat?

Yes, sloping (pitched)
Yes, flat
Yes, part sloping (pitched) and part flat
Only part of the flat has a roof
No

FOR ALL TYPES OF HOME

● **B2. Does your home have a loft?**

Yes No

B3. If yes, is there a heated room that's in regular use within the loft?

Yes No

B4. How many floors does your home / flat have? (Excluding loft rooms or cellars.)

One (e.g. bungalow)	<input type="checkbox"/>	Four	<input type="checkbox"/>
Two	<input type="checkbox"/>	Five	<input type="checkbox"/>
Three	<input type="checkbox"/>	More	<input type="checkbox"/>

B5. How many bedrooms do you have?

One	<input type="checkbox"/>	Three	<input type="checkbox"/>	Five	<input type="checkbox"/>
Two	<input type="checkbox"/>	Four	<input type="checkbox"/>	Six	<input type="checkbox"/>
				More	<input type="checkbox"/>

B6. How many living or dining rooms do you have? (Include study / playrooms etc.)

None	<input type="checkbox"/>	Two	<input type="checkbox"/>	Four	<input type="checkbox"/>
One	<input type="checkbox"/>	Three	<input type="checkbox"/>	More	<input type="checkbox"/>

B7. Is your building listed or in a conservation area?*

Yes, listed Yes, conservation area
No

C. INSULATION DETAILS

● **C1. How much loft insulation do you have?***

(If this is going to prove difficult, please take an educated guess. You can use the ruler provided to help you visualise the depth of insulation.)

None	<input type="checkbox"/>	150mm (6 inches)	<input type="checkbox"/>
25mm (1 inch)	<input type="checkbox"/>	200mm (8 inches)	<input type="checkbox"/>
50mm (2 inches)	<input type="checkbox"/>	No Loft	<input type="checkbox"/>
75mm (3 inches)	<input type="checkbox"/>	Don't know	<input type="checkbox"/>
100mm (4 inches)	<input type="checkbox"/>		

C2. Does your loft have any flooring?*

Yes No

● C3. What type of outside walls do you have?*

- Solid brick
- Solid concrete
- Solid stone
- Cavity – insulated
- Cavity – uninsulated
- Mixed
- Modern timber framed
- Don't know

C4. Which type of windows do you have?

- All single glazed
- Some double or secondary glazed
- Most double or secondary glazed
- All double or secondary glazed

● C5. Is there any draught proofing on windows and external doors? (Assume sealed double glazed windows to be draught proofed.)

- None draught proofed
- Some draught proofed
- Most draught proofed
- All draught proofed

D. HEATING AND HOT WATER

● D1. What is your main heating system?

- Boiler and radiators
- Electric storage heaters
- Warm air system
- Room heaters or fires
- Other

● D2. What is your main heating fuel?

- Mains gas Solid fuel
- Electricity Bottled gas
- Oil L.P.G. (bulk)

D3. Do you have a separate fire that you use regularly?

- Yes, electric No
- Yes, solid fuel Yes, gas

● D4. What heating controls do you have?*

(Mark all that apply.)

- None
- Programmer / timer
- Room thermostat
- Thermostatic radiator valves
- Storage heater dials

● D5. If you have a boiler, how old is it?

- Less than five years old
- Five to ten years old
- Eleven to fifteen years old
- Over fifteen years old

D6. Which of your radiators have foil behind them?*

- None All Some

D7. Do you have a condensing boiler?*

(If you are not sure, please mark 'no'.)

- Yes No

● D8. How is your hot water usually provided?*

- From central heating system
- Gas instantaneous / combi boiler
- Electric instantaneous
- Electric immersion (on peak)
- Electric immersion (off peak)
- Dual electric immersion
- Gas, oil or coal range (e.g. AGA-Rayburn)
- Back boiler
- Other

D9. How would you describe your hot water tank insulation?

- No tank
- Solid foam insulation
- Jacket (no gaps around jacket)
- Jacket (with gaps around jacket)
- No insulation

D10. If you have a hot water tank, is there insulation on the pipes between the boiler and the tank?

- Yes Can't see pipes
- No Don't know