Consumer Focus response to Ofgem's Retail Market Review

June 2011

About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses, public services and policy makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers, and aims to give people a stronger voice. We don't just draw attention to problems – we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

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Executive summary

Consumer Focus welcomes the ambition of Ofgem's Retail Market Review (RMR) which proposes a fundamental challenge to the structures of the market. We agree there is an urgent need for reforms to address problems with the current market which include low consumer confidence and high levels of complexity in the retail market as well as the lack of transparency and illiquidity in the wholesale markets. Any reforms, however, must recognise the fundamental changes that will be presented by the roll out of smart meters and the launch of the Green Deal. The success of both of these initiatives must be accompanied by significant changes in consumer behaviour to mitigate the impact on consumers of the investment required over the next 10 years to decarbonise, and provide security of, energy supply.

The Government has proposed the abolition of Consumer Focus and transfer of some functions to Citizens Advice. We will work constructively with Ofgem, industry and other consumer bodies up until the moment this happens. Our priorities are to help improve consumers' understanding of the energy market, particularly on how to get a better deal and take advantage of the opportunities presented by these new programmes.

Proposal 1

Energy consumers' current understanding of their tariffs and bills is generally poor. This is having an impact on consumers' ability, particularly those more vulnerable consumers, to make informed choices. Improvements will require structural changes to the energy market – by tackling tariff complexity and proliferation. Low engagement levels must be tackled by improving consumers' understanding. This is essential to ensure that consumers benefit from the upcoming changes to the energy market including smart meters and the Green Deal.

Consumer Focus believes the proposals aimed at tackling tariff complexity are ambitious and have real merit but they also carry significant risks. We are concerned that there could be significant unintended consequences. The Impact Assessment will be crucial to understanding the costs and benefits associated with these proposals.

Much of the success of the proposals is linked to delivering behavioural change, which is a very complex and challenging process. Access to better information is a prerequisite for consumer understanding but will not necessarily result in action. **Ofgem must be very clear on what success will look like**, and this definition should be developed in conjunction with consumer groups and industry, particularly with regard to tackling the current low levels of consumer engagement.

Consumer Focus was surprised by the limited references in the RMR to the emerging challenges presented by the smart meter roll out and the Green Deal, which will have a significant impact on consumer bills, the structure of energy tariffs, consumer protection regulation and competition in the energy market. Any changes to tariffs must be future proofed to deal with the evolving energy market and the new challenges it will present.

Consumer Focus's headline views on Ofgem's proposals to change the structure of tariffs are as follows:

Supportive of:

- Price information presented in a standard format to enable easy comparison
- Introduction of common price elements
- All penalties and contract terms must be clear
- An end to auto-rollovers where a termination fee is levied and an improved notification process
- No terms that allow adverse unilateral variations
- Introduction of common language for tariffs and their associated components
- Introduction of a key facts document, similar to that used in the financial services sector

Qualified support for:

- Compulsory standardised element set by Ofgem and identified separately on consumers' bills
- All other revenue recovered through a single unit charge set on a p/kWh format

Remain open minded but have significant concerns:

- Limit suppliers to one standard evergreen tariff per payment method

Recommend that Ofgem introduces the following protections:

- Provide clear guidance on aspects of tariff structures, or the way in which they are sold, which may be at variance with the Standards of Conduct
- Increase the resourcing / priority of the enforcement function within Ofgem
- Introduction of a requirement to ensure 'informed consent' where a discount is not guaranteed
- Introduce behavioural disincentives to offering complex products or dubious discounts
- Consumer First panel to regularly review tariff offerings to determine fairness and user-friendliness

Proposal 2

Consumer Focus welcomes Ofgem's intention to intervene in the wholesale electricity market. There has been a lack of wholesale power market liquidity for many years, particularly on the forward market. We believe that not only does low liquidity constitute a barrier to entry and expansion in supply but also in generation. The slow progress of the N2EX to attract significant traded volumes and a significant variety of market participants proves the need for regulatory intervention.

The development of liquid traded wholesale markets is fundamental to ensuring:

- that consumers receive a fair, efficiently determined market price
- the promotion of efficient competition in generation and supply
- the provision of efficient price signals needed to ensure efficient future investment in generation assets

Liquid wholesale markets are fundamental to ensuring the success of the Government's Electricity Market Reform (EMR) proposals that intend to help better deliver future investment in low carbon generation.

It is not clear to us that the Mandatory Auction and Mandatory Market Maker are entirely distinct proposals. The best elements of each could provide the basis for a satisfactory regulatory solution, although an entirely different approach might be just as satisfactory or even more so.

Below we summarise the key details that any solution should provide to improve the functioning of the wholesale power market:

- The provision of forward wholesale electricity volumes is essential. A standalone day-ahead auction is not a viable solution
- An over the counter (OTC) intermediated market approach is preferable to an exchange approach, principally due to the collateral requirements applied on exchanges
- Both auctions and continuous trading can provide benefits for wholesale market participants and thought should be given as to how electricity volumes can be provided under both approaches
- The optimal volume requirement to foster efficient wholesale markets is 100 per cent of generation output. As such, at least 20 per cent of electricity volume should be openly traded, although there is a strong case to increase this requirement. A greater volume requirement would better encourage an efficient wholesale market
- All electricity generators (above a yet to be determined output threshold) should participate in a solution depending on the remedy design, ie does it support a level playing field between electricity generators?
- Any solution will require adequate regulatory monitoring to ensure compliance

Moreover, we summarise below additional issues that Ofgem should further investigate and report on in the next consultation document:

- How best to incentivise the development of voluntary market makers and bring forward proposals
- Proposals on the design of a self supply restriction and the best way to ensure the participation of the large electricity retail companies
- How to ensure cost effective collateral requirements. At this stage we do not believe a convincing case has been made to weaken the current trading collateral requirements
- Proposals on how to best incentivise commercial market making
- The ability of generators to provide forward shaped products cost effectively
- Learn lessons from the existing market solutions developments to improve liquidity (principally the N2EX) in developing its proposals

Proposal 3

Consumer Focus agrees with the further standardisation of supplier bills and Annual Statements. However, we want any messaging to be carefully trialled to ensure it is sufficiently accessible to all groups of consumers.

We support the Standards of Conduct being transposed into a licence condition(s).

We strongly welcome the commitment to carry out more proactive monitoring and devote more resources to compliance and enforcement work.

Consumer Focus will endeavour to take forward proposals, in conjunction with Ofgem, suppliers and the switching sites, to improve consumer confidence in switching sites. This will include working with suppliers and sites to improve the quality of tariff data.

Proposal 4

Consumer Focus is pleased that Ofgem has concentrated on some of the issues that concern us in micro-business energy supply but believe that there is scope for more effective action.

Ofgem should acquire new powers to deal with third party intermediaries (TPIs) and consider extending domestic back-billing protections to non-domestic consumers, as well as a new approach by suppliers to debt and disconnection.

SLC 7A needs to be reviewed to ensure its spirit is being complied with.

Proposal 5

Consumer Focus broadly welcomes the proposals to appoint a leading firm of accountants to review the transfer pricing strategies of the vertically integrated suppliers. We think that the key to the success of this work will be ensuring the comparability and integrity of the annual segmental statements, and ensuring that they are produced and analysed in a timely manner.

Responses to specific questions

Question 1: Do stakeholders agree with our findings of the Review in relation to causes of persistent consumer harm and barriers to entry in the energy retail markets.

Consumer Focus agrees with Ofgem's general conclusions in the RMR on the causes of consumer harm and the barriers to entry in the energy retail markets.

Question 2: Do stakeholders consider that Ofgem should take action to reduce the complexity consumers face and enhance engagement with the energy market?

Consumer Focus believes there are three distinct problems that need tackling – tariff complexity, tariff proliferation and low consumer engagement in the market. We believe that Ofgem's RMR proposals have the potential to address the issue of tariff complexity – by which we mean the actual structure of tariffs. However, they are unlikely to address the problem of tariff proliferation given that there will be no constraints on the number of fixed term tariffs available. Thus consumers carrying out a price comparison will be required to choose between hundreds of different tariffs. The RMR document notes that the total number of available tariffs, excluding variations by payment types, has increased by over 70 per cent since 2008. This is clearly having an impact on consumers' ability, or willingness, to make an informed switching decision. We are not convinced that improving the price comparison process will necessarily result in a significant improvement in consumer engagement levels. A key reason for low consumer engagement is an inability to discern what the best available deal is for them and the existence of too many available choices can lead to difficult or complex decision making processes. The mobile phone market is a good example where poor decision making is linked to the excessive levels of available tariffs.

Consumer Focus's December 2010 open letter on energy tariffs[1] highlighted our concerns about the consumer confusion caused by tariff proliferation and tariff complexity. We believe this confusion has a negative impact on consumer engagement levels and results in many consumers making poor or inappropriate choices. Our recent consumer research on energy bills and Annual Statements further supports the conclusions reached by Ofgem. Many consumers have a limited understanding of what is meant by an 'energy tariff', with a lot of them merely defining tariffs in terms of different payment methods[2]. Our March 2010 omnibus survey found that 57 per cent of electricity consumers and 59 per cent of gas consumers didn't know which tariff they were on, or how much they paid per unit[3].

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[1] http://consumerfocus.org.uk/g/4my
[2] http://consumerfocus.org.uk/g/4p9
[3] Findings from an online Omnibus survey of 2,048 consumers aged over 18 years conducted by ICM on behalf of Consumer Focus, March 2010. Full findings are available on request.

Ofgem's proposal to simplify standard variable tariffs such that each supplier may only offer one per payment method, and in a prescribed format of a defined standing charge and a single unit rate, is genuinely radical. However this proposal has significant potential advantages and disadvantages that will need to be carefully bottomed-out as the proposals are further developed.

The proposal has to be flexible enough to work with the new opportunities presented by the roll out of smart meters, which have the potential to transform the existing consumer-supplier relationship. Finally, any proposals that will lead to changes to bills or Annual Statements must be joined up with the DECC initiatives to add information about the cheapest tariff and comparative consumption information on bills.

At this stage we are unclear as to how Ofgem would define success, particularly around tackling low levels of consumer engagement.

PROPOSAL 1

Question 3: Do stakeholders agree with our initial proposal for intervention to reduce the complexity consumers face and enhance engagement in the energy market?

Consumer Focus believes Ofgem's proposals have the potential to tackle concerns over the current level of complexity in the energy market. We are unsure whether they will have significant impact on low engagement levels.

Perceived low consumer engagement has a number of potential root causes. Many consumers will be satisfied with their current provider. Some consumers may be unwilling to engage with the market because they are confused by the array of tariffs on offer, or unable to understand how to find a better deal. Others may feel the savings available to them are not worth the hassle of switching (see response to Question 7). Some consumers may be unwilling to engage whatever the circumstances, regardless of whether new information remedies are introduced. Even if radical and sweeping changes are made, there are no guarantees that consumer confidence can be rebuilt, particularly if engagement levels are low as a result of a previous poor experience or because there are few discernable differences between suppliers.

