Consultation on practices concerning Fixed Term Offers in the domestic retail energy market

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Overview:

This consultation considers suppliers' communication with customers on Fixed Term Offers, and the practice of automatic contract rollover in the domestic retail energy market. We note our concerns related to these practices, set out options to address issues identified and seek views on our preliminary recommendations.

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Context

Ofgem's principal objective is to protect the interests of existing and future energy consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems.

This consultation seeks views on our assessment of the use of Fixed Term Offers in the domestic supply market. We received information suggesting this practice was causing consumer harm. As a result we issued an information request in March 2010 to all suppliers regarding their practices for Fixed Term Offers. This consultation discusses our findings and recommends regulatory action to address our concerns.

Associated Documents

- Energy Supply Probe:
  - Energy Supply Markets Probe – Call for Evidence (30/08), 27th March 2008
  - Energy Supply Probe - Initial Findings Report (140/08), 6th October 2008
  - Proposed Retail Market Remedies- (99/09), 7th August 2009

  The 3 documents above can be found via the Ofgem website at: http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx

- Open Letter: Automatic contract rollovers in the domestic retail markets – 31st March 2010
  http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=103&refer=Markets/RetMkts/Compet

- Consultation on proposals for amending Standard Licence Condition 23 - (127/10), 1st October 2010
  http://www.ofgem.gov.uk/Markets/RetMkts/Compl/pricechange/Pages/Noticeofpricechanges.aspx

- Ofgem's review of the effectiveness of the retail energy market – press release R/18, 26th November 2011
  http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Retail%20Market%2026%20November.pdf&refer=Media/PressRel

- Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs)
  http://www.legislation.gov.uk/uksi/1999/2083/contents/made

- Consumer Protection from Unfair Trading Regulations 2008 (CPRs)
  http://www.legislation.gov.uk/ukdsi/2008/9780110811574/contents

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Summary

As part of our Energy Supply Probe in 2008 we looked at how suppliers deal with Fixed Term Offers in the non-domestic market, including where automatic contract rollovers occur. We subsequently introduced remedies to change requirements relating to Fixed Term Offers and automatic contract rollover for micro business consumers. When these measures were introduced for micro business consumers, Fixed Term Offers and automatic rollover were not as prevalent in the domestic supply market. However, concerns raised since then have led us to look at whether domestic consumer protection is necessary in this area.

The Issue

We are concerned that suppliers are not being fully transparent when communicating details of Fixed Term Offers with domestic consumers. This includes any automatic contract rollover terms that may apply. An automatic contract rollover term generally gives suppliers the ability to extend the duration of a Fixed Term Period of a contract, or apply a new Fixed Term Period in respect of the duration of a contract. For example, when a fixed term pricing period expires, the customer may automatically become subject to new pricing arrangements for a new period of a fixed duration.

In particular, we are concerned consumers are not being made fully aware of what will happen at the end of a Fixed Term Offer, both at point of sale and nearing the end of their contract. This includes details of:

- fees that may apply in the event of early contract termination;
- any automatic contract rollover terms associated with a tariff; and
- offers available to a consumer following a Fixed Term Period.

Regulatory Proposals

We set out four regulatory options that could be adopted either individually or in combination to address the concerns we identified:

1. **Continue to use current arrangements.** To rely on existing rules, with Ofgem taking no specific action to amend rules concerning communications with consumers on Fixed Term Offers or address issues relating to automatic contract rollovers. We would continue to closely monitor the practice of automatic contract rollovers and if necessary, review the arrangements in the future. We also note that, potentially, this may be supplemented by other new rules we are considering in relation to notification of unilateral contract variation under standard licence condition 23. This option would not rule out enforcement action, if appropriate.

2. **Draw on existing rules and issue guidance.** To continue to draw on the existing rules, such as licence conditions and provisions of consumer protection law ('relevant rules'). Under this option we would provide guidance, or clarification to suppliers, regarding how relevant rules should

apply with respect to the provision of information on Fixed Term Offers and the practice of automatic contract rollovers for domestic consumers. As with option 1, this would not preclude us taking enforcement action where appropriate.

3. **New rules to increase transparency and promote consumer engagement.** To modify existing standard licence conditions or create new licence conditions to address concerns about the content of information received by consumers about their Fixed Term Offers and the practice of automatic contract rollovers. This would not preclude Ofgem from also drawing on existing rules where appropriate.

4. **New rules to limit suppliers' ability to automatically roll over a Fixed Term Offer.** To effectively prohibit the practice of automatic contract rollover in the domestic market by limiting the circumstances in which a supplier can charge termination fees to consumers who have been automatically rolled over. A consumer whose contract has been automatically rolled over would then be free to switch without being subject to a termination fee.

Based on the impact assessment of these options, set out in Appendix 6, our preliminary recommendation is to implement both option 2 and option 3. We will consider any remedies in light of views expressed through this consultation process and in the context of our work in the Retail Market Review.

1. Background

Chapter Summary

Ofgem has growing concerns around the transparency of tariff information with regard to Fixed Term Offers, which have become more prevalent in the domestic market over the last year. In March 2010 we issued a request for information in order to improve our understanding of the information provided to consumers on Fixed Term Offers. Following this, we have issued this consultation to discuss our findings, our concerns and our proposed regulatory options. This chapter outlines how our concerns around transparency of tariff marketing have arisen and how this relates to Fixed Term Offers.

Monitoring of retail energy markets

1.1. Through our work on the Energy Supply Probe in 2008[1] and subsequent monitoring efforts we identified areas of concern in the retail energy market, including the availability and transparency of information relating to energy products, and the ability of consumers to make well informed decisions.

1.2. We then introduced a range of new licence conditions and modifications to promote competition and protect consumers, which came into force in 2009 and 2010. In particular, the following licence modifications were implemented to improve transparency when suppliers engage with domestic consumers:

- Standard Licence Condition (SLC) 31A requires suppliers to provide consumers with an annual statement. This statement must contain information on the consumers' energy consumption over the previous 12 months, the consumers' current tariff and explain where consumers can obtain impartial information about switching tariff.

- Standard Licence Condition (SLC) 25: Marketing to domestic gas and electricity consumers. The objective of SLC 25 (marketing objective) aims, among other things, to improve consumers' ability to make well informed decisions about energy offers in response to telephone and face-to-face sales activities undertaken by suppliers.

- Standard Licence Condition (SLC) 23: Notification of Domestic Supply Terms. This rule requires suppliers to take all reasonable steps before a

[1] Energy Supply Probe
http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Pages/Energysupplyprobe.aspx

contract is entered into to make consumers aware of the principal terms of a contract and give individual customers written notice of unilateral contract variations.

1.3. In addition to these new requirements we introduced overarching standards of conduct. They set out our expectations that suppliers should treat consumers fairly and communicate key messages clearly. Ofgem has regard to these standards when considering its priorities for investigating potential licence breaches and when considering consumer detriment in the context of investigations.

1.4. We continually monitor markets and are currently undertaking a review of the retail energy markets, including an assessment of the progress companies have made implementing Probe reforms. This review will also include an assessment of the current state of the effectiveness of the retail market and our report on the retail and wholesale prices. We aim to publish that work in March of this year.

1.5. As part of the Energy Supply Probe, restrictions were placed on the practice of automatically rolling over Fixed Term Offers to a subsequent Fixed Term Offers with micro business customers in non-domestic energy markets. This action sought to promote clarity and provide additional consumer protection around this practice for micro business consumers. The proposed recommendations outlined in option 3 of this consultation, to introduce new rules to increase transparency and promote consumer engagement, are similar to those introduced for micro business consumers in the non-domestic market. However, there are more underlying consumer protections in place for domestic consumers compared to the non-domestic consumer. Therefore, in the domestic market we have a greater scope to build on, or modify, existing rules.

1.6. After the introduction of new rules following the Energy Supply Probe, concerns have arisen regarding the extent to which domestic consumers are being provided adequate information to understand the terms they will face after a Fixed Term Offer comes to an end. Fixed Term Offers can provide consumers various product features for a predetermined period of time. Such product features may include, but are not limited to:

- a energy price that is fixed for a set amount of time, or for the duration of the Fixed Term Period;

- a cap on energy prices, where unit rates are prevented from rising above a set level; and/or

- a tracker energy price, where unit rates remain a set percentage below a variable benchmark. For instance, currently one supplier offers an energy tariff which guarantees the energy rates will remain a set percentage rate below their standard energy tariff prices.

1.7. Broadly, these offers are fixed between a 12 and 24 month timeframe and consumers can incur a termination fee if they withdraw from the tariff before the end of the agreed period. For the purposes of this consultation, contracts with a rolling component covering a very short time period (e.g. 28 days) are not considered to have a "fixed term" component.

1.8. Based on information we have seen as well as feedback from consumer groups and others, we have concerns regarding the clarity and transparency of information provided to consumers both at point of sale and towards the end of a contracted Fixed Term Period. This can lead directly to consumer detriment as it can make it more difficult for consumers to make the optimum choice regarding their energy procurement. Also, if consumers are not able to engage effectively with the market this can distort market information about both pricing and consumer preferences.

1.9. An automatic contract rollover occurs when a consumer at the end of a Fixed Term Offer is moved by their supplier to another product offering, without the consumer making an active choice. Often, the new product offering is a subsequent Fixed Term Offer.

1.10. Until recently the use of Fixed Term Offers and automatic contract rollover was not common in the domestic energy markets. However, it has recently become more prevalent. We have received anecdotal evidence, and consumer complaints, suggesting the use of contract rollovers in the domestic market is causing consumer detriment.

1.11. As a result of the issues discussed above, in March 2010 we wrote to suppliers stating that we expect them to have robust practices regarding the process of automatic contract rollover[2]. This letter also included a request for information to all suppliers regarding their current practices relating to domestic automatic contract rollover.

1.12. This consultation discusses our findings and recommends regulatory action to address our concerns. For the purposes of this consultation we are only examining practices in the domestic energy markets. However, responses to this consultation will inform our wider approach where appropriate. We are seeking views on the options discussed in this document, our preliminary recommendations, the draft impact assessment and draft changes to the gas and electricity supply licence by 7 March 2011.

