

The Retail Market Review: Draft Impact Assessments for Non-domestic Proposals

Consultation - supplementary appendices

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Overview:

This document contains the supplementary appendices to the consultation document: 'The Retail Market Review – Non-domestic Proposals.' This consultation document builds on the issues we set out in March this year in our Retail Market Review consultation document. It focuses on proposals for the non-domestic (business) retail market. They aim to:

- help more business customers be aware of their contract terms
- improve the supplier switching experience for business customers
- increase confidence when using third party intermediaries, and
- improve customer trust in suppliers.

We believe that our proposals will help all business customers engage more effectively in the market, leading to greater and more effective competition.

These proposals represent an important development in the functioning of the non-domestic retail market. We want to encourage all stakeholders to respond and share their views.

Our deadline for responses to this consultation is **15 February 2012**.

Context

Ofgem's principal objective is to protect the interests of consumers, present and future¹. The Retail Market Review (RMR) represents Ofgem's initiatives to enhance competition in the retail energy markets and make it work more effectively so that the benefits can be realised more for consumers.

The proposals presented in the document are the results of one of the five workstreams we set out in our March RMR consultation. These are proposals relating to strengthening the Probe remedies in the non-domestic market. Proposals to improve tariff comparability and proposals to strengthen the Probe remedies in the domestic market will soon be published in a separate consultation document². Proposals to improve market liquidity are expected to be published before the end of the year and the initial findings from the accountant's study of company segmental accounts will be published early in 2012.

These supplementary appendices contain the draft impact assessments for the proposals detailed in the consultation document.

Associated documents

- The Retail Market Review – Non-domestic Proposals, November 2011, Reference: 157/11
- The Retail Market Review – Findings and Initial Proposals, March 2011, Reference: 34/11
http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_FINAL.pdf
- Small and Medium Business Consumers' Experience of the Energy Market and their Use of Energy, June 2011.
<http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/SME%20Attitudes%20%20Behaviours%20Report.pdf>
- Energy Supply Probe - Proposed Retail Market Remedies, August 2009, Reference: 99/09
<http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Retail%20package%20-%20decision%20document.pdf>
- Energy Supply Probe - Initial Findings Report, October 2008, Reference: 140/08
<http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Energy%20Supply%20Probe%20-%20Initial%20Findings%20Report.pdf>

¹ This includes the interest of consumers in Ofgem ensuring that customers benefit through the efficient functioning of their national market and in Ofgem promoting effective competition and helping to ensure consumer protection pursuant to Articles 40(g) of Directive 2009/73/EC and Article 35(g) of Directive 2009/72/EC.

² Non-domestic suppliers should note that legal text which will be published in this separate consultation document relates to both domestic and non-domestic suppliers.

Contents

Appendix 9 – SLC 7A Expansion: Draft Impact Assessment	5
Summary	5
Key issues and objectives	6
Options	7
Impact on consumers	7
Option 1: No change	7
Option 2: A new small business definition	8
Option 3: All non-domestic customers	12
Impact on competition	12
Option 1: No change	12
Option 2: A new small business definition	12
Option 3: All non-domestic customers	12
Impact on sustainable development	13
Risks and unintended consequences	13
Post implementation Review	14
Conclusion	14
Appendix 10 – Non-domestic Standard Licence Conditions for sales activities: Draft Impact Assessment	15
Summary	15
Key issues and objectives	16
Options	17
Option 1: Maintain the current non-domestic sales and marketing arrangements	17
Option 2: The addition of a non-domestic supply licence condition covering sales and marketing activities	18
Impact on consumers	19
Option 1: Maintain the current non-domestic sales and marketing arrangements	19
Option 2: The addition of a non-domestic supply licence condition covering sales and marketing activities	20
Impact on competition	21
Option 1: Maintain the current non-domestic sales and marketing arrangements	21
Option 2: The addition of a non-domestic supply licence condition covering sales and marketing activities	22
Impact on sustainable development	24
Risks and unintended consequences	24
Post implementation Review	24
Conclusion	24
Appendix 11 – Draft Impact Assessment for Standards of Conduct proposals	25
Impact on consumers	26
No change	26
Introduction of new SOC's	26

Option 1: Legally binding via an overarching licence condition	27
Option 2: Non-binding + industry commitment	28
Option 3: Non-binding	28
Impact on competition	28
No change	28
Introduction of new SOC's	28
Option 1: Legally binding via an overarching licence condition	29
Option 2: Non-binding + industry commitment	29
Option 3: Non-binding	30
Impacts on sustainable development	30
Eradicating fuel poverty and protecting vulnerable consumers	30
Supporting improved environmental performance	30
Other impacts and post implementation review	30
Impacts on health and safety	30
Cost of implementation	31
Risks and unintended consequences	31
Better Regulation	31
Post implementation review	32
Conclusions	33

Appendix 9 – SLC 7A Expansion: Draft Impact Assessment

Summary

1.1. The 2008 Energy Supply Probe indicated that many small businesses struggled to engage with the energy market. In some cases they lacked basic details of their contract, if they knew one existed at all. In January 2010 we introduced a new licence condition to help micro businesses (SLC 7A) by requiring suppliers to provide contracts in writing with clear terms and renewal details. However, we have continued to see evidence of small businesses with low engagement and poor knowledge of their energy contracts.

1.2. This draft Impact Assessment represents our view of the available options, our assessment of their benefits and costs, and our proposed approach. We welcome responses to inform our assessment and to add further detail to our assumptions regarding benefits and costs.

1.3. Our options are:

- **Option 1: No change.** Continue to monitor and enforce existing licence condition.
- **Option 2:** Expand the coverage of SLC 7A to a **new small business definition**.
- **Option 3:** Widen the scope of SLC 7A to cover **all non-domestic customers**.

1.4. Although we have seen a positive impact from the current licence condition on micro businesses, research has shown that other small businesses would benefit from the additional clarity provided by clear written notice of contractual and renewal terms. The response to our previous consultation and additional consumer research has played a key role in shaping our proposal.

1.5. On the basis of this draft Impact Assessment we believe Option 2, expanding SLC 7A to small businesses, would provide the greatest positive impact. We consider Option 3, expanding to all non-domestic customers, is not a proportional response as such prescriptive rules would be unnecessary for the majority of large business customers.

1.6. We are mindful that there may be implications for supplier costs and competition. We invite comments and quantitative information on the nature and scale of these impacts.

Key issues and objectives

1.7. The Retail Market Review (RMR) published on 21 March 2011 highlighted two areas relating to SLC 7A. Firstly, reviewing compliance with the current licence condition and potential further action if areas of concern were not addressed. Secondly, to consider extending the reach of the licence condition.

1.8. Currently SLC 7A provides protections to micro businesses in the following ways:

Entering a Contract

- Suppliers must ensure they communicate the key terms and conditions before the customer enters into a contract.
- They must ensure all terms and conditions are written in plain, intelligible language and sent within 10 days (or as soon as reasonably practicable after).

End of Contract

- The supplier must send a statement of renewals term 60-120 days before the end of a fixed term contract.
- Customers then have at least a 30 day notification window to negotiate a new contract or switch supplier, and as a final opportunity to opt out of any rollover process.
- If the customer does nothing they can be rolled over for no more than 12 months.
- The customer can write to the supplier at any time between the start of the contract and the end of the notification window to prevent automatic rollover.