Consumer Focus supports the following aspects of Ofgem's initial proposals:

Price information presented in a standard format to enable easy comparison

- We agree this would tackle the existing problems where consumers find it difficult to carry out accurate price comparison due to the differences between the number of first and second tier units
- However we believe that the 'standard proforma' must be carefully tested with consumers to ensure that the comparison information is sufficiently accessible and understandable by the widest possible group

All penalties and contract terms must be clear

- While some suppliers have made some improvements to their processes in response to criticisms, there is still room for extensive improvements

An end to auto-rollovers and improved notification process

- We agree that consumers must actively opt in to a new contract that has a termination fee[4]
- These deals can be attractive, but the choice should always be for the consumer to opt-in
- We agree that consumers should be provided with a statement ahead of the contract end date with details of the roll over offer and switching prompts
- Automatic rollover locks in those consumers most naturally inclined to switch supplier or tariff. It therefore frustrates the development of a competitive marketplace and has a dilatory effect on the extent to which consumers can punish or reward supplier performance

No terms that allow adverse unilateral variations

- We agree this is unacceptable and not within the spirit of the existing licence conditions

Consumer Focus is supportive of the following elements of the proposals, subject to certain qualifications.

Compulsory standardised element set by Ofgem and identified separately on consumers' bills

- It is right that consumers meet the fixed costs associated with having a gas and electric supply and we are supportive of this being identified clearly on bills.
- However to be fully supportive this of proposal we would want to ensure this standardised element would allow for a shift in levying environmental and other taxes to a per unit basis, as opposed to a per household basis. The Fuel Poverty Advisory Group (FPAG) is currently reviewing the way levies are applied to customer bills with a view to moving to a more progressive and fairer collection method. Given the broad correlation between energy use and income levels, and in keeping with polluter pays principles, it may be decided that a change is desirable.
    - There will be circumstances where a small minority of vulnerable households could be worse off under these proposals. In these cases, it may be easier to use other levers available, such as Warm Homes Discount, Energy Company Obligations (ECO), etc, to ensure these households do not lose out
    - The Impact Assessment will need to carefully consider the distributional impacts, in particular the impact on electricity only households

All other revenue recovered through a single unit charge set on a p/kWh format

- The current lack of consistency between suppliers on two-tier tariffs is an area that causes significant confusion for consumers. In particularly the varying rates and volume of first tier units charged across suppliers makes it extremely difficult for consumers to make comparisons. Our preference is for the introduction of a single rate tariff with an associated fixed standing charge
- The current tariff structures do not allow for clear comparisons and transparency about prices, as required under the Third Package

[4] **http://consumerfocus.org.uk/g/4ne**

- It has led to a situation where accurate price comparisons are difficult to carry out without the assistance of a sophisticated calculator, such as those used by price comparison sites. In addition, if consumers under-estimate or over-estimate their consumption, the results may not be accurate
- We accept that a small minority of very low users may be worse off as a result of this change but believe the benefits to the majority of consumers would outweigh the disadvantages

Consumer Focus remains open minded about Ofgem's proposal to limit suppliers to one evergreen contract per payment method. At this stage, however, we believe this proposal has more disadvantages than advantages. The Impact Assessment will be useful for bottoming out the associated cost benefits.

Advantages

- The proposal may better align consumers' and suppliers' interests as complex tariffs could only be offered to those consciously willing to take them on (ie by switching to a fixed price/term product). Consumers would otherwise be on the standard tariff by default
- We suspect that this approach may mitigate, though not eliminate, some of the problems of dubious discounts[5] that many consumers cannot qualify for. Such discounts would appear to be incompatible with the product structure that Ofgem envisages

Our concerns:

- The main aim of most energy consumers is access to a competitively priced tariff and the RMR proposals may not address the current low levels of consumer engagement. This could leave the majority of consumers on an uncompetitive product. We believe that suppliers would have limited incentives to compete for these customers
- There will be substantial costs associated with any migration process and the bulk of consumers could find themselves cross-subsidising the (already empowered) group of consumers who are most likely to take advantage of fixed term tariffs
- The distributional impacts of moving consumers from a wider range to tariffs to a much narrower range with different characteristics will need to be very carefully explored in the Impact Assessment
- There may also be significant costs associated with applying and explaining the changes to consumers
- The difficulties of migrating the majority of energy consumers on to a new evergreen tariff at the same time when several of the major suppliers are moving their billing systems to new platforms should not be under-estimated
  - We are aware that four of the big six are, or will be, undergoing a major billing migration in the coming years. Previous migrations have resulted in extensive disruption for suppliers and their customers – most notably British Gas's migration to its Jupiter billing platform between 2005 to 2007
- The proposals are unclear on what will happen to consumers with variant electricity meters who tend to be on more bespoke tariffs

[5] For further details on the nature of such discounts, please see our open letter to Ofgem of 2 December 2010, **http://tinyurl.com/5rc2svy**

  - There are approximately 5.5 million variant meters in situ at the moment, equivalent to about one in five domestic consumers[6]. This includes 2.5 million meters that use Radio Teleswitching Technology and 3 million meters that have time switched controls
  - A substantial proportion of these households will be on tariffs, including time of use or off peak tariffs, that are tailored to the needs of the meter or heating system installed in their home
- It is unclear what will happen to the households on preserved tariffs. Moving to a standard tariff could prove detrimental to these consumers
- It is also unclear how the proposals will work with the introduction of more complex tariffs likely to be facilitated by smart metering. For example, how would these tariffs be configured or, indeed, would they even be allowed?
  - Much of the benefit associated with the smart rollout will be derived from changes to consumer behaviour. Ofgem must ensure that these opportunities are not constrained by the proposal to limit evergreen tariffs
  - There is expected to be a movement to half hourly settlement in the coming years. As a result, suppliers' cheapest deals are likely to be their demand response tariffs, which will offer lower prices to consumers who can shift or reduce their loads in certain areas and at certain times of the day
- We acknowledge suppliers' concerns that consumers who have actively chosen to switch to a more specialised tariff, such as a green tariff or a fixed price tariff like Staywarm, could be disadvantaged by these proposals as they would need to re-contract every year

Question 4: If not, then do stakeholders have alternative suggestions for proposals to reduce the complexity consumers face and enhance engagement in the energy market?

As mentioned in our response to Question 3, Consumer Focus has significant reservations about the proposal to limit suppliers to a single evergreen contract.

In addition to the proposals listed in our response to Question 3, we believe the following changes should be introduced:

Introduction of a key facts document similar to that used in the financial services sector

- We believe this would allow consumers to more fully understand the advantages and disadvantages of the tariff they are signing up to. See our response to Question 6

This would be a relatively easy proposal for suppliers to implement and would bring the added value of ensuring suppliers review the terms and conditions of their range of tariffs and look to simplify where possible and/or justify the inclusion of complex terms.

Introduction of common language for tariffs and their associated components

- This is a relatively simple proposal to adopt which could improve consumer understanding of energy tariffs

[6] Source: briefing prepared by SMDG Electricity Meter Variant sub group.

Introduction of common price elements

- We are in favour of further exploration of this idea, subject to our concerns listed in Question 3 and 5 being addressed

Ofgem to provide clear guidance on aspects of tariff structures, or the way in which they are sold, which may be at variance with the Standards of Conduct[7]

The proposal to transpose the Standards of Conduct into a licence condition(s) has merit and we believe it is worthy of further discussion. We anticipate that suppliers will argue that such a move would expose them to unreasonable regulatory risk, because the standards of conduct are 'principles-based' rather than 'rules-based'. While a thorny issue, we do not consider that this is an insurmountable problem; we note that principles-based enforcement regimes have been successfully applied in other regulated retail markets (for example, financial services). Regulatory risk may be mitigated by the provision of regular guidance on good and bad practice; ie effectively setting out 'minded-to' positions on what will or will not be likely to be considered a breach of licence. We would also expect the regulatory risk faced by suppliers to decrease over time as regulatory decision making will build up the level of regulatory precedent. Over time there will be increasingly comprehensive guidance available to market participants on what is and is not prohibited. More broadly, it must be borne in mind that the status quo clearly is not working; while a change of tack brings risks, it appears naive to expect voluntary standards to suddenly start working when they have gained little traction to date.

We consider that it may also be worth giving the following ideas further consideration:

Increasing the resourcing / priority of the enforcement function within Ofgem

Applying existing rules with greater vigour may improve supplier behaviours ('credible deterrence').

Introducing a requirement to ensure 'informed consent' where a discount is not guaranteed

You will be aware from our December 2010 open letter that we remain worried that some suppliers are offering dubious discounts that many of their customers may not qualify for or would find difficult to obtain. We would welcome consideration of how to ensure consumers are fully aware of the likelihood that they will qualify for a discount and can factor this in to their decision to switch or stay.

This may take the form of a 'key facts' document, similar to those produced in the financial services sector. A complementary remedy may be to require some form of 'informed consent' to be built in to the sales process. For example, requiring the supplier to include a discrete screen (internet sales) or section of the sales script (phone or face to face sales) setting out the circumstances that may affect whether the customer qualifies or not, checking whether they apply to that customer or not, and telling them the results.

Introducing behavioural disincentives to offering complex products or dubious discounts

There may be merit in considering a requirement that the disclaimers / conditions attached to a discount that is not guaranteed are given equivalent prominence in advertising to the headline discount itself and cannot simply be buried in the small print.

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[7] We were pleased with the contents of Ofgem's recent consultation on guidance for SLC 23 and would support the extension of this approach.

This could create a behavioural disincentive to suppliers offering extremely complex products or ones where customers were unlikely to qualify for discounts.

Ofgem's Consumer First panel to regularly review tariff offerings to determine fairness and user-friendliness

The Consumer First panel, or another suitable consumer body, could informally review new tariff offerings[8] to determine whether a typical consumer would understand the costs and benefits of the tariff.

Suppliers will argue that this approach could constrain innovation and introduce unnecessary delays to the process. However, it would offer the benefit of requiring suppliers to better justify their reasons for introducing new tariff types and over time could provide a constraint on increasing levels of tariff proliferation.

Tackling low consumer engagement

Consumer Focus has done a lot of work this year on seeking to understand whether consumers, particularly which groups of consumers, are reacting or would be more likely to react positively to information remedies or nudges on their energy bills.

Consumers' primary engagement with tariffs is via their energy bills. Research shows that many consumers' overall understanding of their energy bills is quite poor. There is a wide range of evidence (see Consumer Focus 2010[9]; Which? 2009[10]; Uswitch 2009[11] and Ofgem Consumer First Panel 2009[12]) to suggest that energy consumers find bills confusing.

Our research[13] found that:

- Widespread consumer disengagement with energy bills continues
- Distrust of energy suppliers colours consumers' views of information provided on energy bills
- Consumers from low income groups tend to be less engaged with their energy bills
- Information on energy bills does not act as a prompt for behaviour change for the majority of consumers

Consumer Focus was unable to determine however, the interplay between complex tariffs, tariff proliferation and the use of one size fits all messaging. In our research, consumers were polled on their understanding of the existing energy market and it is hard to determine at this stage whether information remedies would be more effective if tariffs were easier to understand. Our assumption is that this would lead to an improvement.