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[2] Open Letter: Automatic contract rollovers in the domestic retail markets, 31st March 2010. This can be accessed via the Ofgem website by the following link: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=103&refer=Markets/RetMkts/Compet

2. Current practice: Fixed Term Offers in the domestic retail market

Chapter Summary

This chapter assesses the current practice for domestic Fixed Term Offers, including the use of automatic contract rollover provisions. The information provided by suppliers and our desk research shows practices can vary significantly between suppliers, and between suppliers' own product offerings. This section describes the range of suppliers' practices for Fixed Term Offers at point of sale, nearing the end of the contract, and their application of any termination fees.

Question 1: Have we outlined in this Chapter the full array of suppliers' practices in respect of Fixed Term Offers?

2.1. This section draws on our own monitoring of the domestic market and information received from suppliers to assess the current practice for automatic contract rollovers in the domestic energy market.

2.2. Information provided by suppliers to consumers on Fixed Term Offers reveals a wide range of practices in relation to both the details provided at various points in the initial Fixed Term Period and the use of automatic contract rollover provisions. Procedures for providing information to consumers, methods of consumer engagement and timescales for consumer contact all vary. This chapter details suppliers' current practices concerning Fixed Term Offers and automatic contract rollover provisions. The details below are largely based on information Ofgem received from domestic suppliers as a result of the request for information sent out in March 2010. Additional information was acquired by our own research, or has come from contact with consumers and consumer bodies.

Provision of information at point of sale

2.3. This section describes the current practice at point of sale for Fixed Term Offers, including contracts that include an automatic contract rollover provision. Suppliers use a range of sales channels. These include, but are not limited to:

- field sales agents (e.g. door-to-door sales people);
- third parties, such as switching sites;
- inbound or outbound calls;
- supplier websites; and

- direct mail.

2.4. Prior to entering into a contract with a domestic customer suppliers must take all reasonable steps to bring the principal terms of the contract to the customer's attention[3]. This is intended to ensure consumers are aware of relevant features and service options to help inform their choice. This information may be provided verbally or in writing. When considering moving to a new energy product it is important consumers receive accurate, clear information to facilitate their understanding of products and promote engagement with the market.

2.5. Overall, the clarity and transparency of information about a consumer's Fixed Term Offer, including details about automatic contract rollover provisions varies. It is important to note that not all suppliers offer an automatic contract rollover feature and only some Fixed Term Offers contain this provision. However, when a fixed term tariff expires there are a range of products consumers may be transferred to at the end of a fixed term arrangement. Our analysis shows that practices differ from supplier to supplier, but we also found that the same supplier may have different practices for different product offerings.

2.6. At point of sale not all suppliers clearly stated all distinguishing tariff features, such as termination fees, the nature of any subsequent "default" offer or automatic contract rollover terms. For example, our analysis showed the following practice:

- When communicating key product futures at point of sale, two of the Big 6 suppliers provided details of termination fees and arrangements at the end of the Fixed Term Period. The remaining suppliers either did not provide this information in the principal features or did not communicate all the information clearly.

- In their marketing materials, several suppliers provided details of termination fees, but did not outline what would happen to customers at the end of their Fixed Term Offer. Other suppliers did provide all relevant information in their marketing materials. However, it was in small print within the terms and conditions.

2.7. A further information source for consumers, which we would generally expect suppliers to provide at the beginning of a contract, is the details of the full terms and conditions of an offer. These detail the rights and obligations of

[3] SLC 23.1. Also, note that addition obligations to provide contractual information to consumers are provided for in other licence conditions and consumer protection law.

both the supplier and the consumer. They can be provided online through supplier websites and are sent to consumers when they sign up for a new tariff.

2.8. Where details of the end of the contract and termination fees were outlined in the terms and conditions, it was often not clear what terms a customer would face at the end of their fixed period or if that agreement was subject to an automatic rollover provision. For instance:

- Some suppliers located information about the end of contract and termination fees prominently in the terms and conditions, and used clear and transparent language to communicate these points. With other suppliers, it was not clear what terms a consumer could expect to face at the end of their Fixed Term Offer.

- For three of the Big 6 suppliers, the terms and conditions of customers' current Fixed Term Offer were difficult to locate online. Similarly, details differentiating tariff features, such as information regarding termination fees and end of contract arrangements, were challenging to locate within the terms and conditions.

- Only one supplier stated that consumers could be placed on another fixed or price protection tariff at the end of their current offer within both their marketing materials and the tariff terms and conditions. Marketing material or terms and conditions for the remaining suppliers stated customers would be transferred to the closest equivalent or most appropriate offer, but did not specify the characteristics of that offer.

Notification of the end of fixed term and automatic rollover

2.9. Consumer engagement is an important aspect of any competitive market. It can place competitive pressure on suppliers through consumer switching (or the threat of switching) and may also encourage suppliers to be more responsive to consumer needs. The marketing activities discussed above offer a way for suppliers to engage with consumers in the domestic market. Offers that may include the possibility of automatic contract rollover onto subsequent fixed period, or onto another product, are more complex than standard contracts. It is therefore, particularly important that suppliers ensure consumers have access to the information needed to understand these deals so that consumers are able to easily engage with process.

2.10. Suppliers typically send direct mailings to engage with consumers who are currently on a Fixed Term Offer that has either expired or is close to the expiry date. Direct mailing can be a central stage of the consumer engagement process both for suppliers and the consumers. For the suppliers it enables them to build a relationship with the consumer and develop branding. For the consumer, such communication provides both information and an opportunity to make a decision about their energy product options. It is important that consumers have sufficient time to consider any offering provided, and contemplate alternative options available to them.

2.11. Based on the evidence we gathered, all suppliers used direct mailing to engage consumers on Fixed Term Offers toward the end of a fixed period. Typically these letters set out what offer a consumer will be moved onto if they take no action, or what other options may be available to a customer. However, the content and frequency of this correspondence varies between suppliers, and can also vary between offers.

2.12. We also found that not all suppliers operate automatic contract rollovers, a small proportion of suppliers require positive assent from consumers before the consumer can be transferred to a subsequent fixed term, or some other, offer:

- The majority of suppliers practice an "opt-out" approach for automatic contract rollovers. This method requires consumer participation only if they do not wish to be rolled on to another, often fixed term, offer. The absence of any consumer engagement is taken as tacit acceptance of the subsequent product offering.

- Two suppliers operate an "opt-in" approach, whereby consumers are only rolled onto another fixed or capped product if they engage with the supplier and request, or agree to, the new deal, otherwise they revert to a standard (evergreen) tariff when the current contract ends.

2.13. Some suppliers' direct mailings encouraged greater levels of consumer engagement than others. Similarly, the timing of communication allows greater or lesser time to consider their options and switch offer, or supplier, if they wish to do so.

- The majority of the Big 6 suppliers used two direct mailings to communicate with consumers. Typically the first letter would be a reminder that the energy tariff was due to end, noting arrangements at the end of the Fixed Term Period. The second correspondence provides details of the new tariff, and information about how the consumer can engage in the process if they desire an alternative tariff. Where only one mailing was sent it offered similar information to second correspondence outlined above.

- Where consumers were notified that they had already been automatically placed on a subsequent Fixed Term Offer, they were able to choose to be removed from the tariff through telephoning the supplier.

- In addition to contact telephone numbers, some suppliers provided consumers with a detachable coupon which could be retuned to the supplier if they did not wish to continue with a new fixed deal.

2.14. The quality of the communication with the customer also varies, and where suppliers offer Fixed Term Offers the customer's role in the process (and the options available to them) was not always transparent.

- In consumer correspondence explaining an "opt-out" policy, the language used did not encourage consumer engagement. In some cases the letters implied the transfer to the new fixed deal contract was already completed and no action from the consumer was required.

- All suppliers used a section within the correspondence to highlight alternative offers and how the customer could sign up to these. Some suppliers more clearly outlined these options to consumers than others.

- For those operating an "opt-out" approach, some suppliers presented consumers with only the standard tariff as an option following a Fixed Term Period, while another informed the consumer they had a range of products to choose from. Where suppliers employed an "opt-in" policy, the section outlining options was clearly laid out, and consumers were offered a similar product to their previous tariff.

2.15. Another aspect of consumer engagement is the duration of the notice period consumers are given before they are automatically placed onto another fixed deal or an evergreen tariff. Information provided by suppliers shows there is a wide variety of different notice periods both between suppliers and among suppliers' own tariffs.

- The period of time a consumer has to respond to the communications noted above varies. In some cases consumers must respond by the end of the Fixed Term Period; with other offers consumers can still switch offer or supplier' up to 30 days after their previous fixed offer expired.

- The latest notice given to inform consumers of their new offer was two weeks after the current fixed period had expired. The longest notice period consumers were provided with was six weeks before the contract ended, with a further thirty days after the end of their Fixed Term Period to agree a different offer. The remaining suppliers provided consumers between fourteen and thirty calendar days to select a new offering, or opt-out of the default option.

Termination fees

2.16. Although domestic consumers cannot be blocked from switching due to the terms of their contract, termination fees may apply and could dissuade consumers from switching in such cases.

2.17. Exit fees can vary depending on the supplier. On average termination fees are currently in the region of £20-£30 per fuel. These charges can also vary depending on the duration of the fixed deal, and how much remains of the fixed period when the customer seeks to exit. For example, for one supplier if a consumer leaves within the first 9 months of the tariff they are charged a termination fee of £75 per fuel, but if they exit the tariff after this point they are charged a smaller termination fee of £35 per fuel.

3. Areas of concern

Chapter Summary

This chapter sets out our key concerns with the current practice relating to Fixed Term Offers in the domestic market. In particular we consider the risks for, and potential harm to, consumers due to lack of transparency around these offers and the potential for automatic contract rollover.

Question 2: Based on evidence in Chapter 2, or any additional evidence you may have, do you agree that our concerns are valid?

Question 3: Do you believe there are any additional areas of practice around Fixed Term Offers which may raise concerns?

3.1. **Transparency**

3.2. Incentives aimed at persuading customers to switch supplier or tariff play an important part in exerting competitive pressure in a healthy electricity and gas market. However, consumer switching decisions that do not serve their best interests may lead to consumer detriment, and can distort market signals concerning price, quality and innovation.

3.3. Therefore, it is important that consumers have the information they need to make well-informed switching decisions. Information transparency enables consumers to engage effectively in the market. For consumers to judge which option serves their best interests, they need to understand fully suppliers' tariff offers.

3.4. The level of transparency provided to consumers on given fixed offers varies: some suppliers offer timelier, clearer and more complete information than others. However, we are concerned that, in general, the current practice by suppliers is not sufficiently transparent to allow consumers to make informed choices and, on the whole, we believe improvements could be made.