1.9. The contract end date and renewal options are vitally important information for customers to be aware of. Many small businesses are unaware of these dates and the prospect of automatic rollover if they do not act before their contract ends. Consumer research commissioned by Ofgem³ has indicated that some customers see rollovers as unfair, and subsequently leave the supplier as soon as possible when they discover they have been rolled over onto a more expensive tariff.

1.10. The main objective of this proposal is to expand existing protections for micro businesses to a wider group of customers.

³ Research conducted by Harris Interactive, Small and Medium Business Consumer's Experience of the Energy Market and their Use of Energy, report to Ofgem. March 2011. This can be accessed at <http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/SME%20Attitudes%20%20Behaviours%20Report.pdf>

Options

Option 1: No Change. Maintain current scope of SLC 7A to micro businesses only. Continue to monitor and enforce existing licence condition.

1.11. This is the baseline option to which other options will be compared. The licence condition would continue to cover micro businesses and we would continue monitoring and enforcement action where appropriate.

Option 2: Expand the coverage of licence condition SLC 7A to **a new small business definition**.

1.12. The new definition of businesses covered by SLC 7A would be:

- i) annual consumption not more than 293,000 kWh of gas per year, or
- ii) whose premises are classified as electricity profile class 3 or 4, or
- iii) employs fewer than 50 employees (or their full-time equivalent) and whose annual turnover and/or balance sheet does not exceed €10m, or
- iv) is already a micro business customer.

Option 3: Widen the scope of SLC 7A to cover **all non-domestic customers**.

1.13. This option would remove any need to define which customers would be covered by SLC 7A as it would apply to all.

Impact on consumers

Option 1: No change

1.14. Micro businesses already covered would keep the same protection and therefore should be unaffected. Small businesses not currently protected by SLC 7A will face the same issues of contract confusion and susceptibility to rollover as currently experienced⁴. A sample of views from Harris Interactive consumer research are shown in the table below:

⁴ Many small business owners feel that suppliers are failing to deliver in providing clear terms and conditions (Forum of Private Business, Utilities Report 2010). 18% of small business are concerned about their limited knowledge and understanding of energy contracts (Federation of Small Businesses, Small business and infrastructure: Energy, July 2011)

Views from micro and small businesses

- *No end dates on the contract. Start date was when contract was agreed, not when it actually started (small business).*
- *Tariff doubled after rollover, and tied in for three years. Only a two week renewal window, when respondent was on holiday (small surveyor).*
- *"I've been educated in the past 12 months. I didn't know I was in a contract until it rolled over and the bills went up. It was a real eye-opener. I'll be on the ball now."
(micro residential care home, Birmingham)*

Option 2: A new small business definition

1.15. Where data is available we have attempted to estimate the impact of the small business definition on the number of business customers covered by SLC 7A. These are detailed below based on employee numbers, electricity profile class and gas consumption.

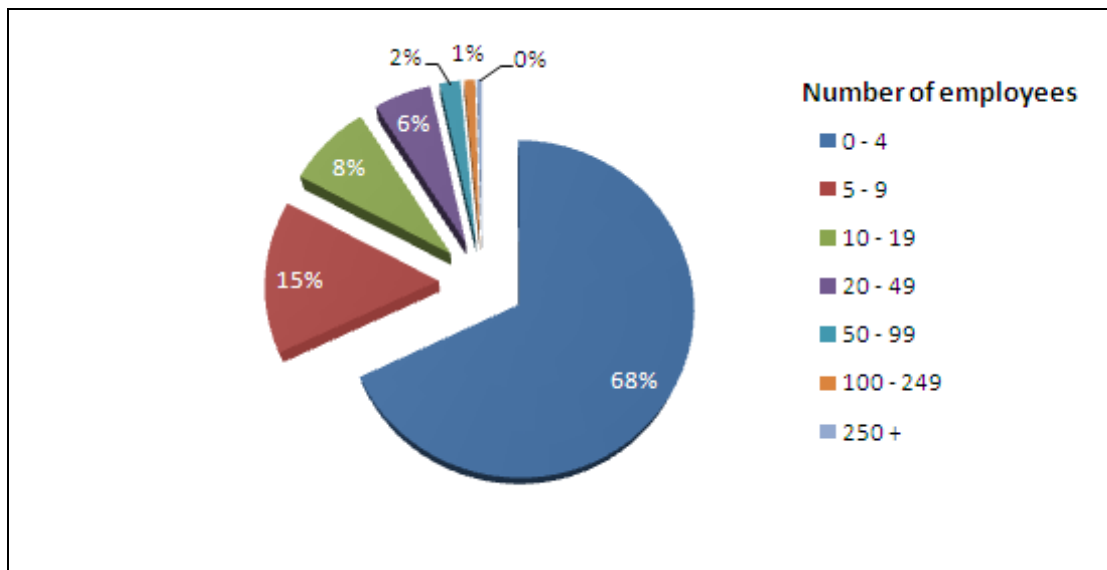
Employee numbers

1.16. Office for National Statistics (ONS) figures for 2011 indicates over 2.46m local units⁵ in VAT and/or PAYE based business enterprises in Great Britain. The current micro business definition of 0-9 employees accounts for 83% of all local units (see Figure A9.1). Extending coverage to 0-49 employees would increase the number of local units covered by 339,280 to 97%⁶. In reality, it may be considerably smaller than this as some of these businesses counted as one unit may be part of a larger multi-site business customer.

⁵ Definition from Office for National Statistics - A Local Unit is defined as an individual site, located in a geographically identifiable place. For example, a company head office would count as one 'Enterprise' as well as one 'Local Unit'. The company's 17 branches throughout the country would also count as Local Units. Alternatively, a single-site company would count as one Enterprise and one Local Unit. Therefore the total number of enterprises at 2.01m is lower than the 2.46m local units.

⁶ 184,610 if based solely on enterprises. BIS Business Population Estimates published 12 Oct 2011 indicate an almost identical increase of 185,520 between 0-9 and 10-49 employees. BIS statistics also include an estimate of all unregistered businesses to obtain a higher total for the whole economy of 4.6m. Accessed at <http://www.bis.gov.uk/analysis/statistics/business-population-estimates>

Figure A9.1: Local units in VAT and/or PAYE Enterprises in 2011 by number of employees



Source: Office for National Statistics

1.17. Unfortunately the turnover statistics available are not directly comparable to the EU Commission thresholds and therefore this increase in coverage is likely to be a maximum increase⁷. Businesses must meet both turnover and employee numbers to be included within the definition.