Both our organisations are currently sponsoring a campaign (Energy Best Deal) to encourage greater consumer engagement in the energy market. While the advisers and consumers reached by the campaign are positive about their experience, there is only limited evidence available about whether these households have switched tariff or supplier and/or made other positive behavioural changes.

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[8] We are referring to new tariff types only, not variations on existing tariffs such as Web Saver Version 1, 2, 3, etc.

[9] Online survey conducted by ICM on behalf of Consumer Focus on smart meters and energy billing. 2,048 consumers aged over 18 years took part in March 2010

[10] **http://bit.ly/jcZ7WM**

[11] **http://bit.ly/mKfxjQ**

[12] **http://bit.ly/kUHjlG**

[13] **http://consumerfocus.org.uk/g/4pc**

Consumer Focus is particularly interested in conducting further work in this area given the implications for the future success of Green Deal and the smart meter roll out. We would be happy to work with Ofgem, Government and industry to develop a better understanding of what triggers positive consumer action and where and what new behavioural nudges would deliver positive changes in consumer behaviour (see also Question 14).

For example, sticky consumers could be targeted via the DECC initiative to put cheapest tariff information on bills. However, we acknowledge that this is not a simple fix – the language used and information provided to consumers is crucial. Different consumer groups react to different messages and may favour different information channels. There are also clear barriers to switching depending on the payment method a consumer uses or is willing to switch to. Our recent consumer research shows the difficulties of using behavioural nudges on energy bills as we found that the groups who would most benefit from the information were the least likely to read or react to the nudges[14].

We are aware that the Energy Retail Association members are currently trialling various messages on bills to test consumer reactions to the cheapest tariff nudge, which is a positive step. However, we note that PPM consumers are not included in this trial, despite this group accounting for approximately 20 per cent of the market. We accept that the practical barriers presented by the current technology are steep, given that these households would require a meter exchange in order to sign up to the lowest cost Direct Debit tariff. However, if this proposal is adopted, suppliers are likely to smear the implementation costs across their entire customer base. This is despite the fact that their PPM customers are unlikely to benefit, until they have a smart meter installed, which should facilitate easier switching between prepay and credit. Furthermore, there is a significant correlation between lower household income and PPM usage and these households would be more likely to benefit from switching to a cheaper tariff.[15]

Question 5: We are proposing to standardise evergreen contracts across suppliers. Do stakeholders agree with the proposed contents of the standardised charge?

Consumer Focus agrees with the proposal to standardise tariff structures in order to allow consumers to compare prices on a per unit price. This is a current failing of the existing market where each supplier has a different distribution of first and second tier units, making the price comparison process extremely complex even for more mathematically minded consumers.

We believe the introduction of a standardised element to include transportation and distribution costs and associated levies has considerable merits. The purpose of the standing charge is widely misunderstood by many consumers given the different ways it is currently levied by suppliers eg embedded in unit rate of tariff versus separate charge. Any changes are likely to upset consumers who have deliberately chosen a no standing charge tariff. However, the fixed costs associated with providing an energy supply need to be recovered, that should ideally be done in a transparent manner as possible.

However, we are concerned by the suggestion that the standing charges may include environmental levies. Applying these levies on a per household basis rather than per unit would be a significant backward step on both social and environmental grounds.

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[14] **http://consumerfocus.org.uk/g/4pc**
[15] **http://consumerfocus.org.uk/g/4lx**

This proposal would seem to be inconsistent with polluter pays principles, because all households would pay the same towards decarbonisation regardless of their carbon footprint. It would also disproportionately load the cost burden on to the poorest in society, because (in broad terms) there is a correlation between income and energy usage.

As previously stated, the Impact Assessment will need to carefully consider the distributional impacts of the proposal for a standardised charge, particularly the impact on electricity only households. We note that FPAG will shortly publish new research aimed at making environmental levies more progressive. The RMR team will need to review the results of the FPAG research in considering any changes.

Question 6: We are proposing to create a standardised metric to allow consumers to compare evergreen and fixed term contracts across suppliers. Do stakeholders agree with our proposal for a standardised metric?

Consumer Focus strongly supports this proposal. There is considerable evidence that consumers are reluctant to read extensive contracts (for any product). Our March 2010 omnibus survey found that 74 per cent of consumers had not read the terms and conditions of their energy contract[16]. We therefore think that Ofgem should require the suppliers to produce short 'key facts' documents – similar to those used in the financial services sector. This document should set out the principal terms and conditions of their non-standard products so consumers can more readily understand and compare tariffs without needing to wade through the small print.

We have carried out extensive research over the past year which has revealed widespread confusion about the definition of an energy tariff versus payment method eg many consumers paying by Direct Debit didn't realise that there were a series of different tariffs available to people paying by this way[17].

Question 7: Do stakeholders have any comments on the costs and risks of our proposal, or any alternative suggestions that you have put forward, to reduce the complexity consumers face and enhance engagement in the energy market?

Our December 2010 open letter on energy tariffs identified a number of practices in the market that lead to consumer confusion, low levels of engagement and supplier gaming on price comparison results tables. Consumer Focus wants a market that delivers fair and transparent tariffs and meaningful choices for consumers. When introducing new tariffs, suppliers must be able to justify the tariff and its structure as something consumers want/will benefit from. Any terms and conditions need to be clear and transparent and marketed responsibly (see our response to Question 4).

As previously mentioned, the fundamental question is whether consumer engagement in the market will improve if tariffs are considerably simplified. Ofgem's and our own research suggests that only a minority of consumers are actively engaged in the market and that past informational remedies have had only a limited effect to date[18]. If consumer engagement levels remains low, the majority of consumers may wind up cross-subsidising the costs of implementation on behalf of the small minority of consumers who are active switchers.

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[16] Findings from an online Omnibus survey of 2,048 consumers aged over 18 years conducted by ICM on behalf of Consumer Focus, March 2010. Full findings are available on request.
[17] http://consumerfocus.org.uk/g/4pc
[18] http://consumerfocus.org.uk/g/4pc

Vigorous price competition between suppliers is also key to improving engagement rates. There is evidence to show that the majority of consumers are willing to switch if there are significant savings to be made[19]. However, different groups of consumers will have varying definitions of 'significant' – some consumers who have had a previous bad experience with switching, may require a substantial saving eg over £100.

Consumer Focus asked the switching sites for evidence about actual consumer behaviour. The evidence we obtained shows that where there is more limited price competition between suppliers, consumers are 55 per cent less likely to switch for a saving of less than £50.

The following table shows the propensity to switch based on the available savings, in comparison to the average conversation rate eg consumers seeing a saving less than £25 are 68 per cent less likely to switch than average, whereas a consumer seeing a saving over £200 are 28.5 per cent more likely to switch than average.

Available saving	Percentage of consumers who switch compared to average conversion rate
£0 - £25	-67.9%
£25 - £50	-48.4%
£50 - £100	-26.6%
£100 - £150	-5.3%
£150 - £200	+7.1%
> £200	+28.5%

Consumer Focus is particularly keen to ensure that the RMR proposals address the needs of more vulnerable households. We hosted a series of events with advisers in 2009/10. Our experience from talking to advice providers and organisations involved in helping and supporting consumers (often some of the most vulnerable and/or marginalised consumers), is that their clients cannot engage and find the entire market too confusing. This then has a number of negative impacts including a 'burying head in the sand' attitude toward energy consumption, and consumers might never switch to a cheaper tariff, seek out ways to make their homes energy efficient or take advantage of the social products and other schemes which may help them pay less for their energy use. Worse still this attitude might also lead to debt building up or more dangerous levels of self rationing.

Further thoughts on other identified areas of concern are provided in our response to Question 27.

[19] Morgan Stanley Research report January 7 2011. Their research found that 18 per cent of consumers would switch for discount of up to £50, 54 per cent for up to £100 and 90 per cent for over £100. It should be noted that the research measured consumer intention rather than actual consumer behaviour.

PROPOSAL 2

Question 8: Do stakeholders consider that low electricity market liquidity constitutes a barrier to entry in the domestic retail supply market?

We welcome Ofgem's intention to intervene in the wholesale electricity market. There has been a lack of wholesale power market liquidity for many years, particularly on the forward market (the market for contracts of longer maturity). We believe that not only does low liquidity constitute a barrier to entry and expansion in supply but also in generation.

The main industry solution to combat low levels of liquidity (the N2EX) is not attracting the required traded volumes, as is shown in the RMR supplementary appendices (Appendix 7, fig. 4 page 24). The majority of traded volumes are executed initially on the OTC market and then given to the exchange for clearing ('OTC give up'). Virtually no small and/or independent market participants have signed up to the new exchange citing excessive collateral requirements as a barrier to participation. There is also evidence[20] that the establishment of a new power exchange has further fragmented prompt power trading (which most market participants consider adequately liquid) leading to a further deterioration in liquidity.

The slow progress of the N2EX to attract significant traded volumes and a significant variety of market participants proves the need for regulatory intervention. It is worth noting that N2EX has taken over five years to be established; there has been no lack of time for the industry to develop and implement a credible solution.

The development of liquid traded wholesale markets is fundamental to ensuring that consumers receive a fair, efficiently determined market price. This risk premia can be observed on wholesale electricity markets by comparing forward contract prices with outturn spot prices for delivery on the same day, as well as wide bid-offer spreads. Any risk premia will be ultimately paid for by consumers. Moreover, liquid wholesale markets also promote efficient competition in electricity generation and supply which fosters efficiently determined market prices.

Potentially most importantly in the case of the GB electricity market, liquid wholesale markets (particularly forward markets) provide efficient price signals for future investment in generation assets. This is particularly important in the case of the GB market with major investment expected to be made in the next decade and beyond.

Moreover, liquid wholesale markets are fundamental to ensuring the success of the government's Electricity Market Reform (EMR) proposals that intend to help better deliver future investment in low carbon generation. Robust price signals which liquid markets deliver are needed to provide a credible reference price for use in the Government's favoured Contracts for Difference Feed-in Tariff model.

It is clear that the Big Six do not have the balance sheets required to make these investments on their own. These balance sheets are also highly leveraged. As such liquid wholesale energy markets are crucial to encourage new equity investment. Without investment the cost to current consumers is likely to be prohibitive in terms of ensuring affordable energy supplies.

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[20] This includes anecdotal evidence from market participants but can also be inferred from fig. 4 on page 24 of appendix 7 as most trading on the N2EX has migrated from the OTC (OTC give up) ie displacement of trading volumes from other platforms rather than new power volumes.

We also note the Environment and Climate Change (ECC) Committee report on the EMR which states that 'The current market arrangements do not facilitate a fully functioning wholesale electricity market which transmits the price information necessary to attract investment'. Moreover, the ECC committee states that EMR is a 'misnomer' because it only 'proposes a number of "bolt on" measures that reform the subsidies and structures around the market, not the market itself'.

Question 9: Do stakeholders consider that our two proposed interventions (the MA and the MMM) could improve the ability of the wholesale electricity market to meet independent participants' needs, and will ultimately improve the likelihood of retail supply market entry?