3.5. There is potentially more risk to the consumer if they are unaware they are being moved to a fixed offer which involves termination fees in comparison to an evergreen contract that a customer can switch away from with relatively little notice, and without being subject to a termination fee. However, in both cases it is important that consumers are aware of all relevant terms of a current fixed, and any subsequent, offer(s).

3.6. One area of concern relates to content provided to consumers both at point of sale and nearing the end of a Fixed Term Period. Evidence suggests some suppliers are not providing consumers with details of all key features. For example, customers are not always provided with clear information concerning the arrangements for the end of a fixed period, applicable termination fees or details on the time limited nature of rates.

3.7. Where information on key product features has been provided, it may not always be clearly presented to the consumer. We are concerned some practices aimed at outlining these details could result in consumers not being able to understand important features of their offer. This may result from lack of transparency (e.g. the use of small print), a lack of clarity (e.g. the use of legalistic or complex language) or a lack of detail (e.g. where specific details of subsequent offers such as price and name of tariff are not given).

Termination fees

3.8. Termination fees exist because suppliers often price Fixed Term Offers on the basis that a consumer will remain with them and on the agreed offer for a period of time. As such, suppliers may be able to offer a different, or more competitive price, to customers agreeing fixed terms compared to those on non-fixed terms. If a consumer were to exit a contract before the agreed fixed time period, suppliers may face added cost risk associated with having excess energy or investment costs that cannot be covered by expected revenues. To help minimise the risk associated with wholesale market fluctuations and minimise the need to build a "risk premium" into the cost of a product, suppliers may choose to charge a termination fee to encourage consumers to see out their contract. In the event a customer does not see out their fixed term, such fees can help defray costs that suppliers incur due to that consumer leaving a contract prematurely.

3.9. However, we would expect such charges to be based on reasonable costs. Behavioural economics suggests individuals are "loss adverse", in other words, a loss has a significantly higher impact on an individual than the equivalent gain[4]. As a result, financial losses to the consumer in the form of termination fees are likely to have a greater impact on switching than the same level of savings available from switching to a new deal. In addition, if the consumer changes to a non-fixed rate tariff, there is a risk that the potential savings from switching would not outweigh the termination fee. We are concerned that in time termination fees could become too onerous, and that more costly termination fees could act as a significant barrier to consumer engagement, particularly where consumers are not fully aware of terms relating to these costs.

[4] Kahneman, D., Knetsch, J. and Thaler, R. 1990, 'Experimental tests of the endowment effect and the Coase theorem', The Journal of Political Economy. 98, 1325-1348

3.10. Based on an initial assessment of termination fees that apply to fixed term arrangements, we note they are currently relatively small when compared to the value of typical annual bills. However, as with any competitive market, over time the features of these products may evolve. We expect the nature of energy offers may change and as market conditions and offerings change we are concerned that termination fees have the potential to rise in future. For example, recently a supplier has launched a five-year fixed price tariff with stepped termination fees, which were the highest observed since market opening. With this offer, if a consumer leaves within the first year of their fixed period they are charged a termination fee of £100 per fuel, if they exit in the second year the charge is £75 per fuel and if they withdraw from the tariff in the final two years they are charged £50 fee per fuel.

3.11. We recognise that some termination fees may be justifiable. Depending on the nature of the energy product offered, suppliers may seek to agree longer term contracts. This can enable suppliers to purchase energy or invest in infrastructure (such as green technology) knowing that they have a set level of demand in place, which can help reduce costs and keep prices lower for consumers. However, we will consider developments in this area going forward, including, where appropriate, compliance with consumer protection law.

Consumer choice and product innovation

3.12. Consumer choice is a key factor in any well functioning competitive market. In the domestic retail energy markets consumers have a choice of both supplier and product offerings. Innovation may help provide consumers with choice, to meet evolving consumer needs and to do so in a more efficient way.

3.13. Fixed Term Offers are an example of a type of product innovation that some consumers value. Many customers appreciate the certainty a fixed tariff provides. We do not wish to discourage the existence of Fixed Term Offers and feel they are an innovation that serves the needs of particular consumer groups. However, Ofgem is also aware of the potential impact of long-term fixed offers on competition as some consumers may be locked into contracts for a period of time, meaning that fewer consumers at any one time may be free to switch supplier.

3.14. In order to prevent any consumer detriment it is critical that consumers understand their rights and obligations, including those that may impact their ability to switch to another energy offer.

Adhering to the spirit of standards of conduct

3.15. The standards of conduct support the standard gas and electricity supply licence conditions, outlining key principles to which suppliers are expected to adhere. The standards set out expectations that suppliers should treat consumers fairly, and communicate key messages clearly. There is scope for the overarching standards of conduct to apply to some aspects of Fixed Term

Offers, and in the event of automatic contract rollover. In particular, we are concerned some current practices do not adhere to the following standards of conduct:

- Standard 1: "You must not sell a customer a product or a service that they do not fully understand or that is inappropriate for their needs and circumstances";

- Standard 2: "You must not change anything material about a customers product or service without clearly explaining why";

- Standard 3:"You must not prevent a customer from switching product or supplier without a good reason"; and

- Standard 4:"You must not offer any products which are unnecessarily complex or confusing".

3.16. A Fixed Term Offer with an automatic contract rollover term is likely to be considered more complex than a standard tariff. We are concerned tariffs with automatic contract rollover terms are not being clearly communicated to consumers, potentially leading to some consumers purchasing products, or being automatically rolled onto offers, which may not meet their needs. This can expose consumers to termination fees if they seek to switch away from these offers, leading to possible financial detriment as well as feelings of frustration with both their supplier and the market as a whole.

3.17. Consumers often find large volumes of information difficult to quickly distil. Therefore, providing consumers with sufficient time to consider market offerings is crucial. Evidence suggests the timing of information provided to consumers around the end of the contract that aims to inform consumers of their options at that point, including automatic contract rollover terms, varies depending on the supplier. We are concerned that, in some cases, the timeframe given to consumers to contemplate this information and seek out other market offerings is insufficient to allow for an informed choice to be made.

3.18. Although these standards of conduct are not binding, we will have regard to them when considering our priorities for investigating any potential breaches of relevant licence conditions or relevant provisions of consumer protection law. We will also have regard to them when considering consumer detriment in the context of investigations. Therefore, it is important suppliers consider these standards when interacting with consumers.

4. Options

Chapter Summary

This chapter sets out four options which could be used to address the concerns identified with our assessment of the current practice. We describe these options, which involve varying degrees of market intervention, and discuss the relevant benefits and risks of each.

Question 3: What is your opinion of the options set out in this chapter?

Question 4: Do you believe there are any additional options we should consider? If so, please provide details.

Question 5: Do you envisage any obstacles to the implementation of options discussed in this document, other than those already outlined?

4.1. In this chapter we consider a range of options that may address concerns we have outlined around supplier practice for Fixed Term Offers in the domestic energy markets. Specifically, we have outlined four broad approaches that could be used to address the concerns identified with our assessment of current practice. These options, as well as an evaluation of their potential benefits and possible risks, are discussed below.

Option 1: Continue to use current arrangements

4.2. One option available is to rely on existing rules. It would continue to be incumbent upon a supplier to consider how existing, and any future, rules should be applied to instances where a Fixed Term Offer is a feature of the product. For this approach we would continue to closely monitor the practice surrounding Fixed Term Offers and if necessary, take enforcement action. We would periodically review the arrangements for appropriateness.

4.3. Under option 1, no separate supplementary guidance would be issued by Ofgem. Individual suppliers would be responsible for ensuring compliance with licence conditions and relevant provisions of consumer protection law without any clarification from Ofgem.

4.4. The advantage of this option is that it would result in minimal cost impact on suppliers, limiting any potential pass through of costs to consumers. Although no immediate action would be taken by Ofgem, we would remain able to revisit this issue in future.

4.5. However, opting for this approach creates a risk that potential consumer harm caused by practices around Fixed Term Offers may not be addressed. These concerns include problems arising from the lack of transparency concerning what will happen to customers at the end of a Fixed Term Offer as well as the risk that customers may be locked into a subsequent Fixed Term Offer when this was not their intention.

4.6. A further potential drawback to maintaining the current arrangements is that there may be questions over the extent to which it is appropriate to maintain differences between domestic and non-domestic licence conditions. The relevant non-domestic gas and electricity supply licence condition for micro businesses has clearly defined consumer protections relating to practices involving Fixed Term Offers and automatic contract rollover in that market. In the domestic retail energy markets a wide range of more general licence conditions and provisions of consumer protection law apply to these types of offers. However, it is possible that different rules governing the practice of contract rollover in each market may be appropriate.

Option 2: Draw on existing rules and issue guidance

4.7. Option 2 would be to draw on the existing licence conditions and consumer protection law ('relevant rules') in order to provide guidance, or clarification, to suppliers. This could be given on either an informal or formal basis and would set out how relevant rules should be applied to offers involving a fixed term component in respect of domestic customers. For example, this may involve writing to individual suppliers or publishing guidance explaining how relevant rules should be applied in the case of Fixed Term Offers, including those with automatic contract rollover provisions.

4.8. In particular, it may be necessary to provide suppliers with clarification or guidance on the application of the following relevant rules:

- Standard Condition 23 of the Gas and Electricity Supply Licences (SLC 23): Notification of Domestic Supply Terms
- Standard Condition 25 of the Gas and Electricity Supply Licences (SLC 25): Marketing to Domestic Customers
- Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs)
- Consumer Protection from Unfair Trading Regulations 2008 (CPRs)

Standard licence condition 23

4.9. Ofgem notes that the rules contained in SLC 23 already apply to certain matters relating to Fixed Term Offers. In particular, we note that:

- SLC 23.1 requires suppliers to take all reasonable steps to make consumers aware of the principal terms of a contract (including terms relating to contract duration and termination fees) before a contract is entered into; and

- where the rules in SLC 23.3 to 23.7 apply, the supplier is required to give individual customers written notice of unilateral contract variations and, in the event that certain conditions are met, the ability to switch supplier without being subject to the variations.

4.10. We also note that we are currently consulting to change the rules concerning timing of such notifications from 65 working days following a unilateral variation to a consumers contract terms to 30 calendar days advanced notice. If this proposal is implemented, this may strengthen our ability to usefully draw on this for some instances of changes to a Fixed Term Offer, depending on the details in the domestic consumer's contract.