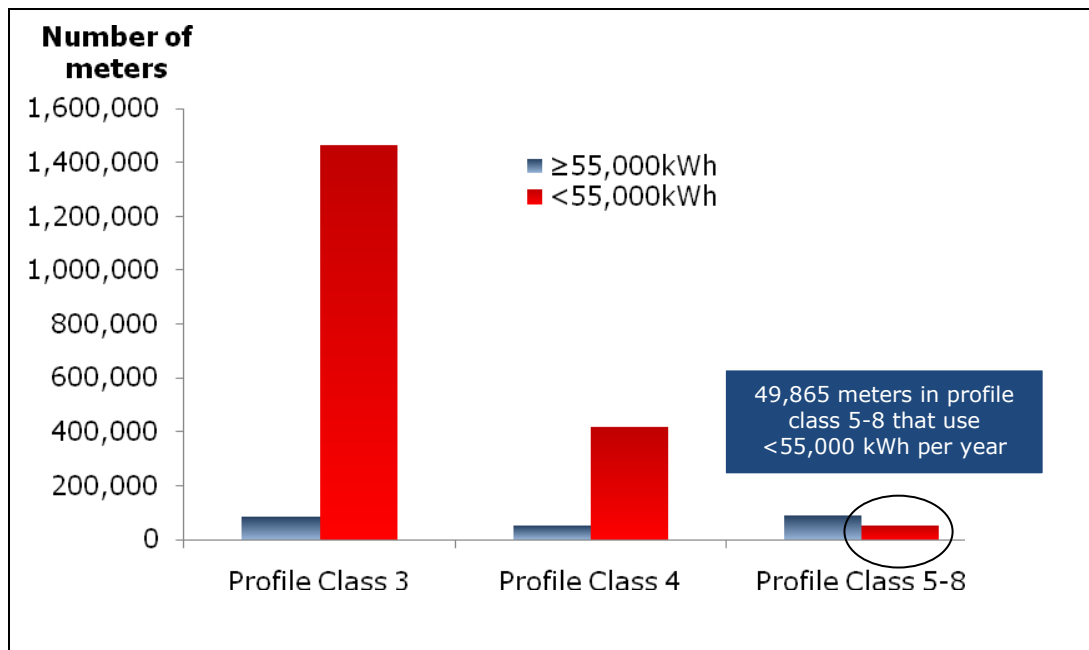
Electricity - Profile class 3 and 4

1.18. Elexon data on profile class⁸ and electricity usage covers 2.16 million meters. The current electricity component for a micro business of $\leq 55,000$ kWh per year accounts for 1.93m meters, 89.5% of profile classes 3-8. A new electricity definition of profile classes 3 and 4 would increase coverage of SLC 7A by 87,050 meters to 93.5% of profile classes 3-8. However, this leaves a potential gap in protection of 49,865 meters for profile classes 5-8 (see Figure A9.2) where electricity consumption is less than the micro threshold. To remove this possibility, our proposed new small business definition retains any business that meets the existing micro business definition.

⁷ This is because we would expect that some businesses with more than 50 employees could exceed the annual turnover limit of €10million. Of course, the reverse could also be true, but we have assumed that the former is more probable.

⁸ Because only the largest users of electricity traditionally had half-hourly metering in the UK, the concept of Profile classes was developed in the 1990's. This separates different types and amount of usage into 8 groups, or profiles, depending on the pattern of energy use within a 24 hour period. Profile classes 1 and 2 relate to the domestic sector, while profile classes 3 to 8 relate to the non-domestic sector.

Figure A9.2: Number of electricity meters by profile class and annual consumption split by micro business⁹ threshold



Source: Elexon

Gas Consumption

1.19. The proposed move from the existing limit of 200,000 kWh per annum to the monthly read threshold of 293,000 kWh per annum should not be a huge change in the number of customers covered. It is less likely to include larger medium sized businesses than if we were to select the threshold of Large Supply Points ($\geq 732,000$ kWh). Figures from Xoserve estimate there are 127,000 meters that are either monthly or daily read which would still fall outside of our expanded definition.

1.20. To summarise, it is difficult to calculate exactly how many additional businesses will be covered by this definition, but it could be up to a *maximum* of 339,280, approximately 16% of all local units in registered business enterprises. Consumer groups indicate that the micro business protections have been well received by customers. Research by the Forum for Private Business (FPB) states that businesses covered under SLC 7A are less dissatisfied with utility providers than smaller firms not protected. By giving small businesses more information about their contract it should improve their customer experience with their supplier and their perception of the industry.

⁹ Note that the electricity component of the micro business threshold is $\leq 55,000$ kWh, not $< 55,000$ kWh. It has been presented as $< 55,000$ kWh in this table as that is how the data has been captured. But we do not believe this will change our proposed impact significantly.

1.21. Small businesses will benefit from increased transparency of their contract terms and conditions. Respondents to our qualitative research showed less than half of small businesses were aware they even had a contract, let alone the period or practice of automatic rollover. Expanding SLC 7A can only increase their understanding and obligations under contract.

1.22. Contract rollovers are common in the small business sector¹⁰. Automatic rollovers will still occur but suppliers will now have to inform customers of renewal terms in writing and they are limited to one year¹¹. This should provide a stimulus for them to review their current contract and rates. It may also encourage small businesses to search for better deals in a sector with historically low switching levels¹².

1.23. Identifying small businesses and providing notices to customers will entail some additional cost to suppliers that may ultimately be passed onto consumers. However, responses to our SLC 7A compliance request indicate that around a third of suppliers already treat SMEs as they would a micro business. An expansion to small businesses would have minimal impact on these suppliers. We would be keen to see suppliers' quantitative estimates for any additional costs incurred.

1.24. The new definition is also aligned to industry standards for monthly gas meter reads and electricity profile class. This should make it easier and cheaper for customers and suppliers alike to identify small businesses that meet the definition.

1.25. Anecdotally¹³ we are aware of customers rolling over onto more expensive tariffs after their fixed term contract ends. If rollovers are shorter and less common it could lead to initial fixed term offers becoming more expensive, as suppliers seek to recover revenue. Overall this impact could be neutral, as higher initial prices may be balanced by the reduced risk of higher prices still on rollover.

1.26. However, although more information will be provided to small businesses and they will benefit from the one year maximum rollover period, there is no guarantee they will engage more with their energy supplier.

¹⁰ 42% of SMEs (including micro) feel they have recently been 'caught out' by a contract rollover (FPB, 2010). Also, 31% rely to some extent on the renewal letter to begin comparing suppliers.

¹¹ We will be revisiting rollover provisions once we have reached a decision on any change to the coverage of SLC 7A. See chapter 2 of the associated non-domestic proposals consultation document.

¹² Around a third of our small business sample had recently switched, typically to a lower tariff (Harris Interactive, 2011).

¹³ Harris Interactive (2011) had respondents claim rates double and treble those from previously negotiated. The Federation of Small Businesses (2011) quotes a customer with rates ten times higher than their previous contract.

Option 3: All non-domestic customers

1.27. If coverage was extended to all businesses then we would expect to see many issues which are addressed by SLC 7A using prescriptive rules. There may be a proportion of medium sized businesses that would welcome the additional clarity to contracts and rollovers provided by SLC 7A.

1.28. However, we consider that many larger businesses will already be highly engaged with suppliers, particularly those with high consumption levels. We believe the marginal benefits of expanding SLC 7A to cover them will be lower than for small businesses. Therefore, although the proposed SOC's will cover many of the same areas, the specific protections provided by SLC 7A may be overly prescriptive for them. It could hamper suppliers' ability and large business users to negotiate contracts to their specific requirements.

Impact on competition

Option 1: No change

1.29. We would anticipate none to a slightly negative impact on current competition levels if the scope of SLC 7A was unchanged. This is because if businesses outside the micro business definition continue to be unaware of their contract terms, they may become even less engaged in the market.

Option 2: A new small business definition

1.30. As small businesses will have to be alerted to the prospect of rollover and their renewal options, more opportunities would exist for new or existing suppliers to compete and gain new business.

1.31. We recognise that extending coverage will impose costs on some suppliers who do not currently treat small businesses similarly to micro. We do not expect this to be prohibitive, as it will be an incremental change to what they already have in place for micro businesses.

1.32. Small businesses will be much better informed of their term and conditions and rollovers terms and this should increase their engagement with the energy market. This may prompt more switching and increase competitive pressures in the whole market. We therefore expect these positive benefits to outweigh the negative cost implications.