We believe that different elements comprising Ofgem's two proposed interventions could improve the efficiency of the wholesale power market. This is because the proposals don't seem all that distinct from one another. At this stage the proposals are still fairly thin in terms of how they will operate in practice, so there is a fair degree of uncertainty about whether the proposals will better facilitate efficient competitive entry. However, based on the different elements Ofgem discusses in the consultation document and, subject to the right mix being implemented, there is the potential for an improvement in the functioning of the wholesale market and perhaps efficient competitive entry. We discuss the various pros and cons of the different elements of the Mandatory Auction (MA) and Mandatory Market Maker (MMM) and a number of dependencies regarding the success or failure of the proposals further in our response to questions 12 and 13.

However, that is not to say another proposal(s) could not work equally well or even potentially better than the proposals Ofgem is currently consulting on. We discuss the potential of other remedies in our response to question 11.

Question 10: Subject to the results of our further wholesale market assessment, do stakeholders consider that both interventions could be necessary to meet the objectives stated in questions 8 and 9?

Both interventions could potentially be required, although as stated above, we are not entirely convinced that the two remedies are obviously separate. One remedy comprising the best elements of the two proposals (or potentially an entirely different one) might be sufficient to improve the functioning of the wholesale market.

Question 11: Do stakeholders consider that there are other intervention options we should be developing?

The most obvious intervention we believe Ofgem should consider further developing is the self supply restriction. This option was discussed in Ofgem's February 2010 consultation (Liquidity proposals for the GB wholesale electricity market). We are concerned at the lack of detail provided by Ofgem on the reason why this proposal does not feature in the RMR consultation document. Following discussions with Ofgem we understand that there are two main reasons why it has decided against further consideration of the self supply restriction. These are:

1. A self supply restriction provides no guarantee in terms of the types of wholesale products which will be made available to market
2. A self supply restriction will be too difficult to monitor and enforce. Ofgem has previously referred to the difficulties of enforcing the previous Self Supply Licence Condition that was removed in 2004

We believe these concerns can be mitigated. Additional measures to ensure the provision of specific product types could be mandated (or incentivised) with other remedies. Also, we do not believe that the previous problems with the Self Supply Licence Condition are directly applicable. The licence condition was related to the supply of in-area customers. As such this aspect should not be of too much concern.

We have previously stated our support for a self supply restriction (see our response to Ofgem's February 2010 consultation). As such we believe that Ofgem should further investigate the pros and cons of implementing a self supply restriction. However, an assessment of this option must not be allowed to delay the process of designing and implementing a regulatory solution.

It should also be noted that the ability of any remedy to improve wholesale market liquidity requires not only willing sellers but also willing buyers. Mandating, by whatever method, generators to sell a proportion of their output on the open traded market will not increase transparency and produce efficiently determined market signals unless there are counterparties willing to buy this output. Consideration should be given to mandate the largest electricity suppliers (who between them have 99 per cent market share of the domestic retail electricity market) to buy a significant proportion of their electricity requirements from the openly traded wholesale electricity market. This option could be undertaken separately or in conjunction with an obligation on generators to sell a proportion of their electricity output.

To ensure that suppliers are required to purchase electricity sufficiently out along the forward curve, a sliding scale approach could be adopted where the obligation on suppliers to buy steadily increases the shorter the maturity of contract becomes. For example if Ofgem mandated the release of 20 per cent of participating generators' output to the wholesale market the sliding scale approach might work something like this (please note that the numbers provided are only indicative and that defined targets could be different/looser depending on the final design eg it might be decided that a greater degree of freedom for generators to choose when to trade would be more efficient):

- 4 per cent (or 20 per cent of power output) would be sold five years out on the curve
- 4 per cent (or 20 per cent of power output) would be sold four years out on the curve (8 per cent or 40 per cent of power output cumulatively)
- 4 per cent (or 20 per cent of power output) would be sold three years out on the curve (12 per cent or 60 per cent of power output cumulatively)
- 4 per cent (or 20 per cent of power output) would be sold two years out on the curve (16 per cent or 80 per cent of power output cumulatively)
- 4 per cent (or 20 per cent of power output) would be sold one year out on the curve (20 per cent or 100 per cent of power output cumulatively)

Large suppliers will argue that to purchase this far out will be too risky as their demand requirements are too uncertain. However, all the large electricity suppliers have a significant number of 'sticky' electricity customers who are unlikely to switch (as demonstrated in Ofgem's analysis in the RMR consultation document). Moreover, the increased risk should be compensated with an increase in collateral deposited to mitigate against counterparty risk.

Question 12: On the basis that we could decide to take forward these interventions, do stakeholders have comments on the indicative design choices we have made, as set out in Appendix 2.

In particular, views are welcome regarding our initial position on each of the following:

- **Volume requirements**
- **Product requirements**
- **Frequency**
- **Governance arrangements**
- **Participation**
- **Platform**

And;

Question 13: Do stakeholders have any comments on the costs and risks of our proposal, or any alternative suggestions that you have put forward, to take action to improve wholesale electricity market liquidity?

Below we provide our views on the different elements comprising the MA and MMM.

Mandatory Auctions

Product requirements

We understand that there is much industry discussion on the possibility of mandating a standalone day-ahead auction (although we recognise that making use of existing trading infrastructure would have the benefit of being lower cost and also reduce implementation timescales relative to a completely new solution). This should allow for the development of robust reference prices which market participants would then be able to use to purchase financial futures contracts to hedge their electricity requirements (which sounds very close to what is currently provided by the N2EX). While this option does have theoretical attractions we are sceptical about whether market participants, particularly independents and small players, will trade in this way. There is much greater preference for forward physical power products which reflects how independent market participants have traditionally traded.

As such we believe that any auction should not be limited to day ahead and/or prompt contracts. There is a need for this intervention to provide forward physical products and as such products of sufficient maturity (potentially five years ahead) must be provided. One way of ensuring the provision of forward electricity volume could be to have a sliding scale of power volumes released in increasing amounts the closer to gate closure the contract maturities get (as discussed above under question 11). This in many respects reflects the current trading practice of many electricity generators.

There is further debate whether shaped forward products should be provided. Independent suppliers have stated such products would be desirable. However, the companies that are envisaged to be mandated to provide electricity volumes (the Big Six) argue that they do not sell forward shape and as such should not be required to provide it for anyone else. We believe that Ofgem should consider the ability of the Big Six to provide forward shaped wholesale products and the relative costs and benefits of mandating the provision of these products.

Platform

The two obvious choices are an existing or new power exchange or the OTC brokered market. While the easier choice might be to use an existing power exchange, there is a risk that the collateral requirements from such exchanges would be too onerous for independent market participants (partly due to the clearing function). The use of margining on exchanges places obligations on trading parties to hold large amounts of cash. For this reason independent market participants find it more expensive to trade on exchanges.

Furthermore, in terms of price transparency both exchanges and OTC intermediated markets provide adequate price transparency. OTC intermediated markets use of indices (produced by LEBA for example), price reporting and trading screens would seem to provide more than adequate transparency.

There is much discussion within the industry of the need to improve the robustness of reference prices. Exchanges can certainly provide a means to achieve this. However, reference prices could also be improved by ensuring more electricity volumes are traded via the OTC intermediated route. This should improve the robustness of broker indices. A further option could be to introduce a formal trading repository. So while exchanges are probably better in terms of providing price transparency this also comes at significant cost to some market participants for the reasons discussed above (although we discuss the issue of collateral requirements in more depth below).

For these reasons we believe that releasing volumes via the OTC intermediated market represents the more pragmatic approach as it provides comparable price transparency (due to the use of price reporting and broker indices) with an exchange but lower collateral costs in comparison with exchanges.

Collateral requirements

The lack of discussion of collateral requirements is the major weakness of Ofgem's consultation. As discussed above the use of margining on exchanges is prohibitive to allow independent market participants to trade. However, in the consultation document Ofgem discusses the need for fair and reasonable credit arrangements. This begs the question as to what is fair and reasonable.

From a competition and consumer perspective we are keen to encourage only entry and expansion in energy markets which is efficient ie provided at least cost (assuming a given level of output/quality). To mitigate the collateral requirements on an exchange to allow it to operate the auction, there has been industry discussion of the possibility of relaxing the credit arrangements. This might involve some form of self industry insurance fund (or other form of centralised arrangements) where credit is only posted to cover the risk of a small market participant defaulting. There might also be some value in assessing the credit arrangements administered by Elexon, as well as the credit required when trading on the wholesale market, to ensure these separate processes are reasonable.

Making such changes might have some benefits in terms of encouraging the participation of a greater number of firms. However, there are significant risks in terms of encouraging inefficient entry and expansion ie higher costs, resulting in excessive bad debt costs to be ultimately recovered from consumers. An impact assessment on methods to weaken collateral requirements would be an interesting exercise, but at this stage we cannot see how the weakening of the collateral requirements in this way would be in the interests of end users.

In terms of reducing collateral requirements on exchanges, there are obligations placed on exchanges (CCPs) in EU legislation, such as OTC derivatives legislation. This would seem to make it very difficult to make alterations that weaken collateral requirements on exchanges.

However, issues related to credit should not be used as a barrier to improve wholesale power market liquidity. By improving liquidity, particularly on the forward market, we can expect to see new and innovative forms of credit arrangements develop. This is because long term price signals will be available to those able to ease the collateral requirement constraints of market participants, giving them the ability to determine the validity of the investment and future profitability ie is this a good investment or not?

Volume requirements

Quite simply 20 per cent of generation volume is better than 10 per cent in encouraging liquid markets. However, it begs the question as to why more volume should not be brought to market to be efficiently tested among competing electricity volumes. As liquid markets are so important for fostering the benefits outlined under question 8, there is a case to increase the volume requirement beyond 20 per cent. The optimal volume of trading, to ensure efficient price signals, that should be conducted on transparent wholesale markets is 100 per cent. Our understanding is that the old Self Supply Licence Condition was set at 25 per cent of volumes. This would seem to provide a precedent for providing greater volumes to the wholesale market. For the reasons above we believe that, as a minimum, 20 per cent of generation volume should be traded on transparent wholesale markets. However, a larger volume requirement would be better in terms of encouraging the development of an efficient wholesale market.

Auction or continuous trading

There is a real question as to whether an auction or continuous trading will better facilitate increased liquidity and competition. A particular issue has been raised with us in relation to spark spread trading. Where an auction in electricity takes places with gas trading occurring simultaneously there is a risk that fluctuations on the wholesale gas market might make it more difficult for market participants to unwind their positions if they have to procure power on an auction. This is just one potential problem and there will no doubt be more.

It is our view that proposals if they are to improve wholesale market liquidity must be accessible to all viable market participants. It seems to us that both auctions and continuous trading have their place in the traded market and as such there might be a case to consider providing power volumes in both ways. However, we do recognise that there is a risk of fragmenting trading and liquidity further but, nevertheless consider this issue worth further investigation.

Market participants

If designed correctly we can see a case to extend the number of mandated market participants beyond the Big Six generators to include all generators who generate above a certain threshold. In one respect mandating independent generators to trade in an open fashion is only formalising existing trading behaviour (as they are naturally long players). However, depending on the design of the proposal, forcing independent generators to provide X per cent of volume to the market risks making it more difficult for these firms to compete in the market, particularly if these market participants were forced to operate on an exchange. From a consumer perspective it seems that the efficiency of the wholesale market will not be improved by increasing costs to certain players which provide no essential benefit.