4.11. Whilst providing more guidance in respect of the application of SLC 23 may address some concerns surrounding Fixed Term Offers, we note that there may be other areas of concern this option would not address. For example, this option may not, in itself, be sufficient to:

- ensure key information is provided to consumers at particular points during the lifetime of an existing Fixed Term Offer;

- ensure key pre-contractual information is given to consumers in a particular form (e.g. in writing), in a prominent manner or in plain and intelligible language;

- address potential concerns with the length of any Fixed Term Offers or notice periods for termination which may apply as a result of a contract being a rolled-over; and

- address automatic rollovers which, depending on the language in a consumer's contract, may not amount to unilateral variations for the purposes of SLC 23.

SLC 25 Marketing to Domestic Customers

4.12. The objective of SLC 25.1 contains an objective (marketing objective) which, amongst other things, seeks to improve a consumer's ability to make well informed decisions about energy offers in response to telephone and face-to-face marketing and sales activities undertaken by suppliers. SLC 25 also contains relevant requirements to provide key information to customers after a face-to-face sale has been concluded. Therefore, the following provisions within SLC 25 could be applied to the issue relating to Fixed Term Offers to address our concerns regarding transparency and information provided before and shortly after a Fixed Term Offer has concluded.

4.13. In respect of all information which is provided to domestic customer during telesales and/or face-to-face sales activities, but not other sales methods, the marketing objective requires the supplier to ensure (amongst other things) that the information is capable of being understood by domestic customers and is otherwise fair both in terms of its content and in terms of its prominence, with more important information being given appropriate prominence.

4.14. As outlined above, under SLC 23, a supplier is subject to separate requirements to make a customer aware of the Principal Terms of a contract before the contract is agreed. Ofgem is firmly of the view that key contractual information including the duration of the contract, duration of any Fixed Term Offer and rollover provisions must be provided during telephone and face-to-face sale activities, and that information must comply with the marketing objective.

4.15. Further, we note that SLC 25 requires a supplier to contact a customer by telephone or in writing within 14 days after a face-to-face sale has been concluded to confirm (amongst other things) that the customer understands the Principal Terms of the contract. Again, Ofgem is firmly of the view that this information must be provided in a way which complies with the marketing objective.

4.16. It is the responsibility of individual licensees to ensure compliance with standard licence conditions and, therefore, to some degree, these rules are open to interpretation. Issuing guidance for the application of SLC 25 would confirm Ofgem's views in more detail and provide a minimum standard for the sale of products that may include Fixed Term Periods.

4.17. Clarifying how communication of Fixed Term Offers applies to SLC 25 would go some way toward helping ensure consumers make an informed choice when initially agreeing to an offer with a fixed component via telephone or face-to-face sales channels.

4.18. However, we note this would not address concerns about the transparency of key information at other points during the lifetime of the contract. Similarly, protections afforded by SLC 25 do not include all sales channels, for example internet sales would not be covered. In addition, existing licence conditions would not address potential concerns with the length of any Fixed Term Offers or notice periods for termination which may apply as a result of a contract being rolled over. Therefore, some consumer harm may persist if existing licensing rules are relied on to address the issues around Fixed Term Offers in the domestic energy markets.

Unfair Terms Consumer Contracts Regulations 1999 (UTCCRs)

4.19. The enforcement mechanisms provided for in the UTCCRs could be used by Ofgem partly to address concerns with Fixed Term Offers and automatic contract rollovers, in particular those regarding fairness and transparency of relevant contractual terms.

4.20. While certain issues relating to interpretation and application of the UTCCRs may ultimately need to be tested before the courts, it may be appropriate for Ofgem to produce guidance in respect of Fixed Term Offers. The parts of the UTCCRS which guidance would likely focus on can be found in Appendix 2. However, for the avoidance of doubt, it would not be necessary for Ofgem to produce such guidance before taking enforcement action under the UTCCRs.

4.21. We note that other enforcement bodies, such as the Office of Fair Trading (OFT) and the Office of Communications (OFCOM) have issued guidance on the application of UTCCRs. The OFT has expressed the view that the automatic contract rollover terms may be deemed unfair if the consumer is not given early enough notice to cancel. OFCOM has indicated that rollover terms may be unfair in circumstances where a clear reminder notice of the rollover is not received within sufficient time for the consumer to consider alternative offers.

4.22. Issuing guidance with regard to the application of the UTCCRs to Fixed Term Offers and automatic contract rollovers may help to address some of our concerns around this practice. The wide scope of the UTCCRs may be sufficient to require a minimum standard of information provision at the point of sale and ensuring that consumers are notified before a roll over takes place, and have the ability to opt out of arrangements at the end of a fixed period, if desired. For instance this may involve ensuring the terms of any subsequent offer are a prominent feature at point of sale and are expressed in clear language for the consumer. In addition, it may facilitate the application of a suitable notice period for consumers to withdraw from a new rollover contract if they desired.

4.23. However the application of the UTCCRs for Fixed Term Offers and automatic contract rollovers may not address all of the concerns surrounding consumer harm. For example, they may not address any concerns with the length of the Fixed Term Periods in roll-over contracts.

4.24. Furthermore, whilst Ofgem could seek to persuade suppliers to amend contractual terms in lieu of enforcement action under the UTCCRs, in the event that enforcement action became necessary, the UTCCRs only allow Ofgem to apply to court for an injunction to prevent continued use of unfair terms. The granting of an injunction is a discretionary remedy and the UTCCRS would not allow Ofgem, or other bodies, to impose any form of sanction for past conduct. There is no guarantee that the courts would grant the discretionary remedy. In addition the overall incentives for compliance may be lower for general consumer protection regulation than for licence conditions which are enforceable though orders and financial penalties imposed directly by Ofgem.

Consumer Protection from Unfair Trading Regulations 2008 (CPRs)

4.25. Ofgem notes that the CPRs would provide an avenue for seeking to address some concerns with the transparency of information relating to Fixed Term Offers and any subsequent arrangements. In particular, misleading statements or the failure to provide information to customers about key contractual matters such as the duration of the contract, are likely to amount to misleading actions or misleading omissions for the purposes of the prohibition on unfair commercial practices contained the in the CPRs.

4.26. Under Part 8 of the Enterprise Act 2002 Ofgem has the ability to seek undertakings to secure compliance with the CPRs and ultimately to seek enforcement orders from the courts. However, as outlined above in respect of the UTCCRs, Ofgem cannot make its own binding enforcement decisions and there are no financial penalties for breaches.

4.27. Therefore the application of the CPRs in isolation for Fixed Term Offers is unlikely to be capable of addressing all risks of consumer harm.

Overall assessment of option 2

4.28. As described above, this option would draw on existing rules to address concerns over practices surrounding Fixed Term Offers and automatic contract rollover terms in the domestic energy markets.

4.29. While this would go some way to tackling current concerns, on balance we feel this option on its own would not be sufficient to address all issues identified. In particular, we feel that existing rules do not go far enough to provide the necessary protections to consumers in respect of Fixed Term Offers. In addition, we have concerns that the narrow range of options available to Ofgem to enforce consumer protection legislation would reduce compliance incentives.

Option 3: New rules to increase transparency and promote consumer engagement

4.30. Option 3 would modify existing standard licence conditions or create new licence conditions to address concerns raised around practice toward the end of a Fixed Term Offer, including automatic contract rollovers. However, this option would not preclude Ofgem from also drawing on existing rules, where appropriate.

4.31. For instance, option 3 may include the introduction of provisions designed to improve transparency, to require clear and timely communication with consumers regarding the choices available toward the end of any Fixed Term Offer, and potentially to regulate the length of roll-over contracts. Such provisions could include:

- ensuring consumers have adequate time to consider rollover (or other) options, explore alternate offers and contact suppliers if they wish to switch - e.g. require that suppliers contact consumers toward the end of their Fixed Term Offer to outline details of the terms of their auto rollover, or other offers, and give consumers at least 30 days advance notice to consider their options (we are considering whether advanced notice 30 calendar days or 60 calendar days before the end of a Fixed Term Offer would be most appropriate);

- make sure that customers have the ability to easily contact suppliers if they wish to switch, or roll onto another offer;

- requiring suppliers to provide specific information to consumers (or alternatively requiring the provision of relevant information within the annual statement or within regular bills); or

- restricting the length of time a tariff could be automatically rolled over for.

4.32. Draft amendments to licence conditions which would implement option 3 are set out in Appendix 3.

4.33. This option would provide Ofgem with the capacity to directly address concerns arising from Fixed Term Offers. This would include the benefit of having consolidated rules within the standard licence conditions that would be subject to Ofgem enforcement mechanisms, and may provide a stronger deterrent to suppliers than relying on wider consumer protection regulations alone. However, this would not preclude us from also pursuing enforcement action, where appropriate, under existing licence conditions and consumer protection law. As a result of these proposed regulations, consumers would be provided with key information at appropriate times to enable them to evaluate their offer and consider alternative options. If appropriate, this policy option would not rule out the possibility of Ofgem making further proposals concerning Fixed Term Offers at a future date, including banning automatic contract rollovers in the domestic market.

4.34. Although this approach would provide consumers with key information and some additional protections, it would largely be a consumer empowerment tool. Consumers would be provided with details needed to make decisions about their energy supply, yet there is a risk that some consumers may still choose not to engage and would be rolled over. In these cases, consumers could potentially incur termination fees if they switch after they have entered a subsequent fixed period. In addition, we have faced some difficulty with a similar provision in the non-domestic market, and we would need to be mindful of this experience when considering how these provisions could be most effective in the domestic market.

Option 4: New rules to limit suppliers' ability to automatically roll over a Fixed Term Offer

4.35. The final option would be to restrict the practice of automatic rollovers in the domestic market by limiting suppliers' ability to charge a fee for early termination of a fixed period, in some circumstances. There are two approaches through which this could be achieved:

a) Positive assent: In order to be rolled over onto and bound into a subsequent offer, which could be subject to a termination fee, consumers would have to provide express (active) consent toward the end of their Fixed Term Offer noting their satisfaction with a subsequent offer. With this suppliers maintain the ability to include a contract rollover clause, or other clauses outlining what may happen to a consumer at the end of a fixed period, in the terms of a contract. However, it would also ensure that consumers were not unknowingly locked into a subsequent offer they did not wish to be on.

b) Limit all automatic rollovers: This would limit the ability of suppliers to apply a termination fee to any automatically roll over. This would not preclude suppliers and consumers from agreeing separate fixed term arrangements that were binding.