Option 3: All non-domestic customers

1.33. We expect that the cost of providing notice of contracts and renewal terms to all businesses will be greater than Option 2. However, we would not expect these to be prohibitive as our information suggests that up to a third of non-domestic

suppliers treat all their customers as if they were micro businesses customers already. The benefit of this option is that any costs to identify whether a business was small or micro would disappear.

1.34. While a supplier may choose to apply this to all their customers, we do not want to impose less flexibility for large business customers and their suppliers - this may act as a barrier to new entrants into the market. A respondent to our previous consultation highlighted that larger businesses would not wish to be bound by any compulsory processes of SLC 7A.

Impact on sustainable development

1.35. We expect no significant impacts on sustainable development either positive or negative for any of the three options. But we welcome your views on this.

Risks and unintended consequences

1.36. Under Options 2 and 3 there is a risk more businesses will go onto relatively unfavourable 'out of contract' rates if they choose to opt out of the automatic rollover but then fail to engage in signing up to an alternative contract. Provided customers are well aware of any higher charges and take action, this potential negative impact should be mitigated. Nevertheless, there may be some consumers who still do not take action when their fixed term contract ends.

1.37. There is a risk of there being an added regulatory burden if government protections differ from our own assessment of who needs to be protected in the non-domestic market. This may complicate how suppliers set up their systems to comply with their various legal obligations, for example redress schemes¹⁴ (that only cover domestic and micro businesses). We aim to keep BIS and DECC well informed of our intentions.

1.38. DECC's current smart meter roll-out programme¹⁵ covers domestic and smaller non-domestic customers. They define the small and medium non-domestic market as sites with electricity profile class 3 and 4, and gas sites with consumption below

¹⁴ See The Gas and Electricity Regulated Providers (Redress Scheme) Order 2008. The Energy Ombudsman provides dispute resolution to domestic and micro-business consumers if suppliers cannot resolve disputes within 8 weeks. If SLC 7A is expanded there is a gap between the coverage of the licence condition and the businesses that can use the Ombudsman. There is a risk that this will cause frustration to small businesses (under Option 2) where SLC 7A provides extra protection to them but they cannot use the Ombudsman if a there is dispute relating to it.

¹⁵ We also note the recent DECC consultation (can be accessed here: <http://www.decc.gov.uk/assets/decc/11/consultation/smart-metering-imp-prog/2545-smip-licence-conditions-consultation.pdf>) that asks whether a Smart Metering Installation Code of Practice should only apply to micro businesses or if coverage should be wider. Decisions on this are expected to be taken by early 2012.

732,000 kWh per year. Our proposed new definition would mirror the electricity definition but be considerably lower than the DECC upper limit on gas usage for medium sized businesses. This still leaves a potential difference between our proposed definition and the one used for the smart meter rollout and there is a risk of confusion if there are different definitions relating to small businesses.

1.39. The proposed electricity definition could include some medium sized businesses. Elexon data indicates 5% of profile class 3 and 4 use more than 100,000 kWh per year. There is a chance some larger organisations could take advantage of protections not intended for them, although it is difficult to estimate if this would be a significant number.

Post implementation Review

1.40. We are currently reviewing supplier compliance to the current SLC 7A. We will continue to monitor compliance after any expansion, and potentially begin investigations to consider enforcement action. Decisions to enforce will be made in line with our published Enforcement Guidelines¹⁶.

1.41. In the future, we are likely to commission further consumer research, including evaluating whether the understanding of contracts and rollover for small businesses had increased following SLC 7A expansion.

Conclusion

1.42. Option 1 is included as a baseline and we would expect the positive outcomes from introducing SLC 7A to continue. There are still businesses that would benefit from similar protections, which leads us to have a preference for Option 2.

1.43. For some suppliers we believe that Option 2 will have very little negative impact as they currently treat all SMEs in the same way. We encourage this practice to continue. We recognise there could be additional costs for some suppliers, but have no evidence that they will be prohibitive, particularly to smaller suppliers and new entrants. We would welcome further information on this.

1.44. Although Option 3 has some desirable features, such as no need to classify non-domestic customers, it seems unnecessary to force prescriptive rules, eg restricting when notice needs to be given, on segments of the market with little evidence that they require them.

¹⁶

<http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20Guidelines%20post%20consultation.pdf>

Appendix 10 – Non-domestic Standard Licence Conditions for sales activities: Draft Impact Assessment

Summary

1.45. On 21 March 2011 we published our RMR consultation. In this, we outlined that we wanted to take further action to prevent unfair contracting practices in the non-domestic sector. As part of this, we said that we were considering a new licence condition to regulate the relationship between suppliers and third party intermediaries (TPIs). This decision was made on the basis of complaints about the actions of TPIs which act both independently and on the behalf of suppliers. We especially wanted to: (a) make consumers aware of potential fees for services provided by TPIs; and (b) capture potential misselling activity over the phone, via full call recordings for example.

1.46. The consultation invited views from stakeholders on whether to take further action to prevent unfair contracting practices in the non-domestic sector. With reference to TPIs, we asked if stakeholders agreed that Ofgem needed to look further at the role of TPIs in the non-domestic markets.

1.47. Respondents were largely supportive of us looking further at the relationship between suppliers and TPIs. However, there was variation on the type of action and the levels of regulation that they thought we should consider.

1.48. This draft impact assessment considers the effects of our proposed introduction of a new licence condition on non-domestic consumers and on competition based on our assessment of evidence and stakeholder responses. We also note that in the main consultation document we reference the potential overlap this proposal has with our new Standard of Conduct (SOC) proposals. A draft impact assessment for the SOC is set out in the following chapter. Given the potential overlap, it follows that some impacts discussed for the two proposals may be similar. However, as we noted in the main consultation document, it may be possible for this licence condition to still be required, including depending on how the SOC is finally drafted and who they apply to.

1.49. Our options are:

- **Option 1:** Maintain the current non-domestic sales and marketing arrangements.

- **Option 2:** Introduce a new non-domestic licence condition covering sales and marketing activities¹⁷.

1.50. Here we discuss each option and evaluate their impact on consumers and competition. We also assess their impact on sustainable development and other areas not covered by these categories.

1.51. On the basis of our assessments, we are proposing to pursue Option 2. We believe that our proposed option will have a net positive impact on consumers and competition based on the assessments made in this document. This will be achieved by increasing the levels of transparency into TPI activities, where they have a relationship with a supplier, and better addressing potential misselling activities. There may be some associated implications for supplier costs which have not been fully evaluated within this draft impact assessment. However, we consider these potential negative impacts to be limited relative to the potential gains in consumer confidence and enhanced consumer engagement.

Key issues and objectives

1.52. At the moment there is a sales and marketing condition for domestic suppliers, but there is not¹⁸ an equivalent supply licence condition for non-domestic suppliers.

1.53. We have been made aware of alleged harmful sales and marketing activities in the non-domestic sector. Our Energy Supply Probe ('the Probe') published in October 2008 demonstrated our awareness of specific concerns relating to the actions of some TPIS within this market. It also recognised the importance of TPIS within the non-domestic sector¹⁹. A range of self-regulatory measures to improve consumer confidence in TPI services were then recommended in our consultation published on 15 April 2009. We also stated that we may consider further action should our concerns continue.

