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

Dear Iain

RWE Innogy was happy to contribute to the work of the Energy Services Working Group (ESWG). The Group usefully brought together the industry and its stakeholders and the ESWG Final Report indicates the value of the exercise.

Unfortunately much of the progress achieved by ESWG is at risk if Ofgem's avowed scepticism, reflected in many areas of this consultative document, is allowed to constrain and devalue the proposed pilot.

The constraints that Ofgem are seeking to impose through this consultation will significantly dilute the value of the pilot and will tell us little about the future potential for energy services packages (ESP). As a contributing supplier with ESWG, we were aware that certain provisions would need to be included within the framework for piloting energy services to ensure consumer interests were safeguarded. However, those proposed within this consultation exceed the ESWG recommendations and go beyond what should be necessary.

These requirements and those associated with the evaluation and monitoring exercise will significantly increase costs to suppliers and may reduce involvement. We have undertaken some initial work on the impact of these proposals and feel that the key areas that will limit or restrict the success of the pilot are:

(a) a minimum savings requirement of 15%

- to achieve a 15% reduction in energy usage and without overly complicating the proposition, a supplier will need to offer cavity wall or (virgin) loft insulation as a basic element of its ESP;
- these insulation products are available at a subsidised price under EEC, which merely militates against energy services further;

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(b) a limit on up-front deposits of 1/3rd of the initial cost

- maximum up-front contributions for these insulation schemes will range between £80 to £100, thus requiring finance packages on between £170 - £200 over the contract life;

(c) a 2-year pilot with maximum contract lengths of 5 years.

- the contract life will determine customers' expectations of payback periods and after application of finance charges and discounting future benefits, no insulation programme has a payback period of 5 years or less.

Moreover, the limited pilot term will also reduce suppliers' willingness to invest in system changes to support the pilot and its requirements – including Ofgem's extensive information requirements. We are currently working up our estimates of these costs and we will be forwarding them to you as soon as possible.

In the meantime the following table¹ indicates the relative unattractiveness of most individual measures – using existing energy efficiency measures by way of an example. Only three measures offer payback within Ofgem's maximum contract life of 5 years whilst two further measures payback within 10 years. Combining these within an ESP will not materially improve the position and it is not possible to put together a qualifying package that does not consist of cavity wall and virgin loft insulation that offers a sensible payback period to the customer. Just as EEC2 looks set to become predominantly an insulation programme, so Ofgem are proposing to impose similar restrictions upon ESPs.

Energy Saving Measure	Financial Savings (£ pa)	% reduction on total consumption	Current typical cost (£)	Typical Payback (yrs)
Cavity Wall (pre '76)	94	20.3%	305	5
Cavity Wall (post '76)	58	12.5%	305	10
Loft insulation 250mm ²	96	20.9%	247	4
Loft insulation 200mm	23	5.0%	221	payback not during the lifetime of the measure
Loft insulation 150mm	10	2.3%	193	payback not during the lifetime of the measure
Hot water jackets ³	11	2.4%	15	2
6 CFLs	3	0.3%	36	8
A rated fridgefreezer (trade-in)	35	3.7%	275	payback not during the lifetime of the measure

We find the consultation overly protective of consumers with little evidence that this is required. Ideally the pilot should see what emerges before taking action, not fearing the worst and therefore reducing flexibility and initiative from the outset.

We have addressed your specific questions in the attachment and we will forward our costings under separate cover. In the meantime, I hope you will reconsider many of the

¹ Using a 9% discount rate and interest charge

² BRE figures for 2000 (e.g. pre EESoP3 & EEC) indicate less than 1 million virgin lofts are left to insulate.

³ BRE figures for 2000 (e.g. pre EESoP3 & EEC) indicate less than 1 million hot water tanks are jacket-less.

consultation proposals in the light of my comments above and within the attachment.

I hope you will not hesitate to call if there are any aspects of this response that you would like to discuss with me.

Yours sincerely

Laurence Poel
Head of Economic Regulation

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

Responses to Ofgem's specific questions

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.

- We welcome Ofgem's proposal to conduct a trial suspension of the 28 day rule.
- We believe a suspension of the 28 day rule for energy services would increase sales of ESPs and so save consumers money and arguably it is this that the trial should be established to verify. Whilst we also believe that adequate consumer protection can be assured by use of licence conditions and regulatory intervention when customers have lost (temporarily) the right to switch suppliers this objective does not feature in ESWG's Final Report.

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

- The proposed grant of a derogation from the relevant conditions by Ofgem seems an appropriate approach to setting up the trial. We may have commented more fully had the consultation document included a draft of Ofgem's proposed direction.

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.