4.36. Draft amendments to licence conditions which would implement option 4 are set out in Appendix 4.

4.37. These two approaches differ in how they may be implemented by suppliers, but both would lead to similar outcomes. Each would result in incentives on suppliers to promote consumer engagement if they wish to encourage consumers to agree another offer with them. This is particularly true where a supplier would like to agree a subsequent offer that may currently be subject to a termination fee, such as a fixed term product. Both approaches would also reduce the incidence of un-intended contract rollovers as consumers who took no action would likely move onto a deemed or rolling 28 day contract, and would be able to switch supplier with relatively little notice, and no termination fee. We note for the purposes of this consultation contracts with a rolling component covering a short time period (e.g. 28 days) would not be considered to have a fixed component.

4.38. With both of these approaches a question remains over what tariff consumers should be placed on if they do not act. Some consumers may be automatically rolled over, but would have the ability to exit that offer at any point without being subject to termination fees. However, there is also a risk that a customer on a fixed term fixed price deal who does not explicitly agree a new offer may be placed on a standard tariff at the end of their agreed contract period. To date in the domestic market deemed rates have had similar terms to standard rolling 28 day offers, and some suppliers put consumers on standard offers in cases where deemed rates would normally apply. However, there are usually a number of offers that are more competitive than the standard offer and there is a risk that consumers who do not take action may face higher prices than if they were automatically rolled onto another Fixed Term Offer. Similarly, if suppliers were happy for customers to go onto deemed or short term variable rate offers, or longer term fixed offers with no termination fee, this option could provide limited incentive for suppliers to engage and may not provide adequate protections for consumers.

4.39. Moreover, there is potential that this approach could stifle innovation and limit the options available to suppliers. Suppliers use Fixed Term Offers as a way to both reduce costs and better manage their hedging strategies. This can be particularly important for smaller suppliers, and for suppliers looking to invest in generation, including green technologies. Therefore, removing the ability for automatic contract rollovers to be enforced by suppliers could act as a barrier to entry or expansion. Additionally, there is a risk that limiting rollovers would cause consumer acquisition costs to increase, and this cost increase could be passed on to consumers.

5. Preliminary recommendations

5.1. With consideration of the benefits and drawbacks of the options outlined this document we **recommend the implementation of options 2 and 3 in combination.** We advise drawing on existing regulations, where possible, and we recommend supplementing these with specific provisions within the standard gas and electricity domestic supply licence that address the concerns in relation to Fixed Term Offers.

5.2. We favour pursuing both of these options as, together, we consider they will help promote transparency and engagement and protect customers on, or considering signing up to, Fixed Term Offers, while minimising the potential costs to suppliers.

5.3. If implemented, this proposal would not preclude suppliers currently operating an "opt-in" policy in relation to any offers following a Fixed Term Offer from continuing to do so. Nor would it prevent other suppliers from adopting such terms in future, if desired.

5.4. As part of this option, we would continue to monitor activity relating to Fixed Term Offers, and compliance with existing and future legislation. Implementation of option 2 and 3 in combination would not preclude us from considering option 4: limiting the use of termination fees, or other policy options, in the future if it were deemed appropriate.

6. Next steps

6.1. We welcome views on this initial consultation on the current practice and the options presented above, including whether Ofgem's preliminary recommendations are an appropriate response to the issues discussed, and if not, whether there are further options we should consider.

6.2. We also welcome comments and views on the draft Impact Assessment presented in Appendix 6. This section provides further analysis of the options we have outlined in this consultation, it is intended to provide an early stage assessment with initial thoughts on the impact of policy options discussed.

6.3. We are seeking responses by 7 March 2011. Responses submitted after this date may not be considered.

6.4. Following the end of this consultation period, we will take responses and views on board, and engage with stakeholders where necessary in order to fully understand stakeholder opinion. We will also consider any policy options within the context of our Retail Market Review.

6.5. We expect to publish a further document later this year summarising the consultation responses and providing our decision. If appropriate, we will consult on licence modifications at that time.

Appendices

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. In particular, we would like to hear from domestic energy suppliers, consumers and consumer representatives as well as other interested parties

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 7 March 2011 and should be sent to:

Katie Brennan
Retail and Market Processes
9 Millbank
London SW1P 3GE

Telephone: 020 790 17195
E-mail: Katie.brennan@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation and our work on the Retail Market Review, Ofgem intends to publish a document summarising response to consultation and providing our decision. Any questions on this document should, in the first instance, be directed to Katie Brennan using the contact details listed above.

CHAPTER TWO: Current practice, Fixed Term Offers in the domestic retail market

Question1: Have we outlined in the Chapter the full array of suppliers' practices in respect to Fixed Term Offers?

CHAPTER THREE: Areas of Concern

Question1: Based on evidence in Chapter 2 or any additional evidence you may have, do you agree that our concerns are valid?

Question2: Do you believe there are any additional areas of practice around Fixed Term Offers which may raise concerns?

CHAPTER FOUR: Options

Question 3: What is your opinion of the options set out in this chapter?

Question 4: Do you believe there are any additional options which we should consider? If so please provide details.

Question 5: Do you envisage any obstacles to the implementation of options discussed in this document, other than those already outlined?

Appendix 2 – Sections of UTCCRs likely relevant to Option 2

The following aspects of UTCCRs are likely to be focused on for guidance in respect to their application for Fixed Term Offers as outlined in *Option 2: Draw on existing regulations* within this consultation.

- The fairness test contained in Regulation 5 (1), i.e. A standard term in a contract shall be regarded as unfair if, contrary to the requirements of good faith, it causes significant imbalance in the parties' contractual rights and obligations causing detriment to the consumer.

- The transparency requirements of Regulation 7 (1), i.e. any written terms must be expressed in plain intelligible language.

- The following indicative examples of terms which may be regarded as unfair contained in Schedule 2, e.g.:

  - paragraph 1 (h): automatically extending a contract of a fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express their desire not to extend the contract is unreasonable early

  - paragraph 1 (i): irrevocably binding the consumer to terms which they had no real opportunity to become acquainted before the conclusion of the contract; and

  - paragraph 1 (j): enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract.

Appendix 3 – New and amended licence conditions to deal with extending the duration of Domestic Supply Contracts

1. Proposed amendments to SLC 1

Principal Terms means, in respect of any form of Contract or Deemed Contract, the terms that relate to:

(a) Charges for the Supply of Electricity;

(b) any requirement to pay Charges for the Supply of Electricity through a prepayment meter;

(c) any requirement for a Security Deposit;

(d) the duration of the Contract or Deemed Contract <u>(including any arrangements for renewing or extending the duration of the Contract or any Fixed Term Periods)</u>;

(e) the rights to end the Contract (including any obligation to pay a Termination Fee) or the circumstances in which a Deemed Contract will end,

and any other term that may reasonably be considered to significantly affect the evaluation by the Customer of the Contract under which electricity may be supplied to his premises;

2. Proposed amendments to SLC 23.1

23.1 Before it enters into a Domestic Supply Contract with a Domestic Customer, the licensee must take all reasonable steps to bring the Principal Terms of that contract to the attention of that customer <u>and ensure that the Principal Terms are communicated in plain and intelligible language</u>.

3. Draft version of SLC 23A (proposed new condition)

Extending the duration of Domestic Supply Contracts

Paragraph 1

The licensee must prepare a statement (hereafter referred to as a "Statement of Renewal Terms") which:

(a) is set out in Writing;

(b) is drafted in plain and intelligible language;

(c) displays the following information in a prominent manner:

> (i) the date the Domestic Supply Contract or, where applicable, any fixed term period of that Contract is due to end;

(ii) where the supplier has the ability to extent the duration of the Domestic Supply Contract for a further fixed term period:

a. a statement to the effect that the Domestic Customer may send a notification in Writing to the licensee or contact the licensee by telephone at any time before the date the Domestic Supply Contract is due to end in order to prevent the licensee from extending the duration of the Domestic Supply Contract for a further fixed term period;

b. a postal address, Electronic Communication address and telephone number for which the Customer may use to send a notification in Writing or contact the licensee for that purpose;

(iv) a statement explaining the consequences of the Domestic Customer not renewing the Domestic Supply Contract or agreeing a new Contract before the Domestic Supply Contract is due to end; and

(v) a reminder that the Domestic Customer may change their Electricity Supplier; and information about where the Domestic Customer may obtain impartial
advice and information about changing their Electricity Supplier.

Paragraph 2

Where the licensee enters into or extends the duration (including the duration of any fixed term period) of a Domestic Supply Contract, it must take all reasonable steps to provide the Domestic Customer with the Statement of Renewal Terms within 10 days, or do so as soon as reasonably practicable thereafter.

Paragraph 3

On or about [30 or 60] days before any type of Domestic Supply Contract or, where applicable, any fixed term period of that Contract is due to end, the licensee must provide the Domestic Customer with:

(a) the Statement of Renewal Terms;

(b) a copy of any relevant Principal Terms that might apply to the Domestic Customer after the Domestic Supply Contract or, where applicable, any fixed term period of that Contract ends, including (but not limited to):

(i) terms that would apply in the event the Customer does nothing;

(ii) terms that would apply if the Customer sends (or has already sent) a notification in Writing to the licensee or contacts (or has already contacted) the licensee by telephone before the date the Domestic Supply Contract or, where applicable, any fixed term period of that Contract is due to end to prevent it from extending the duration of the Domestic Supply Contract for a further fixed term period, but does not appoint another supplier or enter into a new contract with the licensee.

(iii) terms that would apply in the event that the Customer terminates the Domestic Supply Contract and does not appoint a new supplier.

Paragraph 4

Where the licensee has entered into a Domestic Supply Contract for a fixed term period, it may only extend the duration of that Contract for a further fixed term period if:

(a) it has complied with paragraph [1, 2 or 3];

(b) the Domestic Customer has not sent the licensee a notification in Writing, or contacted the licensee by telephone, before the date the Domestic Supply Contract is due to end to prevent it from extending the duration of the Domestic Supply Contract for a further fixed term period; and

(c) the duration of the further fixed term period is 12 months or less.

Paragraph 5

Without prejudice to the Authority's enforcement functions, where the licensee fails to comply with [paragraph 1, 2, 3 or 4] and extends the duration of a Domestic Supply Contract for a further fixed term period, the licensee may not charge or otherwise seek to enforce a Termination Fee in respect of that Contract.