1.54. Our RMR consultation published on 21 March 2011 evaluated the application of our SOC's in dealings with consumers by non-domestic suppliers²⁰. We found that a

¹⁷ We note that our proposals incorporated three approaches. The licence condition is one proposal, but we are also seeking the power to take action under the BPMR's and we are proposing to run an accreditation scheme for any Codes of Practice that are developed. We believe that these three approaches will support and give extra benefits together that are greater than a single approach could give.

¹⁸ SLC 7A does require that suppliers give clear information about contracts to micro business customers, for example the Principal Terms of a contract must be made clear up-front and must be sent to the customer within 10 days. However, this does not cover the breadth of sales and marketing activities and only applies to micro business customers (at present).

¹⁹ Research into business consumers' experience of the energy market by FDS found evidence of TPIS helping a consumer save money on their energy bills and keep records of contract renewal dates. A survey by Datamonitor in 2010 also showed that business customers that used TPIS felt that they saved their business money and time.

²⁰ The SOC's set out the level of service consumers can expect from energy suppliers. They are

number of suppliers had generally incorporated the spirit of the SOCs into their contracts with TPIs. However, there was less consistency in how these were monitored.

1.55. In response to our continued concerns we stated in the RMR consultation our considerations for new licence conditions to regulate the relationship between TPIs and suppliers. We were also aware that we may need to ask for additional powers from government to achieve our aims in this area. We especially wanted to (a) make sure consumers were aware that they may be charged fees for a TPIs service and (b) take steps to address potential misselling over the phone by ensuring that TPIs fully record telephone calls. The stakeholder response to the RMR consultation agreed that TPIs' activities should be more transparent. We are now consulting on a new marketing licence condition/SOCs which is one part of our package of proposals to address our concerns in this market

Options

1.56. The options presented here relate to the regulation of the TPI-supplier relationship.

Option 1: Maintain the current non-domestic sales and marketing arrangements

1.57. We do not currently have direct powers to regulate the sales and marketing activities of TPIs in the non-domestic market. Pursuing this option will leave self-regulation as the main method of reducing the non-domestic market harm that we have previously identified.

1.58. We sent an Information Request to suppliers as part of our evaluation of how they ensure their Representatives adhere to our SOCs²¹. The information we requested from suppliers related to (but not exclusively) our outlined concerns, including call recording to capture potential misselling and TPI fee transparency. This request provided us with a snapshot of the relationship between TPIs and suppliers in the non-domestic sector. Approximately half of the suppliers had contracts (direct relationships) with TPIs. Of those suppliers requiring TPIs to have recording provisions, one supplier explicitly stated that they require the entire duration of telephone calls to be recorded by TPIs. One supplier out of all of the respondents believed that the TPIs they pay commission to actively made consumers aware of

explained in more detail in chapter 5.

²¹ The request for information was sent to suppliers on 21st December 2010 pursuant to SLC 5. We requested specific information relating to these methods. TPIs may act as Representatives directly or indirectly. For example, if a TPI receives any commission they will be deemed to be a representative.

this. However, some TPIs that were Representatives of the respondents could disclose whether the consumer paid any fees for their services upon request.

1.59. Responses to our RMR consultation provided us with further information on current market provisions in relation to our concerns. One supplier has an initiative to tell consumers that they are paying commission²². However, not all of the TPIs working with this supplier had signed up to this agreement²³. One TPI has a self enforced consumer charter which commits them to commission disclosure when requested by a consumer. The same TPI also records telephone calls between TPIs and consumers in full²⁴. Responses here did not address the suppliers' own procedures in relation to call recording and whether they require TPIs to say which suppliers their services cover.

1.60. We are also aware of an operating TPI Code of Practice (CoP) which directly covers TPI activities²⁵. The code is mandatory for full association members, and includes provisions to disclose the origin of all considerations in their consumer contracts. Members are also required to clarify who and where they are sourcing their prices from. We believe that there are currently no provisions for call recording.

1.61. We welcome responses to help us evaluate the full extent of current self-regulatory measures.

Option 2: The addition of a non-domestic supply licence condition covering sales and marketing activities

1.62. In our March RMR, we said that we were considering introducing new licence conditions to regulate the relationship between suppliers and TPIs. These proposals would bring non-domestic market conditions closer to those currently experienced in the domestic market.

1.63. We intend that our proposed new marketing licence condition will contain broad rules that will be capable of addressing our main TPI concerns relating to fee transparency and potential telephone misselling. Fee transparency in its simplest form may require TPIs to tell a consumer whether they have received a payment for their services. With a view to addressing telephone misselling concerns, we also intend that our proposed new rules will have the effect of requiring full call recording where contracts with TPIs have been agreed over the telephone.

²²TPIs are also required to disclose the fee rate to customers if requested.

²³ Some of the largest and most established TPIs are among those who have not signed up to the agreement.

²⁴ They further stated that they see no justifiable reason why the wider market should not operate under such a charter.

²⁵ The Utilities Intermediaries Association (UIA) currently operates a CoP for TPIs.

1.64. We also stated in our RMR consultation that we were considering additional actions to support these licence condition proposals. We are consulting on an Ofgem accreditation/quality mark for CoPs written for or by TPIs. We have also asked BIS to consider conferring on us powers to enforce the Business Protection from Misleading Marketing Regulations (BPMMRs) to allow us to take enforcement action against misselling of non-domestic tariffs.

Impact on consumers

Option 1: Maintain the current non-domestic sales and marketing arrangements

1.65. In the RMR we stated our concerns that some TPI activities continue to have a negative impact on the non-domestic energy market and that we were looking to reduce this. As we have identified these concerns it is our view that a 'do nothing' approach could allow consumer harm to continue.

1.66. We are concerned by the lack of provisions requiring TPIs to tell consumers whether or not they have paid for their services. We believe that suppliers have not taken enough action to ensure that TPIs with whom they have relationships tell consumers that have received a fee for their services. It is our view that upholding current market conditions may result in consumers feeling misled.

1.67. We are concerned that current TPI charters/codes may not be enough to stop consumers from being misled about the actual costs of their TPI's services. We welcome TPI initiatives to improve cost transparency, and encourage them to further develop these proposals. However, we do not believe that the coverage of the market is wide enough. We therefore have the view that relying solely on self-regulation in its current form could allow alleged consumer related problems to continue.

1.68. We have seen reports from consumers of misselling by some TPIs²⁶. We believe that self-regulation alone will not capture alleged misselling activities over the phone. We believe that maintaining this situation would increase the risk of consumers making poor switching decisions. Furthermore, the market may be left without systematic processes for capturing evidence and being able to take action.

1.69. We have also been made aware of customer confusion as to whether the TPIs are agents or represent a single supplier²⁷. Consumers may incorrectly believe that

²⁶ Research published in June 2011 reported that some consumers found that the Terms and Conditions that they received after contacting a TPI differed from those that they were quoted over the phone. This research also reported consumer complaints of some TPIs using scare tactics to encourage customers to commit to agreements there and then.

²⁷ Consumer Focus' research 'Watching the Middlemen' highlighted supplier coverage as an area of concern that may put off non-domestic consumers from using TPIs.

they are dealing with an independent TPI which represents a range of energy suppliers. Where this is the case they are liable to make poor switching decisions. We believe that these conditions may also harm consumers attempting to resolve complaints as they may be unclear with whom they have a contract with.

1.70. We have concerns relating to the potential consumer confusion caused by a lack of coordination between the domestic and non-domestic markets. This situation may leave non-domestic consumers vulnerable as they may believe that they are covered by a licence condition that only applies to the domestic market. Maintaining the current non-domestic sales and marketing conditions would allow this to continue and potentially mislead consumers.