The competition perspective of trying ensure a level playing field must also be considered ie the Big Six are better able to manage their collateral requirements on exchanges in comparison with independent market participants.

As such, before extending the membership of these proposals, thought needs to given to the ability of these market participants to meet the obligations, particularly in relation to collateral requirements.

Governance arrangements

A number of market participants have stated that the governance arrangements of the N2EX have not been conducive to eliciting interest from independent market participants. Ofgem should consider some of the difficulties that have been apparent with the N2EX governance arrangements when designing their final proposals (although we accept that the N2EX arrangements have improved since its inception although could be better still).

Monitoring

Finally, it is very important that whatever remedy Ofgem decides to implement must be monitored adequately by the regulator. This is important to ensure that any parties mandated to trade power volumes are complying with the regulation. The use of a trade repository could be one way to improve the ability of Ofgem to monitor compliance with any potential regulatory intervention.

Mandatory Market Maker

We believe that the issues discussed under the MA proposals section above on products, platform, collateral requirements, market participants, governance arrangements and monitoring are also relevant to the MMM proposal.

The major problem with this proposal is that there is even less clarity over how it will work in practice than the mandatory auction. Therefore depending on how the proposal is interpreted has a large bearing on whether the proposal is viewed positively or negatively.

Some market participants have interpreted this proposal as something like ScottishPower's 6 proposals. If this was the case there might be some merit in the proposals. However it is our understanding that the '6 proposals' have suffered from prohibitive collateral requirements and excessive risk premia. As such the collateral issues which are important to the MA are as relevant to the MMM.

If the proposal is interpreted as market makers similar to those that operate in continental wholesale power markets, like Germany and the Nordpool, then the proposal is more problematic. The use of the regulated market making entity might have unintended consequences in terms of creating market inefficiencies and discouraging 'actual market makers' (like large financial institutions). We would need to see a great deal more information on this proposal before will could view it as a viable solution.

It is our view that market making is best undertaken by entities which have an existing commercial rationale for doing so. We understand that it is common for exchanges to incentivise market making on their platforms. Therefore we recommend that Ofgem investigates ways to incentivise commercial market making. In any case, we would contend that the development of a liquid forward market is essential to attracting more market making entities.

Preferred approach

Below we summarise the key details that any solution should provide to improve the functioning of the wholesale power market. We also provide some issues we believe Ofgem should further investigate:

- The provision of forward wholesale electricity volumes is essential. A stand alone day ahead auction is not a viable solution
- An OTC intermediated market approach is preferable to an exchange approach, principally due to the collateral requirements applied on exchanges
- Both auctions and continuous trading can provide benefits for wholesale market participants and thought should be given as to how electricity volumes can be provided under both approaches
- The optimal volume requirement to foster efficient wholesale markets is 100 per cent of generation output. As such, at least 20 per cent of electricity volume should be openly traded, although there is a strong case to increase this requirement. A greater volume requirement would better encourage an efficient wholesale market
- All electricity generators (above a yet to be determined output threshold) should participate in a solution depending on the remedy design ie does it support a level playing field between electricity generators?
- Any solution will require adequate regulatory monitoring to ensure compliance
- Ofgem should consider how best to incentivise the development of voluntary market makers and bring forward proposals
- Ofgem should further investigate and bring forward proposals on the design of a self supply restriction and the best way to ensure the participation of the large electricity retail companies
- Ofgem should further investigate and report on how to ensure cost effective collateral requirements. At this stage we do not believe a convincing case has been made to weaken the current trading collateral requirements
- Ofgem should investigate and bring forward proposals on how to best incentivise commercial market making
- Ofgem should consider and report on the ability of generators to provide forward shaped products cost effectively
- Ofgem to learn lessons from the existing market solutions developments to improve liquidity (principally the N2EX) in developing its proposals

PROPOSAL 3

Question 14: Do stakeholders consider that Ofgem should strengthen licence conditions around suppliers' communications and interactions with their customers to give suppliers less freedom in how they interpret these obligations?

Consumer Focus broadly supports Ofgem's proposals and agrees there is significant room for improvement in suppliers' communications with their customers. We provide several examples of poor practice in this section.

We agree that there is a need for further standardisation of the format of information on bills and Annual Statements to ensure they provide consumers with clear, useful and comparable information. Consumer Focus reviewed suppliers' Annual Statements in July 2010 and the overall results were poor. Many of the Statements suffered from poor design and confusingly worded information.

Following our review, we wrote to each of the suppliers with our best practice principles as well as individual feedback on their Annual Statement. Since that time, we have worked with several suppliers to make improvements to their Statements. While these changes are welcome, we believe there is merit in introducing further standardisation. In particular many small suppliers have struggled with the requirements of the Annual Statement and further guidance from Ofgem would be welcome.

One of Consumer Focus's work priorities in 2010/11 was testing consumer reactions to existing information on bills and Annual Statements and gauging their reaction to new information on bills. We also wanted to understand how different groups of consumers would react to new nudges on bills and whether this would translate into positive behavioural change[21].

Our quantitative and qualitative research found that there was significant confusion among consumers and, more seriously, that the most vulnerable households were the least likely to remember reading or take action in response to information on bills[22]. Furthermore, our February 2011 quantitative research showed that only 46 per cent of consumers remembered receiving an annual statement. Of those who remembered receiving the statement, 79 per cent found it easy or fairly easy to understand, but only 25 per cent of these consumers took any further action such as comparing prices, switching supplier, etc. It is our view that the poor design of many of the Annual Statements will have had a key impact on consumer engagement levels.

Our research however was unable to separate out the root causes of consumer confusion given the interplay between tariff complexity, tariff proliferation and low engagement.

Any proposed changes should be co-ordinated, and where possible, the messaging trialled to ensure that all groups of consumers are being encouraged into changing their behaviour. In many cases, this could include different messages for different groups of consumers.

This would be aided by the development of common product terms and definitions (see Question 4).

It is essential to ensure that any new proposals are delivered in conjunction with the Government's plans to add new information to energy bills, namely the cheapest tariff and comparative consumption information.

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[21] http://consumerfocus.org.uk/g/4pc
[22] http://consumerfocus.org.uk/g/4pc

There are implementation costs associated with any changes to suppliers' billing systems, the costs of which are ultimately passed onto consumers.

In 2011/12 Consumer Focus intends to carry out further research into better understanding what drives or triggers positive consumer reactions, particularly on whether certain triggers, messaging or information channels work better for certain groups. We would be interested in joint working with other key organisations such as DECC, the Cabinet Office Behavioural Unit, suppliers and Ofgem to take forward this research project.

Price rise notification

Following the price rises in autumn/winter 2010, Consumer Focus requested copies of the notification from all relevant suppliers. We had concerns about whether consumers were receiving sufficient information about the actual impact of price rises on their particular household. While we do not believe any suppliers were in breach of the regulations, there was evidence of poor practice. The following information and our comments were sent to Ofgem at the time.

Consumer Focus's key concerns were:

- One of the Big Six failed to provide its customers with details of the price increase in percentage terms, providing only the old and new unit rates. Given the long standing issues with tariff complexity, whereby the average consumer struggles to understand the implications of first and second tier rates, this makes it difficult for its customers to understand what the increase will mean to them in real terms
- Two suppliers were not sufficiently clear about a customer's right to switch and avoid the price increase
- Suppliers were generally poor at providing information to their customers that helped them understand what impact the price rise will have on their household. Most suppliers' correspondence only provided details about the price impact on medium users
- One supplier reduced its annual prompt pay discount at the same time, which meant that the headline increase provided on the letter would actually have a much more pronounced effect on the standard credit customers currently benefiting from the discount

Consumers must be able to understand what impact the price increase or decrease will have on the prices they actually pay for their gas and electricity. This information is essential to help consumers understand the implications and take required action eg reduce consumption or switch to an alternative tariff or an alternative supplier.

- Suppliers' notification letters should provide details of the percentage increase or decrease to the customer's actual tariff, rather than against their standard tariff
- Customers should be given details of the percentage increase or decrease as well as the old and new unit rates
- Customers should be provided with a monetary sum eg the estimated new annual cost and /or any change to monthly Direct Debit payments etc
- Customers should be notified as far in advance as possible, particularly for price increases
- The right to switch must be clearly signposted on the letter, as opposed to providing it in an accompanying leaflet

We also think there is considerable merit in the introduction of an online calculator that lets customers understand the actual impact of the price increase or decrease eg by allowing customers to input their actual (annual) consumption and tariff name. Consumers will be able to find this information on their annual statement. This calculator could be hosted on supplier websites, and ideally on an independent body's website (see answer to Question 18). When the calculation is provided to a consumer, suppliers or the independent body could provide the consumer with details of a supplier's lower cost tariffs or energy efficiency tips to help them reduce their consumption. In the near future this could be expanded to provide information about the Green Deal. Ideally there would be one single calculator available to all customers, regardless of their supplier, along with an automated telephone line for those without internet access.

Economy 7 and time of use tariffs – current and future considerations

One of the main problems in proposing changes to the energy market is the prevailing attitude, which can be summed up as that 'things have always been done that way so that's the way they are done'. Consumer Focus has sought to challenge this attitude wherever possible as it can lead to possible solutions being rejected out of hand, without considering whether they are actually a long term solution, despite being more difficult to implement initially.

Consumer Focus recently sought to publish an easy to understand chart showing the off peak hours for Economy 7 electricity consumers with a breakdown by supplier and by distribution region. We believe that many households using Economy 7 or other off peak two or three rate meters are not getting the full benefits of this tariff type as they do not use a sufficient proportion of their electricity use during the cheaper night period.[23] We wanted to publish this information as it was not generally available on suppliers' websites. Unfortunately through our information request, it became clear that suppliers did not have standard hours, with the off peak hours varying by region and by meter type within a particular distribution region. Given that this information is hard to come by – the natural assumption would be that suppliers are informing their customers of the cheap hours on their bills – providing them with information to ensure they behave appropriately to take advantage of their existing two rate meters. However, suppliers do not provide this information on their customer bills. Nor do suppliers regularly review their customers' consumption to see whether they would be better on a standard tariff as opposed to an off peak tariff or provide them with feedback on how to shift their electricity load to the cheaper night rate period.

Improving the transparency of charging rates and increasing the level of standardisation is a particularly significant policy issue going forward given the current situation. The DECC Impact Assessment for domestic smart metering is based on one in five consumers moving onto time of use tariffs in addition to those already on them eg those households on simple off peak electricity tariffs such as Economy 7.

The introduction of smart metering and any subsequent changes in settlement rules are likely to result in new tariffs with different rates depending on the time of day people use their energy (day time / night time) but also different periods during the day, day of the week or weekends in addition to seasonal rates. It is essential that there are common time bands for these kinds of deals and some form of standardisation, otherwise carrying out a price comparison will be very challenging even for the most mathematically literate consumers.

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[23] Consumer Focus will be doing more work this year on off peak tariffs and would be happy to work with any interested parties.

