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Dear Andrew,

The Retail Market Review: Domestic Proposals

1. We recognise there is a clear need to improve consumer trust and confidence in the energy sector; it is important that energy customers feel positive about their energy supplier. It is because of this we are in the process of introducing a number of significant changes aimed at improving the transparency of customers' bills and the comparability of tariffs. Improving customer experience is in our interests – and we do not believe deep regulatory intervention is necessary to deliver this.

2. Since the Retail Market Review (RMR) was launched in Autumn 2010, we have engaged fully with Ofgem. We have however, consistently expressed our concerns over a lack of clarity over the objectives and measures of success of the RMR. We have also laid out further concerns that the proposals as originally detailed in March 2011 would impose a range of costs on consumers (unquantified by Ofgem), materially reduce customers' choice, and risk creating a wide range of unintended consequences and distortions for the retail market. We have also repeatedly urged Ofgem to undertake a quantified impact assessment.

3. Despite our engagement, the domestic tariff proposals published in December 2011 (and developed further through the more detailed standing charge consultation in February 2012) have failed to take into account any of the key concerns we have raised.

4. As presented, the core RMR tariff proposals represent a radical and disproportionate intervention in the retail market, unjustified by the evidence presented by Ofgem to date. At a time when regulators in other countries and sectors are looking to <u>increase</u> the ability of competition to deliver benefits to consumers, these proposals will <u>abolish</u> some of the most important innovations that have driven customer engagement and competition for energy customers since the introduction of the retail market.

5. We disagree with Ofgem's arguments supporting the introduction of the RMR package of proposals and believe, if implemented unchanged, they would be detrimental to consumers and the competitive market. We therefore do not support the core RMR proposals as currently proposed. Specifically:

   - <u>The objectives of the RMR are unclear</u>: It is unclear exactly what problem Ofgem is attempting to remedy through its proposals, or what would constitute a successful outcome. Ofgem has not demonstrated that regulatory action is needed in this case.[1]

   - <u>The proposals have not been subject to a quantified impact assessment:</u> The proposals represent a very radical change, but have not undergone the rigorous quantified impact assessment that such radical change would merit.

[1] As it must do under section 4AA(5A) of the Gas Act 1986 and section 3A(5A) of the Electricity Act 1989.

- The proposals carry considerable risk of negative unintended consequences: If imposed, the proposals would have negative consequences for consumers, the market, and UK energy policy. These have not been considered fully by Ofgem:

  1. The proposals would impose a range of direct and indirect costs on consumers. Furthermore they are internally inconsistent, suggesting that they improve comparability in the tariff market, yet should they stimulate a significant move into fixed-term contracts, would actually result in a reduction in comparability for consumers.

  2. They would lead to market distortion, since the mandated standing charge would eliminate competition on standing charges and prevent suppliers reflecting their true fixed cost base.

  3. They would hamper the delivery of UK energy policy by disrupting suppliers' attempts to promote the roll out of smart meters and the Green Deal, environmental objectives to which Ofgem is statutorily required to have regard.[2]

- Many consumers would not welcome the reforms: Our research suggests that many consumers would not welcome the reforms, and that they would have a detrimental impact on trust.

6. We believe an alternative set of remedies would deliver the majority of comparability improvements Ofgem is seeking, while imposing far lower cost – and risk – on consumers. We suggest that Ofgem should:

   - require all suppliers to adopt pricing structures that are based on a "standing charge" and "single unit rate" format – and ensure that any restriction on the number of tariffs suppliers are permitted to offer customers strikes an appropriate balance between choice and simplicity;
   - standardise the way in which suppliers offer discounts to customers on tariffs; and
   - introduce new obligations on suppliers to provide additional tariff information in a standardised way (both a price comparator metric, and a tariff information label).

7. In the following sections we set out our views on:

   - the core tariff proposals (focusing on both the likely costs and unintended consequences of the proposals, and a potential alternative approach);
   - proposed remedies relating to the 2008 Supply Probe remedies; and
   - changes relating to Standards of Conduct.

8. In addition, an Appendix A to this letter sets out our responses to the specific questions Ofgem has posed. We also include a confidential Appendix B setting out our response to Question 16 (detailed cost breakdown).

9. This response is submitted on behalf of the Centrica group of companies (excluding Centrica Storage), is not confidential (aside from Appendix B), and may be placed on the Ofgem website.