Paragraph 6

The notice period for termination of a Domestic Supply Contract must be no longer than 30 days.

Paragraph 7

Paragraph [6] is without prejudice to the licensee's ability to enter into a Domestic Supply Contract for a fixed term which is longer than 30 days.

Appendix 4 – Proposed draft amendments Standard Licence Condition 24 of the gas and electricity licence

Termination Fees

24.3 The licensee may include a term in a Domestic Supply Contract requiring a Domestic Customer to pay a Termination Fee to end that contract except in any of the following circumstances:

(a) the contract is of an indefinite length;

(b) without prejudice to sub-paragraph (a), the contract allows for both a Fixed Term Period and a period of indefinite length and it is brought to an end during the period of indefinite length; or

(c) the licensee gives Notice of a unilateral variation of a term of the contract in accordance with paragraph 3 of standard condition 23 (Notification of Domestic Supply Contract terms) and paragraph 5 of that condition binds the licensee.

<u>(d) where licensee's has applied an additional Fixed Term Period or extended the length of any Initial Fixed Term Period in respect of a Domestic Supply Contract, without obtaining the express [written] consent of the Domestic Customer during the Relevant Period.</u>

[OR]

<u>(d) where the licensee's has applied an additional Fixed Term Period or extended the length of any Initial Fixed Term Period in respect of a Domestic Supply Contract.</u>

24.4 The restrictions imposed by paragraph 24.3 will not apply to such extent as the Authority may direct.

Application of this condition

24.5 If a Domestic Supply Contract provides for both the supply of electricity to a premises and the provision of any other good or service, a reference in this condition to ending that contract is a reference to ending it for the supply of electricity to the premises only.

Definitions for condition

24.6 For the purposes of this condition:

"Relevant Period" means at least [30] days before the date the Initial Fixed Term Period of a Domestic Supply Contract is due to end; and

"Initial Fixed Term Period" means the first Fixed Term Period which applies to the duration of any Domestic Supply Contract.

Appendix 5 – The Authority's Powers and Duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority ("the Authority"), the regulator of the gas and electricity industries in Great Britain. This appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010) as well as arising from directly effective European Community legislation.

1.3. References to the Gas Act and the Electricity Act in this appendix are to Part 1 of those Acts.[5] Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This appendix must be read accordingly.[6]

1.4. The Authority's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with:

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity; and
- the provision or use of electricity interconnectors.

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests.

1.7. In performing these duties, the Authority must have regard to:

- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;

[5] Entitled "Gas Supply" and "Electricity Supply" respectively.

[6] However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

- the need to secure that all reasonable demands for electricity are met the need to secure that licence holders are able to finance the activities which are the subject of obligations on them[7]; and
- the need to contribute to the achievement of sustainable development.

1.8. In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.[8]

1.9. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed[9] under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems; protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and secure a diverse and viable long-term energy supply, and shall, in carrying out those functions, have regard to the effect on the environment.

1.10. In carrying out these functions the Authority must also have regard to:

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.11. The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.12. The Authority has powers under the Competition Act to investigate suspected anticompetitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation[10] and therefore part of the European Competition Network. The Authority also has concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

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[7] Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Acts in the case of Electricity Act functions.
[8] The Authority may have regard to other descriptions of consumers.
[9] Or persons authorised by exemptions to carry on any activity.
[10] Council Regulation (EC) 1/2003.

Appendix 6 – Impact Assessment

Key Issues and Objectives

1.1. Automatic contract rollovers are a feature in both the non-domestic and the domestic market. In the non-domestic market, these are subject to rules which aim to protect micro business customers. However, for the domestic market under the current obligations there are no bespoke licence conditions for automatic contract rollovers. We are concerned energy suppliers are causing consumer harm with this practice by not being fully transparent.

1.2. The Energy Supply Probe initial findings report in Oct 2008 raised concerns with poor information provision and transparency for consumers. The following new licence conditions and modifications to existing obligations were introduced to address these issues:

- SLC 25: Marketing to domestic gas and electricity consumers. The objective of SLC 25 is to improve a consumers' ability to make well informed decisions about energy offers in response to telephone and face-to-face sales activities undertaken by suppliers.

- SLC 23: Notification of Domestic Supply Terms. This rule requires suppliers to take all reasonable steps before a contract is entered into to make consumers aware of the principal terms of a contract and give individual customers written notice of unilateral contract variations.

1.3. These licence conditions are supported by consumer protection law and the standards of conduct. Consumer protection legislation such as UTTCRs and CPRs can be used to require fairness and transparency of contractual terms. The standards of conduct set out our expectations that suppliers should treat consumers fairly, and communicate key messages clearly.

1.4. Consumer bodies suggested the practice of automatic contract rollover was resulting in consumer harm and Ofgem received anecdotal evidence to support this. As a result, we issued an information request in March 2010 to all domestic suppliers to assess the practice and gather information on consumer experience.

1.5. As outlined in Chapter 3: Areas of Concern, we have observed a number of practices for automatic contract rollovers which may be causing negative impacts on consumers. In particular, customers unintentionally being rolled over onto another Fixed Term Offer and paying exit fees if they wish to withdraw. The extent to which this is occurring is unclear; however, the number of Fixed Term Offers is currently increasing, a trend which may continue. Therefore, the prevalence of Fixed Term Offers and the use of automatic rollover of Fixed Term Offers may increase in the future.

1.6. Although existing licence conditions and consumer protection law could be used to address some of our concerns, it is our view that they will not fully address the issues raised in Chapter 3 of this document.

1.7. On this basis, we are recommending to draw on existing licence conditions and consumer protection law, where possible. In conjunction with this, we are minded to create additional provisions in the standard gas and electricity supply licences to address specific issues with automatic contract rollovers. It is our view that the increased transparency of this option will reduce consumer detriment through improving consumers' understanding of contract renewal terms and their implications. In addition, this option will provide consumers with sufficient time to consider alternative tariff offerings. For those consumers who do not wish to renew the contract, we believe they should have an adequate time period to consider their options prior to any rollover provisions taking effect. This is discussed in greater detail in Chapter 5: Preliminary Recommendations and this Impact Assessment.

1.8. In recommending this course of action we have considered Ofgem's duties and objectives which are set out in legislation. Namely, our principal objective to existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. We have also considered the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.

Options

1.9. As outlined in Chapter 4 of the main consultation document, the options we are considering are as follows:

I. Option 1: Maintain current arrangements - rely on existing requirements and suppliers' self regulatory measures to provide adequate protections around the practice of automatic contract rollovers, reviewing these arrangements at a future stage if appropriate.

II. Option 2: Build on existing requirements and self-regulatory measures, Ofgem would use the current arrangements to address problems as well as issuing guidance clarifying how existing gas and electricity licence conditions, and relevant consumer protection laws, apply in the case Fixed Term Offers.

III. Option 3: Increase transparency and promote consumer engagement - Ofgem would modify existing standard licence conditions, or create new ones to plug gaps in existing protections and ensure customers on Fixed Term Offers are adequately protected when their Fixed Term Offer comes to an end.

IV. Option 4: Direct regulatory intervention to limit the use of automatic contract rollover in the domestic market by limiting suppliers' ability to charge termination fees to consumers.

(a) where a supplier has not received positive assent from a consumer that they wish to be placed on a subsequent Fixed Term Offer; or

(b) where a supplier has applied a subsequent Fixed Term Period to any initial Fixed Term Offer.

1.10. We propose that a combination of options 2 and 3 may be most effective. However, as part of this assessment we also consider option 1 and option 4.

1.11. Where option 4 is concerned, we feel that, in practice, a requirement for "positive assent" and preventing automatic contract rollover on subsequent offers with termination fees would have a similar effect. With both, action from the consumer at the end of their contract is needed before another fixed deal can be put in place, and customers would face the same risk if they did not act, for example that they could potentially face higher priced standard or deemed rate arrangements.

Impacts on consumers

1.12. This section sets out the potential impacts on consumers of three of the regulatory options outlined in the previous chapter of this Appendix. The aim of this section is to develop an understanding of the overall affect on consumers each of our proposed options. These are: (i) option 1 to maintain current arrangements and review in the future if necessary (ii) our preliminary recommendation, a combination of options 2 and 3, relying on existing regulations and the creation of bespoke obligations specific to Fixed Term Offers and automatic contract rollovers and (iii) option 4 to limit supplier’s ability to automatically roll consumers onto a subsequent Fixed Term Offer. As mentioned above in the options section, we have proposed two variations to limit automatic contract rollovers - in practice we believe each will have a similar impact on consumers; therefore, this section will largely discuss the overall impact of limiting automatic rollovers. However, we will differentiate between the methods of limiting this practice, where appropriate.

Option 1: Maintain current arrangements and review in the future if necessary

1.13. We have identified a number of impacts on consumers of applying option 1 to maintain current regulations.

1.14. As discussed in Chapter 2: Current Practice, we have observed a number of suppliers not providing consumers with sufficient information, clearly and prominently. This includes both at point of sale and nearing the end of the contract. As a result, there is the potential that a proportion of consumers are unable to make an informed decision. A consumer may have difficulty assessing the impact of contract renewal if they lack adequate information about alternative products and therefore they may find it difficult to compare it to other market offerings. This could result in poor switching decisions or consumers not engaging with the market.

1.15. Furthermore, where automatic contract rollover terms are not prominently located in relevant communications material this could result in a lack of understanding of the tariff by consumers. As a consequence consumers may be unaware they will be automatically rolled over on to another Fixed Term Offer when the current Fixed Term Offer expires. Consumers may not have had an opportunity to assess whether product features are beneficial compared to available alternatives. In addition, some consumers may be unaware they have the ability to switch to another deal when their current offer ends. As a result, there is the possibility consumers will switch less.

1.16. In some instances we have observed suppliers providing limited notification windows for consumers to consider the contract renewal offer. This has the potential to cause consumer detriment if a consumer is not given adequate opportunity to consider other offers in the timeframe provided. As a result, a proportion of consumers may be automatically rolled onto a subsequent offer and be obliged to pay exit fees if they wish to switch away from that offer before it is due to end.

1.17. Recently the length of Fixed Term Tariffs being offered has increased. Consequently, there is a concern that automatic contract rollovers terms with fixed terms of considerable length may prevent consumer engagement in the market for long periods of time.