- At the outset we do not believe the trial will provide information relevant to community energy schemes and prepayment meter customers. We do not consider that these areas are critically affected by those rules that are being relaxed within this pilot. We will consider the impact of the proposed Energy Bill changes (recovery of other than energy-related debt through prepayment meters) when the proposal has been drafted, debated and adopted.

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

- For the trial period these levels seem acceptable but it would seem sensible to allow for the possibility of variation in the event that customer take-up is more positive.
- However, the consultation document is unclear as to how Ofgem will police these limits. For instance, we are intending to process all energy services contracts through a single licensed entity on the assumption that the limit will be applied corporately. Setting up separate systems for each licensee will add to the costs of the 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% 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 1/3^d of the total cost to be paid up-front by the householder.
- We believe the ESWG's definition of energy services provides a more appropriate starting point (Annex 3 of the Final Report) although this recognises that "considerable work remains to be done to turn ...[this] into a legal definition". ESWG defined energy services as:

- advice on energy saving opportunities tailored to the customer's dwelling
 - installing energy saving measures such that there are reasonable expectations of a reduction in energy consumption and/or increased comfort
 - customer choice as to how they pay for the measures "for example, ranging from taking out a loan from the energy supplier to paying cash themselves".
- Ofgem's proposals are significantly more restrictive. The personalised energy efficiency audit that assesses the efficiency of the heating system, the efficiency of insulation, the performance of appliances and the lighting of the household so as to outline the energy saving opportunities of that household is significantly more than the advice ESWG sought.
 - Given that the pilot is just that it seems surprising that Ofgem should seek to make mandatory the terms of the Energy Efficiency Partnership for Homes Code of Practice for Energy Efficiency Providers. Moreover, Ofgem should know that most suppliers have already voluntarily signed onto this. However, the treatment of energy services sales activities is surely a consideration after the pilot and when a more permanent relaxation of the 28 day rule may be being considered.
 - Ofgem's proposed 15% threshold requirement for required savings will effectively exclude any relatively modern house or those houses where a reasonable level of energy efficiency work has been undertaken. Again, Ofgem's concern that suppliers will immediately begin cherry-picking seems to pre-judge the position and is overly protective from the outset.
 - We believe it is unreasonable to expect suppliers to "be able to demonstrate on request that it has in place procedures to verify that each customer is in fact saving money." The costs incurred to fulfil this requirement will be prohibitive and again exceed the requirements outlined by ESWG. It should be sufficient to provide a breakdown of the estimated savings at the outset of the ESP, knowing that this is likely to be subject to a second opinion. The "ex ante only" approach avoids the need for suppliers to assess changes to the property, in consumer behaviour or enhancements to comfort levels that might otherwise obscure the savings that energy services have generated.
 - Customers' discount rates (to assess whether customers save money as a result of the package) will probably reflect their opportunity costs for finance.

5.10 *Comments are requested on the proposed duration.*

- Ofgem's proposal to allow contracts of up to five years is to be welcomed. However, the length of the contract is likely to influence the customer's expectation of the relevant payback period. Coupling this expectation with the 15% target for required savings and the 30% cap on a customer's capital contribution may limit suppliers' offers further.

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.*

- We would have preferred to have been able to offer bundled charges but, in line with ESWG, accept the option to offer fixed, capped or indexed prices. We would prefer to avoid a lagging index but clarity is probably the main consideration.

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

- We broadly agree with the consultation document's requirements for a written quotation. ESPs would typically quote expected savings based on data from EEC assumptions etc. It would be better to provide stylised consumption assumptions rather than specific estimates.
- We note that ESWG's Final Report merely sought access to an independent second opinion. Ofgem indicate that suppliers should make this available with no up-front cost although conceding that "the cost may be rolled into the overall package". Again, Ofgem seem to have increased the burden upon suppliers unilaterally and we do not agree with this proposal.
- Ofgem use EACs as an example of the suggested source for this second opinion although many are funded by suppliers.

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

- We agree with Ofgem's conclusions that existing consumer protection provisions offer sufficient 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.*

- We believe it is reasonable for suppliers (and consumers) to accept normal commercial risks on energy services contracts. We believe that it is acceptable to allow for the premature termination of energy services contracts because of change of tenancy (however, see the comments below relating paragraph 5.21) and when contracts do not comply with the terms of the supply licence.

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

- We agree with Ofgem that product guarantees could reasonably be left to competitive forces. Such additions to a basic energy services contract are a means of differentiation between suppliers.

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

- It is appropriate to include a relatively comprehensive reporting process as part of the pilot, but Ofgem should not expect unduly complicated or expensive system development merely to service this requirement.
- Ofgem should explain more fully why they require a regular, board-level approved statement of compliance from suppliers.