Core RMR tariff proposals

10. As stated in point 5 above, we have four major concerns with the core RMR proposals: the objectives of the RMR are unclear; the proposals have not been subject to a quantified impact assessment; the proposals carry considerable risk of negative

[2] See DECC's *Social and Environmental Guidance to the Gas and Electricity Markets Authority* at §§14, 16. Ofgem is statutorily required to have regard to this guidance, which has been laid before Parliament, under section 4AB of the Gas Act 1986 and section 3B of the Electricity Act 1989.

unintended consequences; and many consumers would not welcome the reforms. We address these in turn below

11. As stated in point 6 above, we believe that an <u>alternative approach</u> would be preferable to the remedies Ofgem has proposed. We set this out below

The objectives of the RMR are unclear

12. Retail competition has delivered major benefits for consumers, and a range of indicators show competition remains strong:

    - The GB market remains amongst the most competitive in the world; we currently enjoy the lowest average domestic gas prices of the EU15 and amongst the lowest electricity prices.[3]
    - There is no evidence of excess profitability. Ofgem's analysis has shown that energy retail margins have averaged only 1.6% since 2005.[4] It is unsurprising, therefore, that the focus of Ofgem's review has shifted away from supplier profitability.
    - A substantial proportion of consumers have switched supplier. Independent research shows that between 71% and 79% of customers have switched (depending on the supplier).[5] Although the point is fundamental to its analysis, Ofgem appears to underestimate the total number of consumers who have switched by between 30 and 40 percentage points.
    - The GB energy market also continues to maintain relatively high levels of switching, with rates at around 20%,[6] equivalent to 155k customers switching every week. This compares favourably to most other international comparators, including Sweden, Norway, and Texas, as well as to other markets (with switching rates being higher than in the banking and mobile phone industries which see switching rates of 3%[7] and 9%[8] respectively).
    - Of those consumers who did not switch supplier in 2010, 77 per cent explained that this was because they were happy with their existing supplier.[9]
    - As recently as December 2010, DECC concluded that the retail energy market was delivering "increased choice in tariffs and services" which enable consumers to switch suppliers.

13. Given this, it is unclear exactly what problem Ofgem is attempting to remedy through its proposals, or what would be viewed by Ofgem as a successful outcome.

14. Ofgem has stated it is keen to engage those customers who either "choose not to switch, cannot switch due to their circumstances, or are put off from switching due to other features of the market such as tariff complexity." We do not accept that Ofgem has convincingly identified an issue justifying intervention such that regulatory action is needed in this case[10], still less demonstrated that its proposed remedies are a

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3 http://www.ofgem.gov.uk/Media/FactSheets/Documents1/Why%20are%20energy%20prices%20rising_factsheet_108.pdf

4 See Appendix 9 of the March 2011 Retail Market Review – Findings and Initial Proposals.

5 Morgan Stanley Research Energy Survey 2011.

6 http://ec.europa.eu/consumers/strategy/docs/retail_electricity_full_study_en.pdf

7 http://www.fsa.gov.uk/Pages/Library/research/Consumer/index.shtml

8 http://stakeholders.ofcom.org.uk/binaries/research/consumer-experience/tce-11/research_report_of511a.pdf

9 March 2011 Retail Market Review, Appendix 6.

10 The precondition for regulatory intervention: see section 4AA (5A) of the Gas Act 1986 and section 3A(5A) of the Electricity Act 1989.

proportionate response[11]. Indeed, given the level of satisfaction expressed by 'non-engaged' customers identified in Ofgem's own research, the proposals could result in reduced customer satisfaction due to forced rather than voluntary engagement.

15. Levels of switching or engagement are not out of step with comparable markets and Ofgem has not attempted to demonstrate that they are. It is also unclear why "engagement" would be an end in itself if the market is already delivering relatively low cost energy and modest profit margins.[12]

The proposals have not been subject to a quantified impact assessment

16. Any regulatory intervention must be demonstrated to be proportionate and clearly in the interests of consumers. Guidance from the Office of Fair Trading[13] states that where policy proposals may adversely affect competition an attempt should be made "to quantify and objectively justify the costs of such an impact on competition". It suggests that such an assessment should be completed if the proposal "limits the scope for innovation" or controls or substantially influences "the price(s) suppliers may charge."

17. We believe the RMR proposals meet these requirements and that a rigorous quantified impact assessment must be undertaken, given the changes proposed are so far-reaching. Not undertaking a quantified impact assessment for such a radical set of proposals would seem extraordinarily risky for consumers and the market as a whole, given most indicators suggest competition in the retail energy market is strong. At the very least, a quantified impact assessment is critical to understanding whether these proposals would create any net benefits to consumers.

The proposals carry considerable risk of negative unintended consequences

18. We believe that the proposals as currently expressed will have a range of negative consequences for:
    - consumers;
    - the energy market; and
    - the delivery of the UK's energy policy.

19. For <u>consumers</u>, the proposals will have an immediate and direct impact in that they will, at a stroke, remove several of the main tried and tested ways suppliers have encouraged engagement with customers since retail competition was introduced.

20. For the majority of our customers who prefer flexible tariffs over fixed term deals (around 75% - 80% of customers), the proposals will mean:
    - an end to dual fuel discounts;
    - no discounts for purely "online" paperless billing accounts;
    - no prompt pay discounts;
    - no ability for low consumption users to choose "no standing charge" offers;
    - no ability to reward customers for switching consumption from "peak" to "off peak";
    - no ability to reward customers for loyalty (e.g. through the awarding of Nectar points);

[11] As it must do under the statutory scheme: see, again, section 4AA(5A) of the Gas Act 1986 and section 3A(5A) of the Electricity Act 1989.
[12] Consumer "engagement" is not a statutory objective for Ofgem: see section 4AA of the Gas Act 1986 and section 3A of the Electricity Act 1989.
[13] Completing competition assessments in Impact Assessments, Guideline for policy makers, August 2007, pages 4 and 8

- no "affinity" tariffs, through which customers have been able to make donations to charities such as Age UK, National Trust and Cancer Research; and
- no ability for suppliers to offer a "green" flexible tariff (effectively foreclosing the market to all suppliers apart from those who offer a green product as their single standard tariff offering per payment method).