Option 2 and 3 in combination (our preliminary recommendations)

1.18. The following section discusses the impact on consumers of our preliminary recommendation, a combination of options 2 and 3.

1.19. As a result of this option consumers will have more information available to them at point of sale and nearing the end of contract. As outlined in Appendix 3, the Statement Of Renewal Terms (SORT) will require suppliers to provide consumers with a written notification before the consumer's contract expires. This notification will provide consumer with additional information. For example, when the current contract expires and how the consumer can opt out of the automatic rollover contract. The improved information will encourage consumers to engage with the process and consider other deals when the contract expires. In addition, the increased awareness of the automatic contract renewal terms will contribute to preventing consumers from inadvertently being rolled over onto a new contract.

1.20. Existing licence conditions and consumer protection law combined with the SORT will require suppliers to be clear and concise with the information they provide to consumers with respect to automatic contract rollovers. To engage in the process consumers must understand the offer they currently have and the new automatic tariff which they are being offered. This understanding allows consumers to assess if the tariff meets their individual needs. The improved clarity will, once again, encourage consumers to engage in the contract renewal period as it will develop their understanding of the product offers which will ease product comparison and therefore potentially increase switching.

1.21. The application of the proposed new licence obligation will require suppliers to notify consumers on or about a set number of calendar days (i.e. 30 or 60 days) in advance of the end of a Fixed Term Period. Consumers will then have the ability to opt out of rollover at any time before the contact expires and would be able to terminate the contact in accordance with the terms of the prevailing contract. If consumers are provided with a short notification period to exit the new deal, work and home commitments may prevent a consumer from switching before exit fees are applicable. The increased time period may encourage switching as consumer will have a greater length of time respond to suppliers if they wish to exit the new contract. Furthermore, the longer notification window will give consumers additional time to research and assess other deals.

1.22. Alternatively, consumers could find the increased information provided by the SORT difficult to process and as a consequence they may become confused. In order to make a decision on a product, consumers research product offerings based on their own requirements and the information they have available to them. The additional information provided by SORT aims to provide the consumer with easily accessible information to assist their decision. However, if consumers are unable to process this additional information they may find it too difficult to compare to other tariffs. If consumers are unable to compare offerings, they may make a poor switching decision or alternatively disengage from the market. Potentially this could result in a reduction in consumer switching.

1.23. We note there is potential for suppliers to incur costs if they have to adjust their mailing periods and amend current systems to comply with these proposals, and that these additional costs may be passed through to consumers.

Option 4: Introduce a limit on suppliers' ability to automatically lock consumer into subsequent Fixed Term Offers

1.24. The next section outlines the potential impact on consumers of restricting the practice of automatic contract rollovers, by limiting supplier's ability to charge termination fees to consumers who have not actively engaged to with them to confirm their wish to be moved onto a further, or subsequent, Fixed Term Offer.

1.25. We are aware that introducing such measures would have a positive impact on consumers who have been automatically rolled onto a Fixed Term Offer without their full understanding. Under these measures, such consumers could still be automatically rolled over, but would no longer incur termination fees to switch tariff.

1.26. If the practice of automatic contract renewal is limited in this way, consumers may face a reduced choice of product offerings. Although consumers may still be automatically rolled onto subsequent Fixed Term Offers, in practice, suppliers may choose to not put consumers onto longer term offers because of the consumers may leave at any time. This could be detrimental for those customers who benefit from this service. For those consumers who currently value automatic rollovers, this could increase their search time to find energy services at the end of their Fixed Term Offers.

1.27. The limiting of suppliers' ability to enforce automatic contract renewal offers raises the issue of which tariffs consumers are transferred to at the end of their current offer. Currently, if they are not automatically rolled over onto another Fixed Term Offer, they are typically transferred to a standard offer. There is a risk in the future if this practice is limited, deemed contracts may become more prevalent in the domestic sector. The prices of these tariffs may be higher than standard products to take into account the short term wholesale risk. This would be detrimental for consumers who could be transferred to a high price tariff. Consumers would be free to switch suppliers or tariffs under such deemed offers; however, there may be a proportion of customers who would not switch from the high deemed rates.

1.28. More widely, consumer choice could be stifled through a reduction in product innovation, as discussed in detail in Chapter 4 of the consultation document. Fixed Term Offers can help suppliers have greater certainty about their energy demand and better manage their hedging strategies. The process of automatically rolling consumers onto a new contract may amplify these benefits as this practice provides suppliers with more certainty regarding future consumer energy demand. However, preventing a supplier from using automatic renewal terms limits the options available to them when developing new products and could result in a reduction in product choice for consumers.

1.29. As discussed in Chapter 4 of the consultation document, there are also cost implications for suppliers of implementing a restriction on automatic contract rollovers. If suppliers are prevented from automatically placing consumers onto another Fixed Term Offer they will have to increase their spending to acquire customers on these products. This increase in acquisition costs could be passed onto consumers through higher priced Fixed Term Offers, increasing energy costs for consumers.

1.30. Finally, under this proposal our concerns with lack of transparency and information for consumers will not be addressed. Consumers will be prevented from being locked into offers where an automatic rollover was used through limiting termination fees on the following fixed term tariff. However, this proposal does not address our concerns that consumers are not fully aware of the product they are signing up for. Therefore, consumer harm will still occur as some consumers will still be automatically rolled onto a product offering unintentionally. Considering the impacts of our proposals discussed above, we believe, on balance, our recommended option is the most beneficial for consumers. Implementing options 2 and 3 in combination will have a positive impact on consumers by increasing engagement and information, enabling consumers to make better choices, which we believe outweighs any potential negative impacts.

Impacts on competition

1.31. The following section discusses the impact of a range of options on competition. This assessment is based on general principles of competition economics, qualitative analysis and results from consumer research.

Option 1: Maintain current arrangements and review in the future if necessary

1.32. The following section discusses the impact option 1 would have on competition within the domestic retail energy markets.

1.33. With this option there would be no change to current regulatory obligations for existing or prospective suppliers; therefore, the short run impact of this measure on competition would be neutral. We would expect little or no near term impact on supplier business models, or the type of offers they make available if we pursued this option.

1.34. However, over time this strategy may lead to a reduction in competitive pressures within the market. The practice of automatically rolling domestic consumers onto subsequent offers means that, a number of consumers on Fixed Term Offers may find they are automatically locked into a subsequent fixed term, or other, energy product. Depending on the terms within a consumer's domestic energy contract, suppliers may be able to do this without engaging fully with consumers or making customers aware of specific options available to them within a timeframe that would allow consumers to explore alternate offers. Consequently, there would be effective retention of a share of consumers on Fixed Term Offers, with consumers potentially being locked into to subsequent terms that are dictated by their supplier. Over time, this could lead to a decrease in competitive pressure on the market as customers that are automatically rolled over may not be able to actively seek out other offers. Similarly, customers who are automatically locked in may become frustrated by this experience and choose to disengage from the market.

1.35. If the use of automatic contract rollover in the domestic market continues to grow, there is a risk that the negative impact this practice has on competition in the retail markets will grow with it.

Option 2 and 3 in combination (our preliminary recommendations)

1.36. Below we consider the impact pursuing option 2 and 3 in combination would have on competition within the domestic retail energy markets.

1.37. This approach could positively impact competition in a number of ways. Most significantly, it would help give consumers the tools they need to engage with the market and consumers who are more engaged are better able to exert competitive pressures on suppliers. This option would result in consumers on Fixed Term Offers receiving information needed to fully understand their existing offer. New regulations would also ensure that the information is provided to consumers in a timely way so they have an opportunity to understand the details presented and use that information to inform their energy procurement decisions. Crucially, they will also have visibility regarding what their offer would revert to in the event they do not agree to another offer with their existing, or another, supplier.

1.38. Clear and accurate information can enable customers to more easily access the details needed to understand their offer. This information can, therefore, empower customers to make an informed choice with regard to which offer best meets their needs. Research conducted via our Consumer First Panel shows consumers indicate they value clear information that is directly relevant to them.

1.39. When customers are engaged with the market, and make decisions about which market offering to chose based on the option that is best for them, this provides important signals to the market and to suppliers. Active and informed customers are better placed to shop around and compare offers, and they indicate their preference for certain options through the products and services they choose. Engaged customers are better placed to offer direct and indirect feedback to suppliers about what types of options they prefer. This can happen through supplier's tracking of market trends, but active customers may also seek out or request alternate service packages directly from suppliers, which can help suppliers innovate and develop products in response to consumer needs.

1.40. This policy should help competition by ensuring that customers who are automatically rolled onto a further Fixed Term Offer are given the opportunity to engage with the market and switch supplier at least once in every 12 month period. This option also provides some protection to consumers who, despite the additional information, do not engage with the market, or chose to be automatically rolled over onto a subsequent offer. In the event a consumer on a fixed deal does not act to agree a new offer with their supplier and is automatically rolled onto a subsequent Fixed Term Offer, the length of time a consumer can be locked in would not exceed 12 months.

1.41. Although there are clear benefits to competition from this policy option, there are also risks associate with these measures. The requirement to provide increased information to lead to some uncertainty in the market as suppliers may be uncertain over the exact nature of consumers' response to additional information.

1.42. This proposal has the potential to restrict some forms of innovation, although it would only directly impact the length of Fixed Term Offers available when a customer is automatically rolled over. This proposal may lead suppliers to offer longer initial fixed contract lengths to increase certainty that the customer will stay will them over a longer period of time. In principle we do not see this as problematic, providing consumers agree to such terms with full awareness of their implications. This could be a useful type of product innovation; however, it may also negatively impact competition by locking consumers in for a greater length of time, therefore limiting the frequency with which they may look to evaluate other energy options.

1.43. A further risk is that suppliers may lose some ability to price subsequent fixed offers in a more responsive (i.e. real time) way due to the need for advanced notification of offers well in advance of the end of a fixed period. In practice, we do not think this will have a material effect on the market.

1.44. As with any rules, suppliers may face additional costs due to the introduction of new rules. This can take the form of direct costs, due to the need to circulate additional information, and indirect costs. Such costs may have a relatively larger impact on smaller suppliers who may be less able to benefit from economies of scale compared to larger suppliers. To the extent that this would deter companies from the market this could cause a reduction in competitive pressure.

1.45. These remedies largely seek to ensure that consumers have an opportunity to engage with the market and understand the energy offers they are agreeing to. Therefore, we consider the potential benefits to competition are significant, and the downside risks relating to this proposal are minimal in comparison.