Option 2: The addition of a non-domestic supply licence condition covering sales and marketing activities

1.71. We intend that the effect of our proposals for complete, accurate and non-misleading information to be provided to customers will require TPIs to disclose they are charging a fee to consumers where the TPI is acting as a Representative of the supplier. We believe that this proposal will increase the levels of transparency within the market. We hope that this will allow consumers to make more informed decisions when choosing a TPI and their energy supplier.

1.72. We intend that our proposals for complete, accurate and non-misleading information to be provided to customers will also have the effect of requiring TPIs to fully record their telephone conversations with consumers. We believe that this attempt to address potential TPI misselling activities could reduce this bad practice within the market.

1.73. Our intended licence condition will also aim to make TPIs clarify to consumers who they represent at the beginning of their dealings with them. Such proposals should allow consumers to be clear about who the TPI they are dealing with represents. This could reduce potential misselling activities as consumers will have an increased awareness of how TPIs produce their quoted prices.

1.74. Responses to our RMR consultation highlighted a potential 'protection gap' that may arise from regulating TPIs with an obligation on suppliers. Respondents pointed out that not all suppliers have a relationship with TPIs²⁸. One supplier also had concerns that the imposition of obligations through licence conditions would force TPIs away from the supplier sales model, towards the consumer sales model²⁹. This would see TPIs move away from direct contractual relationship with the

²⁸ An Information Request to non-domestic suppliers on 21st December 2010 indicated that approximately half of suppliers had contracts with TPIs.

²⁹ One respondent defined the supplier sales agent model as when TPIs directly contracted to the supplier and operating on behalf of the supplier to gain customers. The customer sales agent model has the customer contracted with the TPI, with the TPI acting as the customer's agent. In the current market, TPIs choose which model they prefer to follow.

suppliers. We are aware of this potential protection gap and have plans to introduce a TPI CoP quality mark to cover the activities of all TPIs signed up to accredited CoPs, including those who do not have relationship with suppliers. We therefore do not agree that the introduction of a new licence conditions will leave a large protection gap for consumers. In any event, we note that TPIs will need to continue to comply with the BPMMRs or risk enforcement action by the OFT and/or trading standards departments (or Ofgem, if we are given the powers to enforce the BPMMRs).

1.75. The introduction of a non-domestic marketing licence condition will bring the regulation of sales and marketing activities in this market closer to those of the domestic market. We believe the effect of this will be to provide consistency and clarity on the levels of protection that consumers can expect.

Impact on competition

Option 1: Maintain the current non-domestic sales and marketing arrangements

1.76. We are concerned that maintaining the current non-domestic market conditions relating to fees would not increase market transparency, which could lead to consumers becoming disengaged with TPIs³⁰. We recognise the importance of TPIs in helping consumers to find the most appropriate tariffs. A scenario where consumers reduce their usage of TPIs due to a lack of clarity around how they are paid could result in less consumers engaging with the market or negotiating with their current supplier. We believe that this scenario would make the non-domestic market less competitive.

1.77. We have identified problems relating to current provisions to address potential misselling activities. If this remains unaltered, we foresee consumer doubts relating to the completeness and relevance of the information obtained from TPIs persisting. We believe that a lack of coordinated action to tackle these doubts could damage the credibility of TPIs within the market. If consumers are less inclined to engage with TPIs, there may be a negative impact on competition. This is based on the importance of TPIs in helping consumers find appropriate energy deals.

1.78. Some consumers have made us aware of their concerns about the lack of clarity around who TPIs represent³¹. Consumers are not clear whether they are

³⁰ Harris Interactive conducted research into small and medium business consumers' experience of the energy market. Some consumers were put off from using TPIs as they believed that TPIs would only provide details of suppliers who they had received commission from. Others assumed they could get a better deal directly from the supplier as either they or the supplier had to pay for the TPI.

³¹ Respondents to FDS's qualitative research into consumer's views of issues in the small business energy supply market found that it was not obvious to consumers who TPIs represented.

dealing with TPIs that represent a single supplier, or a number of them. This makes consumers sceptical as to whether they are receiving accurate and relevant information from the TPI. This could discourage them from using TPIs and engaging with the non-domestic market as a whole, therefore having a negative impact on competition. We believe that this proposal will foster this unclear consumer environment.

Option 2: The addition of a non-domestic supply licence condition covering sales and marketing activities

1.79. We intend that our proposals for complete, accurate and non-misleading information to be provided to customers via a new licence condition will have benefits for suppliers and market credibility as a whole. Formalising their relationship with TPIs could provide a strong incentive for suppliers to be associated with TPIs who best consider consumers' interests in the market. This could improve consumer confidence in the market as a whole, leading to increased consumer engagement.

1.80. Our intended proposals for complete, accurate and non-misleading information to be provided to customers will have the effect of requiring suppliers to ensure that their TPI Representatives have appropriate arrangements for disclosing information about fees to consumers. It is our belief that this will increase the levels of transparency in the non-domestic market. This could subsequently increase the levels of consumer confidence which could encourage consumers to further engage with TPIs. This in turn could result in a more competitive non-domestic market.

1.81. Our proposal to better address potential TPI misselling activities could reduce these throughout the non-domestic market. The reduction in these harmful actions may increase industry credibility and provide consumers with increased market confidence. Our view is that this increased confidence will encourage them to engage with TPIs and the market as whole. This process may make the market more competitive as more consumers actively seek out the best energy plan.

1.82. We intend that our proposed marketing licence condition will have the effect of requiring complete, accurate and non-misleading information on TPIs services to be provided to consumers. This could have the effect of TPIs clarifying who they represent from the outset of their dealings with consumers. This would provide additional market transparency and allow consumers to make informed decisions when choosing a TPI. It is our view that increased consumer confidence in TPIs and the non-domestic market will follow. This may promote the levels of consumer engagement with TPIs, encouraging more consumers to find better energy offers.

1.83. Responses to our RMR consultation have made us aware of several supplier concerns regarding commission declarations. One supplier suggested consumers may be deterred from switching if they are made fully aware of the associated sales costs. However, there is evidence³² that business customers value the service for their

³² Datamonitor 2010 B2B consumer survey. This showed that the two main reasons customers

increased knowledge of the market and are happy to pay for this, particularly when they are time-poor. We believe that the increased transparency will encourage consumers to engage with TPIs further. This in turn could enhance competition as TPIs help consumers to find the most appropriate energy deals. We therefore believe that increased awareness of the costs will benefit market competition.

1.84. We are also aware of similar concerns from TPIs relating to disclosure of the commission amount. They are concerned that consumers may use the TPI to find the cheapest offer then go directly to the supplier to get the offer. The consumer would therefore avoid paying commission to the TPI whilst getting the best available deal. We consider that this argument could equally apply in today's market. Further, we do not currently expect that the fee itself is disclosed upfront, which may lessen whatever impact this may have.

1.85. One supplier has brought to our attention potential additional costs associated with recording telephone calls. We acknowledge that TPIs will incur costs associated with recording. One TPI has made us aware of a quoted figure of £600 plus VAT for the set up of telephone recording equipment and services for a four person office. We understand that this sum is not particularly onerous, even when dealing with reasonably small contracts. We therefore do not believe that these costs are excessive. Moreover, it is our view that these costs will be outweighed by increased levels of consumer confidence in TPIs, resulting in a positive impact on competition. We welcome further assessments of costs relating to this issue from TPIs and suppliers.