5.19 *Should the objections process be widened to cover ESP contracts?*

- We agree that the use of the objections process should be extended to cover instances where a customer has signed a non-terminable contract. Enforcing the terms and conditions of the contract through traditional legal means is uneconomic.

5.20 *Should the new supplier be told the reason for the objection?*

- This is a moot point. On the one hand, this might be helpful to prevent the new supplier from continuing attempts to register the customer. Against this, however, is that for other objection reasons, for example, debt, new suppliers are not told, not least because such information is personal data under the Data Protection Act and disclosure without the data subject's consent therefore creates an offence. In addition, there may be costs in implementing and operating two types of objections process in parallel: one where new suppliers are told of the reason; the other where they are not. On balance, leaving the customer to tell the new supplier the reason for the objection may be the best way forward.

5.21 *What to do about change of tenancy?*

- ESP contracts would require terms and conditions to cover this type of eventuality to ensure that the cost of the energy efficiency measures could be recovered. In addition based on our knowledge of homemover processes, it is the case that we will often not be informed that an ESP customer has moved out, with the consequences, including:
 - sending bills which include ESP repayments to the property after the ESP customer has left; and
 - not being able to follow up ESP accounts, because by the time we know a move has occurred we can no longer track down the customer.There is, of course, a likelihood that ESP customers will have a higher rate of homemoving than standard (as they may improve a property and then move on, making a profit on their investment). It maybe that the industry has to agree with OFGEM some specific debt follow-up processes for ESP customers who move house, which may need to be more stringent than current arrangements.

5.22 *Ofgem would be interested to establish 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.*

- Who would create and keep such a list up to date? How often would it need to be updated? From a supplier perspective, it would be resource intensive to ensure that all its sales channels were made aware of the latest version of such a list. Unless these issues are addressed, the approach would have limited value. In addition, if such a list was created, would it be used in conjunction with, or as an alternative to, the objections process? On the face of it, the two approaches appear mutually exclusive.
- We believe that if the national list approach is to be taken forward it might usefully be considered within the Customer Transfer Programme. This work completes its Stage 1 review in March and that might prove to be an appropriate opportunity to discuss whether a national list is something that could be accommodated within the planned work for Stages 2 & 3.

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

- We are currently working up our estimates of these costs and we will be forwarding them to you as soon as possible.

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

- This pilot should provide indications of how ESPs and supplier-customer long-term relationships may evolve. To that extent, evaluation should not seek to provide a precise or overly-pedantic analysis of what is a two-year pilot of broadly existing energy efficiency products within a relatively tightly defined framework.
- We believe that a successful energy services market will be radically different from that seen within this pilot. Therefore, significant effort expended now on evaluating this pilot will be of little longer-term benefit.

Appendix 1 - comments on the draft RIA are requested.

- It is helpful that the RIA concludes that the proposed trial of the suspension of the 28 day rule best serves encouraging customer take-up of energy service packages even if this is not Ofgem's preferred option. The "level playing field" approach looks unsupportable, not least because there is nothing in arrangements as things presently stand that have attracted non-energy supply companies to provide an ESP. The same can be said of a wider use of termination fees through arrangements already allowed for by licence. Given that these latter two approaches are not being tested by the trial, it would seem sensible for less emphasis to be given to the costs and benefits of either in the RIA.
- Regarding the benefits of the trial scheme to ppm customers. While Government has apparently accepted an amendment to the Energy Bill, the effect of which is a relaxation of the existing ppm provisions which will allow non-supply debts to be collected through such meters, it is not clear when this will become law. To try and factor something to address this level of uncertainty into the trial in a meaningful way will prove extremely difficult.
- For non-terminable contracts, where there is suspicion that customers may end up paying higher prices than would otherwise be the case if they were subject to the 28-day rule, this is conjecture and speculative. We accept that the pricing and structure of the contract is important in this respect.
- In terms of competition, the RIA implies that the impact of non-terminable contracts could inhibit its positive benefits. We believe this is a pessimistic view, and that with the trial parameters being so tightly defined, those customers who choose to forfeit their right to switch will make that decision fully in the knowledge that they will accrue benefits. This will of course depend on the clarity of the proposition put before them.

- The trial will be important to assess more financially able customers' willingness to take up energy efficiency measures. The trial should, where possible, be considered completely separately from those programmes primarily aimed at the fuel poor. The assertion that the former may divert resources from the latter is again a speculative one.

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

- The proposed grant of a derogation from the relevant conditions by Ofgem seems an appropriate approach to setting up the trial. We may have commented more fully had the consultation document included a draft of Ofgem's proposed direction.