Option 4: Introduce an effective ban on suppliers' ability to automatically lock consumer into subsequent Fixed Term Offers

1.46. The following section discusses the impact option 4 would have on competition.

1.47. This option will encourage suppliers who wish consumers to agree a subsequent Fixed Term Offer that is binding, to ensure that any such agreement would be made as a result of clear engagement with the consumer toward the end of their contract. If this does not take place, consumers can terminate the agreement without being subject to any termination fees. This would help promote competition by providing a clear incentive for suppliers to prompt consumers on Fixed Term Offers to actively select an energy option toward the end of their fixed term arrangement. Increased consumer engagement facilitated by such a prompt from suppliers may bolster the competitive pressures consumers exert within the market.

1.48. However, this arrangement would place limits on the use of automatic contract rollovers in the retail energy markets. This leads to concerns about how some suppliers' business models may be impacted by such a measure and the wider impact this may have on competition within the market.

1.49. From our experience in both the domestic and non-domestic markets we know that some suppliers, particularly new entrants and smaller suppliers, may use Fixed Term Offers to help manage their exposure to wholesale market risk. We are aware that some consumers may choose not to act at the end of a fixed period. Under this option these customers could be placed on a subsequent Fixed Term Offer, but would not be liable for termination fees if they chose to switch away. Having certainty over their customer base and the total amount of energy they need to purchase over a period of time can allow suppliers with given business models increased certainty over their costs, which minimises the risk premium they need to build into their pricing. As such, they are able to pass the savings on to consumers and to remain competitive with larger, often vertically integrated, suppliers who have larger consumer profiles and benefit from economies of scale when procuring energy. If suppliers were prohibited from enforcing Fixed Term Offers this may greatly increase some suppliers' exposure to risk and could also impact their business models. If such suppliers exit the market, this could cause a reduction in competitive pressures within the domestic retail market as a whole.

Impacts on sustainable development

Eradicating Fuel Poverty and protecting vulnerable customers

1.50. Maintaining current arrangements with respect to Fixed Term Offers, as outlined under option 1, may result in some risk to vulnerable and fuel poor customers. There is a risk that consumers would not receive full and clear details regarding what offer they would revert to following a Fixed Term Offer. As a result consumers may find themselves automatically rolled onto subsequent Fixed Term Offers which may be costly or may not meet their needs, this can be particularly harmful to fuel poor consumers who may already struggle to pay their energy bills. Also, if information about rollover offers is not clearly presented it may be a particular challenge for some vulnerable customers to be in a position to seek out the relevant information and engage effectively.

1.51. Policies outlined in option 2 and 3, including improved information requirements and limiting automatic rollovers to a maximum of 12 months, may empower consumers coming to the end of a fixed term arrangement to seek out the offer that is best for them. While this would apply to all consumers on Fixed Term Offers, it could be particularly helpful to fuel poor and vulnerable consumers on fixed term deals. For consumers who are not as literate or numerate as others, the provision of information that clearly explains their energy offer can be critical to them understanding which options are available, and enabling them to engage with the retail energy markets. Similarly, this policy option can help ensure fuel poor consumers are better placed to avoid getting locked into an offer that may be more costly than others available.

1.52. By limiting suppliers' ability to charge a termination fee to consumers who have been automatically rolled over onto a subsequent offer, the rules proposed in option 4 would help to mitigate any negative impact vulnerable or fuel poor consumers would face as a result of rollover provisions within consumer contracts.

Managing the transition to a low carbon economy

1.53. Although Fixed Term Offers do not make up a significant portion of the market at the moment, in future there is potential for their popularity to grow. Suppliers may use longer Fixed Term Offers and automatic contract rollovers to give them increased clarity over levels of consumer demand, which can reduce potential risks associated with investing in generation capacity, including low carbon sources such as nuclear, wind and hydropower. Any attempt to limit, or prevent, suppliers from being able to lock consumers into fixed term arrangements, including when this is done automatically, may increase the uncertainty suppliers’ face with regard to levels of consumer demand.

1.54. This is a particular risk with regard to option 4, as consumers who are automatically rolled over will be able to move supplier without being subject to a termination fee.

Promoting energy savings

1.55. Measures that lead to suppliers providing more information to consumers about their energy offers and encouraging engagement may help promote consumers' interest in all aspects of energy procurement and use. This can include increased consumer awareness of personal energy consumption patters as well as potential costs savings available through demand reduction and energy efficiency measures.

1.56. Conversely, if consumers feel they have limited ability to take control of their energy decisions, which may happen if they are automatically rolled onto an offer without their knowledge, they may become frustrated with the energy market and be less likely to take an active interest in exploring energy options or demand reduction measures.

Ensuring secure and reliable gas and electricity supply

1.57. As noted above under "managing the transition to a low carbon economy", there is potential that limiting suppliers ability to automatically lock consumers in may provide them with some uncertainty over expected levels of demand for their consumers base.

1.58. This could lead some suppliers to face additional risk, and therefore costs, when seeking to invest in new generation capacity. In some cases it is possible that suppliers could use customers on fixed deals as collateral, or as part of a business case, to help secure funding for investment. Our preliminary recommendation would have some impact on this as contracts could only be automatically rolled over for up to 12 months at a time; however, option 4 may be more problematic in this context as all consumers who were automatically rolled over could switch away without being subject to a termination fee.

Supporting improved environmental performance

1.59. The options considered in this consultation are likely to have a neutral impact on environmental performance.

Risks and unintended consequences

1.60. In earlier sections of this Appendix we have discussed the likely impacts on consumers and competition of recommended options. The following section discusses any risks and unintended consequences of the proposed options.

1.61. Any regulatory intervention to address our concerns may have unintended consequences on suppliers incentives for product offerings and sustainable development. Both our recommended option and the proposal for banning automatic contract rollovers could distort product innovation. The future of the domestic energy market is changing with significant developments in technology, such as smart meters and new challenges, such as security of energy supply. It is likely energy suppliers will innovate with consumer energy tariffs to adapt to these future developments. Any restrictions we impose on automatic contract rollover features may alter future new tariffs, both in terms of range of products and tariff types. The outcomes of these market distortions at this time is unclear, they could be either beneficial or detrimental for consumers.

Other Impacts

1.62. We do not perceive there to be any additional impacts as a result of our proposals. However, we welcome views in the responses to this consultation.

Impacts on Health and Safety

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

Post-implementation review

1.64. To some extent, the nature of post implementation review may differ depending on which option is ultimately adopted. If we decided to maintain current arrangements or draw specifically on existing regulations we would continue to consider how clearly suppliers communicate key terms of contract and changes of any subsequent or rollover offers to their customers. If we introduce new regulation we will monitor both the implementation of these measures and the impact they have on consumers and the market.

1.65. Regardless of the option pursued, Ofgem will continue to monitor information provided to consumers on Fixed Term Offers, with particular attention to information outlining offers for any subsequent period(s). In all cases we maintain the ability to take further action, where appropriate.

Conclusion

1.66. We are concerned the practice of automatic contract rollovers in the domestic market is causing consumer detriment. There are existing licence conditions and consumer protection rules that may be applied to address some of these concerns. However, no bespoke domestic licence conditions currently exist.

1.67. We recommend implementing a combination of options 2 and 3 which will rely on existing licence conditions and consumer protection rules and introduce bespoke conditions to address our specific concerns with automatic contract rollovers. We believe there is a net positive impact on both competition and consumers of introducing these options. We have presented a range of regulatory options. However, on balance, it is our view that this combination of options has a larger positive impact than the other options discussed.

1.68. We invite interested parties to comment on the options presented and where appropriate, suggest alternatives that might better meet the stated objectives. Where possible please include any supporting evidence to substantiate your views.

1.69. Following closure of this consultation and consideration of the responses it is our intention to publish a consultation on any proposed changes.

Appendix 7 - Glossary

A

Automatic contract rollover

Where a supplier extends the duration of an existing Fixed Term Offer or applies a new Fixed Term Period.

Annual Bill

The amount that a customer would have to pay for gas and/or electricity over one whole year.

Acquisition costs

Suppliers' costs attributable to the marketing and sales activities to attract new domestic customer accounts, and costs associated with influencing existing customers to change tariffs.

B

Big 6

The name collectively given to the six companies that hold supply licences and supply most of the energy to domestic households in the GB market. They are: Centrica plc (three retail brands, British Gas, Scottish Gas and Nwy Prydain in England, Scotland and Wales respectively), E.ON UK, Scottish and Southern Energy (SSE), RWE npower, EDF Energy and ScottishPower.

C

Capped Energy Tariff

A tariff which guarantees that the price paid per unit of gas or electricity used will not rise above a set level, and with no explicit bounds on how low the price may fall.

D

Deemed Contract

A contract deemed to be in place pursuant to paragraph 8 of schedule 2B to the Gas Act 1986 and/or paragraph 3 of schedule 6 to the Electricity Act 1989, e.g. where a customer takes a supply of electricity and/or gas otherwise than under a contract that has been expressly entered into with a supplier.

E

Evergreen contract

A supply contract of indefinite duration which may be terminated by the customer by giving notice in accordance with the contractual terms, e.g. 28 days' notice.

F

Fixed price tariff

A tariff that guarantees that the price paid per unit of gas or electricity used will not change for a given period of time.

Fixed Term Offer

An product which provides specified features for a predetermined period of time.

H

Hedging

Deals based on the future price of a good or service instead of dealings based on the daily price of a good or service. This enables those purchasing a good or service to reduce the risk of short term price movements.

I

Inbound sales activity

A sales channel used by suppliers to access the market that requires proactive engagement by the consumer. These include online (e.g. switching sites), supply companies' own websites, and direct calls to suppliers.

M

Micro Business

Businesses that employ fewer than ten people and which have an annual turnover of less than 2 million euros; or which use less than 200,000 kWh of gas per year or 55,000 kWh of electricity per year

P

Price guarantee tariff

A tariff that provides customers with a degree of price certainty.

S

Small suppliers

Suppliers which operate in the gas and electricity market but do not hold significant market share.

T

Termination (exit) fees

The contractually agreed price a customer must pay (where part of their contract) if they terminate their contract before the agreed contract end date.

Tracker tariffs

Guarantees that the energy prices charged to consumer on such offers will follow either another specified energy tariff or the wholesale cost of gas and electricity

Appendix 8 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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