1.86. We have examined the viewpoint that call recording will impact on the confidentiality of suppliers. This issue relates to the recording of the whole phone conversation of TPIs who represent different suppliers. We intend that potential recordings will only be listened to by Ofgem, or any other regulatory authority, and in circumstances where we think there is a good reason to do so. We therefore do not consider that full call recording will infringe on supplier confidentiality and have a negative impact on competition. Furthermore, only recording the verbal contract part of the phone call, for example, would not necessarily capture all of the sales activities and therefore may not capture any potential misselling.

1.87. A response to our RMR consultation expressed concerns that our proposals would disproportionately disadvantage smaller suppliers as there will be no requirement to declare internal sales costs. The supplier believes that a requirement for TPIs to disclose their fee costs may put off consumers from using them. And small suppliers have a higher reliance on TPIs, so this scenario could impact those suppliers harder. However, we do not share this view as we believe that the increased transparency created by TPIs being clear that there is a fee attached to

used TPIs was cost saving (39%) and time saving (15%).

their service will foster trust and increase consumer confidence in TPIs. This may result in an increased uptake in their services.

Impact on sustainable development

1.88. It is our view that both of the proposals will not have any significant impacts on sustainable development, but we invite comments on this issue.

Risks and unintended consequences

1.89. Our views of the potential impacts on consumers and competition from Option 2 have been described in the 'impact' sections of this appendix; however unintended consequences and risks may arise from our proposal. We are aware that our proposal to introduce a new licence condition could change the relationship between suppliers and TPIs. There may also be risks and unintended consequences associated with TPIs offering Green Deal options to non-domestic consumers.

1.90. We invite respondents to draw our attention to other potential risks and unintended consequences, and provide additional information relating to the cost implications of our chosen proposal.

Post implementation Review

1.91. We plan to assess the impact of the proposed introduction of a new non-domestic licence condition using various methods, including through ongoing market monitoring activities and investigations into specific complaints.

Conclusion

1.92. We are proposing to introduce a new marketing licence condition for non-domestic sales activities as outlined in our 'Options'. We believe that this proposal will have a positive effect on consumers and competition by increasing the transparency of TPI activities, and better capturing potential misselling. We are aware of some implications for TPIs and suppliers; however we currently believe the benefits of our proposal outweigh the negative impacts.

Appendix 11 – Draft Impact Assessment for Standards of Conduct proposals

Summary

1.93. This draft Impact Assessment represents our view of the benefits and costs of our proposed options around the Standards of Conduct (SOCs) that are presented in the associated consultation document, these options are also briefly outlined below. We welcome views on our assessment, including further information regarding benefits, risks and costs.

1.94. Our objective throughout both the Probe and the RMR has been to address issues that may reduce the effectiveness of competition in the market, and to improve the experience of retail energy consumers. The RMR found that further action was needed to make retail energy markets in GB work more effectively for both domestic and non-domestic consumers. Our initial RMR findings document included a range of measures to strengthen Probe remedies. Within this we considered giving greater force to the SOCs.

1.95. We propose to modify the existing SOCs to make them applicable to all interactions between suppliers and consumers, and to take a more principles-based approach where the SOCs are concerned. The current SOCs apply to all domestic and small business consumers. We propose the new SOCs would apply to the whole of the domestic and non-domestic markets, but are seeking views on that proposal.

1.96. The options below discuss the legal status of the expanded SOCs:

- **Option 1: Legally binding via an overarching licence condition.** Binding SOCs in the licence. We would recast the existing SOCs and apply them to all interactions between suppliers and consumers. Under this option, we would incorporate them into an overarching licence condition. We would be able to enforce supplier adherence directly.
- **Option 2: Non-binding + industry commitment.** Non-binding SOCs with strong voluntary commitment. As per Option 1, we would recast the SOCs and apply them to all interactions between suppliers and consumers. In addition, suppliers would make a public commitment to uphold them. We would monitor their performance against this commitment.
- **Option 3: Non-binding.** Non-binding SOCs. As per Option 1, we would recast the SOCs and apply them to all interactions between suppliers and consumers. However, they would retain their current, non-binding status and we would not be able to enforce them directly.

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

1.98. As noted in our consultation document, **we propose implementing Option 1 (Overarching licence condition)**. Our RMR evidence shows that low consumer trust in suppliers and low engagement with the market needs to be addressed. A key mechanism for improving the situation is supplier conduct. We consider that stronger, broader SOC's will support improvements in conduct and give consumers more confidence in suppliers.

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

1.100. We note that much of the impact detailed for our proposed sales and marketing licence condition (in appendix 10) would equally apply to overarching SOC licence conditions applying to all consumers, assuming our SOC's do not change.

Impact on consumers

No change

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

1.102. With this option we would continue to lack the ability to directly enforce the SOC's, although we are able to have regard to them in relation to determining consumer detriment and prioritising enforcement activity. Consumers' views of suppliers may continue to worsen over time, and their willingness to engage in the market may fall further. It is also possible that the relatively prescriptive existing SOC's will become less relevant as technology and products change – particularly in the context of our plans to roll out Smart Metering.

Introduction of new SOC's

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

1.104. This could result in improved outcomes for all consumers. Discussions with business customers, including large businesses, and evidence from consumer research³³ shows that the poor supplier practice is one of the main reasons customers do not trust energy suppliers; and this lack of trust could mean that many do not engage with the energy markets. Therefore, improved supplier practices could lead to increased levels of consumer engagement in the market, and greater transparency may also improve the effectiveness of such engagement.

1.105. The principles-based nature of the proposed SOC's should mean suppliers are better-equipped to deliver benefits to consumers in the context of technological, and other, change. For example, they may be more likely than more prescriptive measures to retain their relevance as we roll out Smart Metering. Therefore, the SOC's would not inhibit innovation with regard to both products and services consumers value. A principles-based approach also means suppliers have a degree of flexibility with regard to how they meet the SOC's. Therefore, we expect that the additional cost required for a competitive supplier to meet our standards would be low under this proposal. In particular, our view is that this cost would be lower than an alternative scenario in which we relied on more detailed rules, and would be outweighed by the benefits.

Option 1: Legally binding via an overarching licence condition

1.106. We see the key factor that separates this from other options is that suppliers would be under a legal obligation to adhere to the SOC's with this proposal. In our view, making the SOC's legally binding is fundamental to improving supplier conduct and addressing consumers' poor perception of some of them. If the SOC's are part of an overarching licence condition, suppliers could face financial penalties or enforcement orders if they do not adhere. The likelihood of adherence is therefore significantly greater with this option. As a result, we believe this option is most likely to deliver the intended benefits to consumers.

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

³³ Research on SME business customers showed that some felt that suppliers acted in an 'underhand' way when they 'quietly' allowed contracts to roll over rather than proactively ensuring their customers are on the best tariff available to them. This annoyance had been heightened following experiences of energy companies suddenly offering a much better price once challenged. See full research at the following link:
<http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/SME%20Attitudes%20%20Behaviours%20Report.pdf>

Option 2: Non-binding + industry commitment

1.108. With this option these measures would, ultimately be voluntary. Although we could report publicly on suppliers' adherence to the SOC's, we note that Ofgem would still lack formal enforcement powers (see further discussion in Risks section). In our view this significantly limits the potential impacts of this option. Given the frequently negative views expressed about suppliers, it is less likely that a voluntary (albeit public) commitment from suppliers to adhere to the new SOC's will result in an immediate improvement in consumers' trust in suppliers.