In addition, consumers will need free access (no upfront cost) to their own energy consumption information (half hourly patterns over the period of a year) in a format and via a medium that allows them to compare deals and calculate the best offers for their situation. Consumer Focus's information request to suppliers in 2010 found that some suppliers were charging non domestic customers to access their own energy consumption data – in one instance up to 52p a day to access it via an online portal. If suppliers continue with this practice and/or roll it out in the domestic sector it will severely hinder consumers' ability to make informed switching decisions.

Given the assumptions in the DECC Impact Assessment and aims of smart meter rollout, we believe Ofgem should consider introducing protections around time of use tariffs as part of the RMR review. It is critical that suppliers do not offer time of use tariffs to consumers unless they are able to provide projections based on their actual consumption over a number of different seasons. In addition, consumers will need to be made aware of the advantages and disadvantages of different deals. Strong consideration should also be given to adopting a similar approach to mortgage sales where different projections are given based on best and worst case scenarios if the consumer does or doesn't reduce their consumption at different hours. This should also include guidance on the impact of different lifestyle changes, such as working from home, having a baby, falling ill, etc.

The introduction of dynamic time of use tariffs – where the price varies depending on the wholesale price, or supply of energy at that time pose a whole range of new challenges when it comes to helping consumers find the best deal. This will be a step change in how consumers engage with their energy and are charged and careful consideration needs to be given as to how the consumers will engage with these kinds of new deals and are made aware of the increased financial risks.

Question 15: Do stakeholders consider that Ofgem should increase its monitoring and enforcement activity to enhance suppliers' compliance with licence conditions?

Compliance and enforcement work

We strongly support Ofgem's intentions to increase its monitoring and enforcement activity as well as the speed of reaction to concerns. Consumer Focus hopes that this will lead to faster investigations – for example we have been waiting over a year for a response to one of our referrals. We have been concerned that the resourcing and priority given to enforcement activity has been insufficient to deliver a credible compliance regime; we are still awaiting the outcome of several investigations commenced more than a year ago.

The allocation of additional resources to compliance and monitoring is thus very welcome. We would like to see a clearer articulation of how Ofgem will deliver a more timely and muscular enforcement regime; for example, will it be increasing its headcount in this area and/or modifying its approach to investigations?

Consumer Focus is awaiting the publication of Ofgem's guidance on the application of the Unfair Trading Regulations 2008 (CPRs) so that their interpretation and use in the energy sector can be better understood. Our predecessor organisation energywatch made the initial request for this guidance.

This guidance will be useful in assisting other enforcement bodies to pursue prosecutions for poor practice. Surrey Trading Standards recent successful prosecution of Scottish and Southern Energy (SSE) was a welcome development given the long running concerns over SSE's sales and marketing practices[24]. Consumer Focus was able to provide evidence to assist Surrey Trading Standards after Ofgem failed to launch a formal investigation into concerns over the sales script.

We acknowledge that Ofgem is more restricted than Trading Standards or other enforcement bodies in its ability to take rapid action under the CPRs and believe this guidance could help inspire other bodies to take action.

Finally Consumer Focus accepts the following issue is not within Ofgem's gift, but it is important that there is clarification as soon as possible over the enforcement and redress framework that will tackle problems associated with the Green Deal, smart meters or existing markets such as combined heat and power (CHP) and heating oils. This is particularly important given the Government's proposal to abolish the Office of Fair Trading and transfer its powers to local Trading Standards. Consumers in the latter markets arguably already face a protection gap and it is important that this is addressed (see our response to Question 27).

The smart meter roll out is likely to lead to the introduction of a series of new offerings including multiple rate time of use tariffs, seasonal tariffs, load limiting tariffs, managed credit tariffs, seasonal tariffs, potentially different feed in tariffs and connection charges, tariff offerings that combine supply and displays, or associated products and services. Consumers who feel they have been missold will face problems obtaining timely or effective redress given the potential for disputes over which company was responsible for the problem eg the supplier or the manufacturer of an In Home Display unit which developed a fault and meant the consumer was unable to react to the changing time of use tariff rates?[25]

Reputational regulation

Consumer Focus welcomes the intention to make increased use of reputational regulation – 'naming and shaming' and 'naming and faming' – to try and improve supplier standards. However, it is important that such tools are seen as supplements to, and not alternatives for, the application of traditional regulatory tools, such as sector specific and general consumer law.

The RMR highlights that about two-thirds of energy consumers are disengaged from the market and that consumer trust in energy companies is very low. This combination of high reluctance to switch and a common perception that energy firms are 'all as bad as each other' mean it is unlikely that reputational regulation will be effective in improving consumer outcomes in isolation – because consumers may only punish or reward suppliers (by switching or staying) to a limited degree in response to these signals.

As you are aware, Consumer Focus publishes quarterly performance tables26 showing which suppliers are receiving the most and least consumer complaints. We believe these tables are a useful tool to help consumers make an informed decision about a choice of supplier.

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[24] energywatch formally referred SSE to Ofgem over its sales and marketing practices in 2005 and 2008, with extensive evidence of poor behaviour provided to the regulator between those periods. Following Surrey Trading Standards 2009 announcement that it intended to pursue SSE for a breach of the CPRs, Consumer Focus provided evidence and support to the Trading Standards Officer leading the case.
[25] Our discussion paper on Green Deal and Redress has more information **http://consumerfocus.org.uk/g/4o3**
[26] **http://consumerfocus.org.uk/g/4pd**

Encouraging suppliers to compete on customer service and not just on price can help consumers to make informed choices and 'vote with their feet' if they are not happy. In our experience publishing quarterly performance information can lead to significant investment and improvements in customer service, with positive outcomes for consumers.

Consumer confidence in energy companies is low, with the sector coming last in a 2009 survey of 45 markets.[27] As the market further matures, consumer decision making in relation to their choice of supplier is likely to become more complex eg while the majority of switching decisions are still primarily price driven, other consumers may place a greater value on service or convenience over price around issues such as choice of payment method. Other issues such as how 'green' a company is matter to many consumers or whether they can take bundled deals or access newer technology such as smart meters. Smart meters and the Green Deal will present further challenges.

The test will be to come up with a range of indicators that encompass all of these aspects and provide clear pointers to industry on how to improve their customers' trust in their company. This is an area where Consumer Focus is looking to do more work this year, in collaboration with industry, and we would be happy to work with Ofgem.

Question 16: Would stakeholders welcome the extension of some elements of the Standards of Conduct into domestic supply licence conditions?

Consumer Focus agrees with Ofgem that suppliers have not delivered the expected benefits and behavioural change to consumers following the Probe. The fact that several high profile investigations into compliance with SLC 25 and the Complaint Handling Standard have been opened into supplier practices following the Probe is particularly disappointing.

Consumer Focus's December 2010 open letter to Ofgem on tariff confusion was prompted, in part, by the explosion in new and increasingly complex tariffs that followed the Probe's conclusion. We do not believe that the Standards of Conduct have been effective in moderating supplier behaviour.

The absence of licence backing weakens the prospect that the suppliers will embed these standards in their ways of working because they are not enforceable. We support the introduction of the principles behind the standards of conduct into licence conditions.

Furthermore, as mentioned in our response to Question 4, we believe Ofgem should provide more detailed guidance on the aspects of tariff structures, or the way in which they are sold, which may be at variance with the Standards of Conduct and/or future licence conditions. This approach is already used by the Financial Services Authority to clearly signal what behaviours it finds unacceptable. This would assist suppliers and should ensure the end to dubious discounts and overly complex tariff structures.

In tandem with the publication of more detailed guidance, we think there is a role for Ofgem's Consumer First panel or other consumer bodies in providing an informal review function of new tariff types (note we are not referring to updated variations of existing tariffs such as Web Saver, Version 1, 2, 3, etc) to assess whether the typical consumer is capable of understanding the core aspects of the tariff. This role will be particularly important with the introduction of new smart tariffs, which have the potential to introduce even further levels of complexity.

[27] http://consumerfocus.org.uk/g/4ol

Question 17: Do stakeholders agree that more needs to be done to improve consumer trust and use of switching sites?

As Ofgem is already aware, Consumer Focus was required to make a series of changes to the Confidence Code in 2010, in response to concerns about supplier practices and increasing tariff complexity. During the consultation process we suggested several proposals to address problems in the market including the development of a central repository for tariff information and a new code of conduct for suppliers. The tariff repository would ensure price comparisons were conducted in an open and transparent manner.

For example, there are ongoing issues with suppliers not providing updated tariff information to switching sites in a consistent and timely format. In addition, some suppliers are not providing sites with the details of the new tariff that a consumer coming off a fixed term tariff was being rolled onto[28]. This leaves the consumer unable to carry out an accurate price comparison to see if there are better available deals.

The majority of suppliers did not support our proposals for a code of conduct at the time. Similarly, the central tariff repository did not find broad support among suppliers and switching sites. Our alternative suggestion of developing a standard template for the provision of tariff information also did not find broad support at the time. However, given the RMR's findings, we believe these proposals are worth reconsidering.

Our Confidence Code currently stipulates that price change information must be uploaded within two working days of receiving the information. This two day window is to allow flexibility as a result of technical restraints at switching sites. If suppliers were willing to submit the information in a common and more easily usable format, it could be feasible to reduce this to one working day.

Given the recent changes to SLC 23, Consumer Focus will now be looking for further progress in this area and will work with suppliers to deliver this. Ofgem's support would be welcome.

We note Ofgem's suggestion in Paragraph 3.38 that it could operate its own comparison site. Clearly there is already a well established market for providing price comparisons and Ofgem therefore must be satisfied that its intervention is necessary and/or offers significant benefits. The provision of information through Confidence Code accredited price comparison sites is much more rigorous that suppliers' own marketing channels. We feel that Ofgem should move industry towards more standardised comparisons across all direct sales channels (internet and telesales, as well as doorstep) to ensure consumers are getting accurate and consistent information. We believe this would go a long way to address trust issues.

However if there is strong evidence to support an independent price comparison tool, our preferred option would be for a single consumer body to host this comparison site and act as a one stop shop for energy consumers. We believe a consumer body hosting the site would offer advantages over a regulator hosted site as it would be more likely to be perceived as a) independent, b) there would be no confusion over whether the organisation is on the side of the consumer or the company, which is a balancing act all regulators must manage, c) better placed to build brand awareness and reach, and d) with the skills and capacity to carry out information gathering and analysis work (see Question 18).

[28] Suppliers are only required to provide switching sites with tariffs that are publicly available.

Question 18: Do stakeholders have any comments on the costs and risks of any of our suggested policies under Proposal 3?

It is hard to comment in detail without seeing an Impact Assessment. However, any changes introduced as a result of the RMR, must be future proofed to deal with the implications of Green Deal and smart meter rollout, which is expected to result in fundamental challenges to existing supplier / customer relationships.

We note that Ofgem has proposed taking a wider role in interacting directly with consumers including potentially operating its own comparison site and providing more consumer facing materials. Given the uncertainty of Consumer Focus's future and the transition of Consumer Direct's responsibilities to Citizens Advice, we agree the proposals need further exploration.

Our preferred option would be for a single consumer body to act as a one stop shop for energy consumers. The body would be responsible for advice, information, advocacy and representation covering all aspects of consumers' relationship with the energy market.

This would include providing first tier telephone and online advice as well as second tier complaint handling for vulnerable consumers looking for information on any of the following topics:

- Any aspect of the relationship with energy suppliers, distributors and transporters
- Advice on customer service and redress
- Energy efficiency advice and measures
- Engaging in the market and getting the best deal
- Energy debts
- Green Deal
- Smart meters and the related equipment
- Microgen
- EPCs

It will also be important that any future model of advocacy and representation for consumers takes account of the devolved context and ensures that Welsh and Scottish consumers continue to be well represented.

PROPOSAL 4

Question 19: Do stakeholders consider that Ofgem should strengthen licence conditions to prevent unfair contracting practices in the non-domestic sector?

Contracting practices is just one area where non-domestic consumers suffer from a "protection gap" when compared to domestic consumers[29]. The table below summarises the key differences and reflects our general concern that micro-businesses are currently suffering from a market that is not regulated in their interest.

	Domestic	Non-domestic
Contracts	Evergreen or fixed – and RMR should improve things	Rollovers at punitive rates, expensive deemed rates otherwise
Back-billing	Back-billing code = 1 year	Up to 5/6 years
Debt and disconnection	ERA vulnerable Safety Net, negotiation and ability to pay LC	Disconnection in a matter of weeks even when debt due to back-billing
Marketing	SLC25, self-regulation, consumer protections	Unregulated brokers exploit businesses' lack of knowledge
Information	SLC31 & 31A - Annual Statements	Lack of visibility of contract terms, minimal info on price in public domain
Switching	Debt Assignment Protocol, Confidence Code	Churn at half domestic rate, levels of objections

Ahead of our closure in 2013, Consumer Focus will campaign for enhanced protections for micro-businesses across these areas, with our starting point being that both groups should receive the same or similar protections unless it can shown conclusively why this should not be the case. We view both groups as consumers who suffer from time pressures and knowledge gaps, as well as a lack of information.

We agree with Ofgem that it is appropriate, as a very minimum, to conduct a review of supplier compliance with gas and electricity supply Standard Licence Condition 7A. Our opinion on 7A is that suppliers do not respect of the spirit of the rules and do the very minimum they can get away with, for example in their poor communications with businesses where contracts are coming to an end.

[29] http://consumerfocus.org.uk/g/4pe

On unfair contracting specifically we remain to be convinced regarding either the equity or efficiency of rollover contracts, despite 7A's partial limiting of them. We still believe that micro-businesses should not be punished for failing to engage fully with the market and that rollovers are extremely punitive in terms of the price of the contract. They also incentivise suppliers to behave in a non-competitive fashion as it is far easier to rollover than trying to retain existing customers through bespoke contracts. We would also like to see more detailed monitoring and reporting on the state of competition in the non-domestic market because of this.

Regardless of the results of any more granular monitoring initiative, we are no longer of our Probe-era view regarding a ban on rollover contracts. We would now strongly urge Ofgem to consider proposing a setup similar to that proposed for domestic consumers after fixed-term offers expire ie one where micro-businesses are placed on some sort of non-punitive new contract, perhaps with a unit price not exceeding by any significant amount (by licence condition) the price of the previous contract. This could still be fixed-term (rather than evergreen) but would no longer be the default option for suppliers seeking to lock in less engaged businesses.

In terms of extending 7A beyond micro-businesses, we are aware that many business groups are in favour of this proposal. We consider it more of a priority that existing beneficiaries are properly served by it before it is extended. There is little point in having medium-sized businesses covered by any rules if they are not adhered to. Regardless, we also understand that several suppliers treat all business customers, large and small, as micro-businesses for ease of doing business with them. This is best practice that we very much encourage.

Question 20: In particular, would stakeholders welcome additional licence conditions surrounding the objections procedure?

Consumer Focus recognises that some suppliers appear to abuse the objections process in the interests of retaining businesses which wish to leave them, however we believe the problem is not as simple as that.

We have been shown some evidence of cases where suppliers' 'frequent' or apparently unfair objections are valid in so far as the problem appears to be worrying behaviour by unscrupulous brokers. Ofgem should be aware of this when drafting any new licence conditions in this area; it would be unfortunate if in 'cracking down' on objections Ofgem gave more powers to some disreputable brokers to engineer forced or non-consumer-requested transfers. Further research may therefore be necessary.

On issues much more important than objections, the RMR makes a good start in several places, but Ofgem need to go further to give micro-businesses market confidence and support. As top priorities, given the statistics coming from both Consumer Direct and our own Extra Help Unit, we would like to see the extension of protections on back-billing for micro-businesses that are comparable to those granted to domestic consumers. Consumer Focus would also like to see better protections around the debt and disconnection processes.

The context of these concerns is that our Extra Help Unit has received a rising volume of contacts from micro-businesses since its founding in 2008, with volumes rising from 11 per cent of contacts in October 2008-September 2009 to 18 per cent the following year. A recent review of cases found that 61 per cent of micro-businesses referred to the EHU were at risk of closure if their energy supply remained disconnected. A further 12.5 per cent of EHU clients were unable to understand complex contract terms.[30]

[30] Consumer Focus board paper - **http://consumerfocus.org.uk/g/4pf**

Question 21: Would stakeholders welcome the extension of some elements of the Standards of Conduct into non-domestic supply licence conditions?

While Consumer Focus is very keen to see a general uplift in micro-business protections, we are of a mind that the extension of the Standards of Conduct, as they stand, should not be a priority. As stated in our recent consultation response on domestic fixed term offers,[31] we consider that these standards are less than optimal given that four of the five have been consistently flouted by suppliers over just one area of policy, that of contract rollovers. Thus a better enforcing of the standards in the domestic sector (as well as existing rules in the non-domestic sector) should be the starting point.

On a very worrying and consistent issue of poor supplier conduct, back-billing remains a major source of detriment for micro-businesses. Last year, Consumer Direct's helpline received 1,848 complaints from micro-businesses who received unexpected bills after their energy charges were initially underestimated. 40 per cent of all the complaints it received from small businesses about energy bills related to back-billing issues. The problem is compounded as energy suppliers can back-bill businesses for up to six years of usage, compared to just one year for domestic consumers, and can demand instant repayment of amounts potentially exceeding £50,000.[32]

Ofgem should, in collaboration with suppliers, come up with a scheme that effectively 'extends' the domestic back-billing protections to the micro-business sector. Ofgem should consider the introduction of protections that require suppliers to take into account the businesses' ability to pay the debt in setting a realistic timescale for repayment, rather than demanding full payment immediately. This would be more useful than simply transferring the ignored Standards of Conduct across to micro-businesses.

Furthermore, Ofgem should endeavour to publish guidance for suppliers on the application of back billing rules, given the longstanding problems in the domestic sector over the lack of consistency in their application. Consumer Focus wrote to Ofgem in September 2010 requesting that the regulator publish detailed guidance on the application of the back billing rules in the domestic sector to assist with the creation of a level playing field and remind all suppliers of their obligations.

Question 22: Do stakeholders agree with our position, at this stage, not to extend our proposals on tariff simplification into the non-domestic sector?

It is worth reiterating that there is little evidence to suggest that micro-businesses are better equipped to deal with the complexity of tariffs than domestic consumers are. We think that Ofgem should ensure that both types of consumers are provided with the same kinds of 'key facts' information summarising the main points of their contract. Tariff simplification is almost always of net benefit to consumers of all types, whatever the form this takes; in business this might mean limiting tariffs to one per the size of the business (in terms of energy consumed, turnover etc) and is worthy of further work. This could then lead onto the development of a Confidence Code or similar for the non-domestic market, itself something Consumer Focus will be scoping in the coming months.

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[31] http://consumerfocus.org.uk/g/4pg

[32] In order to be defined as a micro-business, the maximum amount of energy a company can consumer per year is 55,000kWh of electricity or 200,000kWh of gas. Based on DECC estimates (pp28-29) of average prices paid per MWh by non-domestic energy customers of £27/MWh for gas and £90/MWh for electricity, the maximum energy bill last year for a micro-business is estimated to be £10,350

We are particularly pleased that Ofgem is undertaking separate work on deemed rates for micro-businesses as this is an area of concern for ourselves and business groups. Simplification of the literature for businesses regarding the difference between 'deemed' and 'out of contract' rates may be useful, particularly in the context of aggressive marketing by suppliers to get out of such contracts. As with rollovers we think that punishing businesses with seemingly non-cost-reflective tariffs does both businesses and their consumers no favours and is the result of suppliers avoiding vigorous competition for business customers.

We also look forward to helping Ofgem produce more and better factsheets for micro-business consumers as suggested in the consultation.

Question 23: Do stakeholders agree that Ofgem needs to look further at the role of Third Party Intermediaries (TPIs) in the non-domestic market?

Consumer Focus recently conducted research[33] into the activities of Third Party Intermediaries (TPIs or brokers) which suggested a range of problems in that sector, most notably that:

- Micro-business consumers are being committed by TPIs, through means fair and foul, to contracts that are not best-suited to their needs
- The disclosure of commission to consumers, who ultimately bear this cost in the prices they pay, can be poor and this impedes consumer understanding of the role, value and appropriateness of TPI services

We would urge Ofgem to study the content of the report in detail as we believe that TPIs is an increasingly problematic area for micro-businesses, which experience misleading marketing (eg on the extent of the market searched) that would not be permitted in the domestic supply market.

The issue is such that we believe, particularly given the Government's proposal to transfer the OFT's enforcement powers to Trading Standards, that Ofgem should be given new powers to properly regulate such business-to-business transactions. Such powers would need to be fleshed out properly in another full consultation but the process of acquiring this new role and responsibility should begin as soon as possible. Alongside these powers would be a requirement on suppliers not to contract with TPIs unless they have signed up to some kind of code of practice, possibly accredited by Ofgem.

Question 24: Do stakeholders have any comments on the costs and risks of any of our suggested policies under Proposal 4?

The biggest risks (and costs) fall on already struggling micro-businesses. Ofgem needs to justify its decisions if it is not to begin treating micro-businesses in a manner befitting their vulnerable position in the energy market.

In particular Ofgem might like to consider the costs to the consumers of micro-businesses' goods and services, who will ultimately pay for any market deficiencies such businesses face. Any cost-benefit analysis should include them as well as the conventional accounting costs energy suppliers or TPIs would face from any proposed changes.

[33] *Watching the middlemen – brokerage services for micro business energy consumers*, 18 March 2011. **http://tinyurl.com/3nh3mkz**

PROPOSAL 5

Question 25: Do stakeholders agree with Ofgem's proposal to appoint a leading firm of accountants to review the transfer pricing and hedge accounting practices of the vertically integrated suppliers?

We broadly welcome Ofgem's proposal to appoint independent accountants to review the transfer pricing and hedge accounting practices of the Big 6; report on the likely impact of these practices on reported profits and transparency; and make recommendations on how the usefulness of the reporting could be enhanced in future years.

To be successful, the reporting will need to focus on three key principles: comparability; integrity and timeliness.

Comparability

The guidelines should be developed to ensure consistency in whether items are reported as direct or indirect costs to ensure that the regulatory accounts are mutually consistent and comparable.

Integrity

The reporting needs to be cost reflective; suppliers should be obligated to report figures based on actual operating behaviour.

The apportionment of costs, revenues and profits to different parts of the business should be adequately explained.