1.109. We recognise that this would expand the scope of the SOC's compared to their current status; however, there would be no direct regulatory burden on suppliers, since the SOC's would not be incorporated into a licence condition.

Option 3: Non-binding

1.110. The new SOC's are expected to bring some benefits, as discussed earlier. But, the extent to which the proposed SOC's deliver impacts for consumers ultimately depends on supplier adherence. Under this option, the new SOC's would not be legally binding. We would not be able to enforce adherence to the SOC's. In our view this significantly limits the potential positive impact of this option for consumers. Our interactions with business consumer stakeholders and the research and issues we set out in our consultation document (including our findings on Objections to supply transfer and SLC 7A) suggests that the existing SOC's have not delivered the intended higher levels of consumer trust in suppliers, and engagement in the market.

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

Impact on competition

No change

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

Introduction of new SOC's

1.113. Improving competition within the market is one of the key goals of this proposal, and we anticipate that the new SOC's would have a positive impact on competition. The direct benefits to consumers regarding greater clarity and fair treatment should help to improve the reputation of individual suppliers and the

industry as a whole. Increase levels of trust in energy suppliers will help facilitate consumer engagement and, ultimately, greater levels of competitive pressure within the market.

1.114. We do note that the nature of the non-domestic market, with more suppliers in the market and a tradition of bespoke contracts, particularly with larger business customers, could mean that there are already higher consumer engagement levels than we see in the domestic market. However, we have anecdotal evidence from discussion with business consumers and some research evidence that some non-domestic consumers do not have confidence in supplier actions³⁴.

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

Option 1: Legally binding via an overarching licence condition

1.116. As discussed in the section on consumer impacts, we believe that making the SOC's legally binding is fundamental to improving supplier behaviour and addressing consumer mistrust. We therefore anticipate an increase in competitive intensity driven by improvements in consumer engagement.

1.117. We recognise that there is an increased regulatory burden with this proposal. But of the proposed options, Option 1 (Overarching licence condition) should maximise the long-term benefits resulting from increased competitive intensity. These benefits could be realised sooner than would be possible under the other options below. If there is consumer mistrust of suppliers, a voluntary public commitment from suppliers may contribute little to increasing consumer engagement. Under this option, the SOC's would be backed by a formal licence condition. Moreover, wider awareness of these rules could result in an immediate increase in trust and engagement, if consumers anticipate improved supplier conduct.

Option 2: Non-binding + industry commitment

³⁴ Harris Interactive published research in June 2011 which evaluated small and medium business consumers' experience of the energy market. They found that consumers often had a negative view of energy suppliers. Consumers alleged that suppliers were profiteering, demonstrated a lack of proactivity relating to contract renewals and displayed insufficient transparency regarding issues such as bill rates and contract terms.

1.118. There is potential for this option to have a positive impact on competition; however, the extent to which this would materialise would depend on supplier adherence. Suppliers may have an added incentive to adhere to the SOC's if they give a verbal commitment; however the new SOC's would not be legally binding. We would not be able to enforce the desired outcomes that we have set out. In our view this significantly limits the potential positive impact on competition under this option.

1.119. If suppliers do adhere, we would anticipate an increase in trust in the market would help to drive consumer engagement and increased levels of competition. While this mistrust should diminish if suppliers' conduct improves, this would not be expected if some suppliers do not adhere to these standards. Given the prevailing sentiment towards suppliers, we consider that it is unlikely that a voluntary (albeit public) commitment from suppliers to adhere to the SOC's will result in an immediate impact.

Option 3: Non-binding

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

Impacts on sustainable development

Eradicating fuel poverty and protecting vulnerable consumers

1.121. This section is not applicable to non-domestic customers.

Supporting improved environmental performance

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

1.123. If better treatment of consumers and information helps to promote trust and increase levels of consumer engagement, this may support sustainable development goals. For example, engaged consumers may be better placed to participate actively in demand reduction activities in response to supplier communications.

Other impacts and post implementation review

Impacts on health and safety

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

Cost of implementation

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

Risks and unintended consequences

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

1.127. There is a risk that the proposed measures may not be effective. If suppliers do not adhere to the SOC's then, as noted, consumers' trust in suppliers and engagement in the market is likely to remain low (and could even fall). This could require us to implement more prescriptive measures in the future. This risk applies in particular to Options 2 (Industry commitment) and 3 (Non-binding), where adherence to the SOC's would be voluntary on the part of suppliers.

1.128. There is also a risk that the proposed measures are not effective in the short-term if consumers' are sceptical of their potential impact. In this instance we may be able to take some action to help consumers understand the intended impact of our proposal and to ensure supplier compliance.

Better Regulation

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

- Proportionality – Regulators should intervene only when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimised.
- Accountability – Regulators should be able to justify decisions and be subject to public scrutiny.

- Consistency – Government rules and standards must be joined up and implemented fairly.
- Transparency – Regulators should be open, and keep regulations simple and user-friendly.
- Targeting – Regulation should be focused on the problem and minimise side effects.

1.130. Our proposed SOC's are seeking to achieve our policy aims in a way that is consistent with these principles. We believe that they impose the minimum burden needed to secure the desired level of treatment for consumers. Our interaction with stakeholders and our research suggests that consumers' lack trust in suppliers from experiences with them in a wide range of circumstances. Some research also suggests this impacts on consumer's willingness to engage with the market, which would ultimately decrease competitive pressures in the market. Therefore, the proposed SOC's target interactions between suppliers and consumers. Moreover, the principles-based approach allows these issues to be addressed, while allowing suppliers' a degree of flexibility with regard to how they meet the standards over time. We consider this to be a proportionate response. We believe the proposed SOC's are consistent with what would be expected of a reasonable supplier within a competitive market.

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

Post implementation review

1.132. There are three scenarios for post implementation review depending on the option adopted:

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

1.133. We will measure the success of the proposed SOC's based on industry actions, consumer views of the industry, consumer feedback on experiences within the market and consumer engagement levels. We will draw on data sources including consumer research; feedback from stakeholders such as industry representatives, TPIs, trade organisations and consumer groups; complaints data; quantity and quality of switching; and media coverage.

1.134. We recognise that it may be difficult to isolate the impact of our proposed SOC's given that we would intend to introduce it as part of a broad package of RMR measures. We have noted in our consultation the potential interactions between this proposal and others in the non-domestic market. There are also areas that are not targeted by other RMR proposals and it would be possible for us to consider the impact on these areas along with other data and information.

Conclusions

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

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

1.137. We are concerned that a purely reputational incentive would not deliver such impacts. This concern is based on experience to date that the non-binding SOC's introduced following the Probe have not resulted in our intended increases in consumer trust or engagement. In our view the proposed SOC's formalise what we expect a competitive supplier should do as a matter of course, and so we do not anticipate that this proposal creates unreasonable or overly burdensome compliance costs.

1.138. We acknowledge that this would impose some new regulatory burdens on suppliers. However, we believe this is in part mitigated by the relatively flexible, principles-based nature of the SOC's and the relevance of the SOC's in helping to facilitate compliance with the requirements under the Business Protection from Misleading Marketing Regulation 2008 that all non-domestic suppliers must already comply with as a matter of law. We therefore take the view that any additional burden should be proportionate and have concluded that the net impact in non-domestic markets is positive.