The reporting also needs to unwind any international distortions. Ofgem's analysis of the Big 6 companies' 2009 results suggests that that RWE and Eon effectively expatriate fuel costs and profits from their UK generation activities into their overseas trading arms through their tolling agreements. This is likely to distort the regulatory accounts, artificially reducing the scale of revenues and profits attributed to these firms and impeding meaningful comparison between the Big 6.

It also has wider implications given the scale of public subsidy that the generation sector already enjoys, and that is likely to expand as the Electricity Market Reform project is implemented; because it implies that the sector is significantly less profitable than it actually is. The absence of genuine clarity on the profitability of production activities may create distortions in the application of subsidies.

Timeliness

The older data gets, the less informative it is – because it becomes less indicative of current performance and drivers.

The Big 6 companies prepare and report their statutory or group financial accounts within three months of the end of the financial year, but are given six months to prepare their regulatory accounts. The lag between the final regulatory report for 2009 (by SSE) and the publication of Ofgem's analysis has been a further six months.

We recognise that the complexity of the reports significantly constrains how quick the publication timescales can be. But we do think the timeline could be significantly tightened. We would like to see the deadline to prepare accounts shortened to three months from the end of the financial year. Ofgem should commit to turning round its own analysis within a similar timescale of receiving the last annual submission.

Question 26: Do stakeholders have views on how Ofgem could improve segmental reporting in future years?

Please see our separate response to your consultation on Financial Information Reporting (your reference 41/11) submitted on 19 April 2011 for our views on this.

We note that you issued amended guidance on Financial Information Reporting on 23 May 2011 (your reference 69/11) that ‘takes into account comments received as a result of the 24 March 2011 consultation’. It does not include any clear explanation of what has changed and why; it would be useful if this could be provided. It would also be useful if you could set out more detail on how any comments received in relation to this consultation will be used in practice – for example, do you intend further revision to the segmental reporting before the 2010 results are published or is the version just published now the definitive guidance for that year?

Conclusion

Question 27: Do stakeholders consider that our proposals will be sufficient to protect the interests of consumers, including vulnerable consumers, or are additional consumer protections measures necessary?

The aim of the RMR consultation proposals, to improve competition in the retail energy market, is one we entirely support. Genuine competition will provide efficiently determined market prices and superior quality of service in comparison with uncompetitive markets. However, while we can expect competitive markets to allocate resources efficiently and thus reduce the total costs consumers can expect to pay, the allocation of costs might have negative consequences for particular types of consumers (most likely thorough some form of price adjustment). If these distributional effects have a negative impact on vulnerable consumers a case can be made to implement additional (and complementary) non market based remedies.

However, there is a fine line between regulatory policy, which is the duty of the regulatory body, and social policy, which is the responsibility of Parliament. It seems to us that many of the issues related to vulnerable consumers relate most appropriately to social policy. As such any remedy is best achieved by the state, unless a genuinely voluntary industry solution can be achieved ie one with the backing of the company board and shareholders.

Consumer Focus believes that the Government should be willing to consider a more radical solution to problems in the energy market. It may be a more cost effective solution to consider whether those who are most vulnerable and on the lowest incomes should be able to opt out from the competitive market by moving to a low cost tariff. Ultimately, consideration will be needed on how such a subsidy would be funded. It is important to note that income transfers via the state provide the optimal approach to providing cross subsidies.

Whichever changes are put in, there will still be a substantial base of consumers who are either a) too poor to afford to heat their home to a reasonable temperature, b) lack ability to switch to a cheaper deal due to payment methods or the tariff type open to them or are c) unwilling to contemplate switching to a different supplier based on a previous poor experience or fear of the unknown.

The large and growing number of consumers unable to afford to heat their home to a suitable temperature is a social policy issue and unlikely to be fully addressed through the implementation of remedies to improve the state of competition in the energy market.

Consumer Focus has long called for Ofgem to use a wider range of indicators to monitor the competitiveness of the energy retail markets and we welcome the proposals in the RMR. We are pleased by the increased use of direct consumer feedback, for example through the Consumer First programme and far more frequent polling of consumer experience, to inform and develop policy and hope that this continues.

We recognise that the proposals to directly provide consumers with information and advice regarding the switching process and how they can use available information to assess their options is intended to help them consider switching. However, we consider that the evidence from existing schemes is relatively limited on how many consumers actually change their behaviour.

Consumer Focus Scotland is, with support from Ofgem, delivering Energy Best Deal Scotland (EBDS). As with the Energy Best Deal (EBD) campaign in England and Wales, the main activity is to train frontline advisers who work with vulnerable and disadvantaged consumers on a daily basis. An independent evaluation of EBDS will shortly be published, and its findings show clearly that the training provided has been very well received by advisers, the majority of whom are now assisting clients to reduce their bills. However, the numbers of consumers benefiting, as with EBD, are limited to around 10 per adviser trained, and so total impacts of this approach are very small when compared to the total number of consumers in fuel poverty, or, more widely, those who have not engaged with the market. Similarly, due to the nature of the scheme, it is difficult to assess or monitor how many consumers reached by the EBDS or EBD have subsequently switched supplier and / or changed their behaviour[34].

Furthermore, Consumer Focus would also question whether the sector regulator is best placed to provide such information as it does not deal directly with individual consumers. Given the uncertainty over our future, we believe this proposal is worthy of further consideration but as stated in Question 18, we believe this role would be better left to an independent consumer body that acts as a one stop shop for energy consumers.

There are several areas where Consumer Focus's concerns have not been directly addressed in the RMR.

Growth in long term contracts

Suppliers are increasingly introducing longer term contracts eg 12+ months. In the mobile sector, Ofcom recently reduced the maximum contract length to 24 months, following concerns about the impact on competition. It is worthwhile Ofgem stepping up its monitoring of the impact of such contracts on the energy market to ensure that there are no negative impacts on competition.

With the roll out of smart meters and the Green Deal, there is likely to be a further increase in longer term contracts – with consumers buying bundled energy services and products and supply contracts including new products such as energy monitors, boiler controls, etc. For many consumers, price may no longer be the key determinant; rather it will be which company offers the most attractive package. How will the RMR proposals work with these emerging trends?

In the energy sector, there are already a growing numbers of households locked into long term contracts for CHP systems. Consumers are already raising concerns about the cost effectiveness or fairness of such deals. In some cases, there is evidence of insufficient disclosure by the developer or landlord ahead of signing the contract. We believe this is a protection gap as Ofgem does not have direct responsibility for such consumers. Consumer Focus intends to do further work this year on the existing protection gaps facing consumers is more usual situations and we will seek to work closely with Ofgem and DECC (see also our response to Question 15).

PPM users

We were disappointed that the RMR did not make specific reference to the PPM market. Consumer Focus continues to have concerns about the level of competition in the PPM market where there are some key barriers to switching. For example, many suppliers still do not allow PPM users to switch online using a switching site, a situation energywatch flagged up back in 2008. There are limited savings available to PPM consumers considering switching supplier once consumers have moved to a dual fuel deal. This was a key concern flagged up by advisers participating in our EBDS sessions.

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[34] **http://bit.ly/loixWM**

As Ofgem is already aware, one of our key reasons for supporting the smart meter roll out was the potential to revolutionise the PPM market and we are eager for improvements to be delivered as quickly as possible.

Debt assignment protocol

During the Probe, Consumer Focus requested that a review be carried out of the debt assignment protocol to understand why consumers were not taking advantage of it. Although Ofgem raised the amount of consumer debt that could be used with the DAP from £100 to £250, there was no review to understand whether the process could be made more consumer friendly.

There is an opportunity ahead of the smart roll out to review how the process could be simplified so that more consumers could take advantage of the protections. We would like Ofgem to commit to a review of the debt assignment protocol.

IGT surcharges

As previously mentioned in our December 2010 open letter on energy tariffs, we would like to see Ofgem review the cost reflexivity of suppliers' surcharges for consumers served by Independent Gas Transporters (IGT)[35].

Consumer Focus is concerned that the surcharges charged by certain suppliers are not cost reflective. The new price control arrangements introduced in 2004 which was supposed to lead to a gradual withering away of IGT surcharges, as the balance of customers on the old and new pricing arrangements shifted. Our predecessor body energywatch published a 2006 report[36] about problems facing consumers served by IGT networks and it is disappointing that the chart below shows that the majority of suppliers are still levying a surcharge five years on.

[35] http://consumerfocus.org.uk/g/4my
[36] http://bit.ly/kG9df7

Suppliers	Details of charge	Charge varied by IGT?
British Gas	No surcharge	Not applicable
E.ON Energy	£42 per annum. Billed £10 per quarter	**Only customers served by the following IGTs are subject to the surcharge:** Independent Pipelines Ltd, East Surrey Pipelines, and Global Utility Connections. There are special products that have their own Terms and Conditions, and which may omit the IGT charge.
Ecotricity	No surcharge	Not applicable
EDF Energy	Approximately £40.33 per annum (0.1105p/day). Line on the bill called Gas Transportation Charge, with an amount payable of the number of days the bill covers x £0.1095p (price excluding VAT).	No The following customers do not pay the surcharge: Prepayment (Quantum) meter customers (unavailable); and customers on the Energy Assist tariff.
Npower	£30 per annum. The first tier unit rates ie the first 4,572 kWh charged to an IGT customer annually are 0.656p/kWh higher than the first tier unit rate charged to a non-IGT customer in the same area.	No
ScottishPower	£42 per annum, Line on the bill with the amount payable of the number of days the bills covers x 0.11p (price excluding VAT).	No
Scottish & Southern Energy	No surcharge	Not applicable
Telecom Plus	£36 per annum. Customer charged £3 per month, with the surcharge rolled into the monthly standing charge.	No
Utilita	£25 per annum.	No

Question 28: Do stakeholders consider that our measures to simplify tariffs will reduce the ability for suppliers to price discriminate between regions and so reduce the need for a licence condition prohibiting undue discrimination.

The proposals to simplify customer tariffs (Proposal 1) could potentially be designed to monitor any regional price differentials which are prohibited under the Undue Discrimination Licence Condition. However, as the specific design of the proposal is quite vague at this stage we need to understand how the design would allow the regulator to monitor price differentials in practice.

Before the introduction of the undue discrimination licence condition in early 2009, Consumer Focus was concerned about a number of price differentials which could not be objectively justified by the cost to serve (including in area and out of area price differentials). We continue to believe that non cost related pricing, in some cases, is not in the interests of all energy consumers.

However, the important question is whether the undue discrimination licence condition has provided cost reflective prices that benefit all consumers. Unfortunately all the theoretical and empirical evidence suggests it has not (although the cost reflective payment type regulation seems to have provided concrete benefits to consumers including vulnerable customers). Ofgem's claim that price differentials have reduced might be true but do not provide evidence that the total costs to consumers has reduced ie out of area prices have been raised to near equalise in area and out of area retail prices. We therefore believe that an alternative method to monitor price differentials might be warranted and that a strong case has been made that the undue discrimination licence condition should be allowed to lapse as allowed by the sunset clause.

Consumer Focus
Campaigning for a fair deal

Consumer Focus response to Ofgem's Retail Market Review
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