21. Furthermore, the proposals have the potential to stifle future innovation as the retail energy market evolves.

22. As a consequence, we believe these proposals are actually likely to result in lower levels of engagement in the energy sector not higher, and will also bring with them significant costs to the large number of customers who are already engaging successfully with the market.

23. While the proposals focus on improving comparability in the tariff market, the FTC segment will face no such restrictions. However to continue to enjoy the range of discounts / propositions they currently enjoy (as well as the ongoing benefits of competitive innovation), customers will need to engage with a market. This will mean customers have to work harder to gain the benefits of competition – leading to a risk of a "two speed" market where the disengaged (who are unable or unwilling to move to the FTC market) will lose out. Recent independent evidence from the telecommunications sector also illustrates well that fixed term contract markets are no guarantee of achieving the best outcome in terms of consumer welfare[14].

24. The forced removal of discounts from standard tariff customers for online, dual fuel and prompt payment would be particularly worrying. At present we are able to reduce customer bills by offering them discounts to adopt cost-saving behaviours. These behaviours include taking both fuels from the same supplier (which lead to savings in administrative / billing costs to suppliers), paying promptly (for cash customers), and going online (which save further costs to suppliers through eliminating the need for paper billing, and encouraging use of online services).

25. By removing the ability to offer these discounts, we will have no way of encouraging tariff customers to adopt cost saving behaviours – which will in turn lead to higher costs and bills for our customers. It is difficult to see how regulation of this type can be in the interests of consumers, given it will clearly lead to higher costs. These costs are not to be understated; the proposals mean some customers on standard tariffs would <u>immediately</u> lose cash discounts equal in value to up to £66 / annum[15].

26. Ofgem's own consultation document recognises that the "elimination of dual fuel discounts in the standard segment of the market carries a risk of frustrating a significant number of consumers." Yet no analysis is undertaken to assess the level of this cost despite the fact that dual fuel customers represent over 60% of our customer base. It also ignores the non-price advantages customers derive from having a single supplier for both fuels (i.e. a single contact point, combined energy bill and direct debit arrangement).

27. In the absence of a convincing answer to these concerns, Ofgem cannot safely conclude that its proposals are an appropriate means of promoting the interests of consumers.

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[14] Billmonitor research on mobile contracts showed 76% of consumers were on the "wrong contract" wasting an average of £194.71 each per year. http://www.billmonitor.com/national-billmonitor-mobile-report.

[15] For a customer of average consumption who has both an online and dual fuel discount.

28. We have significant concerns that vulnerable customers will be disproportionately disadvantaged by these proposals.[16] Customers who are either unwilling or unable to commit to fixed term contracts will be denied access to the choice of tariffs and discounts available in the market today. To the extent that vulnerable customers are less able or willing to move to a fixed term contract – or understand/compare the range of offers available in this part of the market – then they are particularly likely to lose out from these proposals. Customers who are unable or unwilling to switch to FTCs may lose out further if prices of standard tariffs increase as a consequence of competition softening in this segment (a scenario Ofgem presents as a possibility)[17].

29. In addition to these direct costs to consumers, the proposals will create a number of material indirect costs that will inevitably result in increased energy prices for customers. The impact of these proposals on the cost to serve our customers is likely to be considerable.

30. The switch of large numbers of customers from flexible contracts to FTCs that may result from these proposals would lead to an increase in both one-off and ongoing costs. We have estimated incremental one-off costs to us of the RMR tariff proposals, and believe there is a risk these could be up to £60m. These will be driven largely by far higher numbers of calls into call centres (and calls of a longer duration) at time of transition, a one-off customer communication exercise and extensive system changes. Ongoing costs will also be expected to increase by up to £31m per annum, due to the higher costs related to managing increased customer contacts at time of renewal, more complex systems and the proposed information remedies.

31. We also have concerns that the nature of the existing arrangements for enforcing fixed term contracts will mean that hedging costs for suppliers will increase under the core RMR proposals. We believe that the vast majority of FTCs would need to be fixed price contracts (FPCs), as customers tend to show little appetite for tracker products. Fixed term contracts incur additional hedging costs, as a result of:

    - **increased forward buying**. 100% of the forecast demand for an FPC needs to be hedged forward, to protect against rising wholesale commodity prices. Hedging in advance is generally more expensive than buying close to delivery, as an element of risk is built into the forward curve. On average from 2001 to 2011 this premium has averaged 5p/therm;
    - **higher trading capital costs**. In order to trade forward we need to maintain additional credit liquidity to protect counterparties against falling prices; and
    - **churn risk**. In falling commodity price environments we face increased levels of churn on FPCs as customers move onto cheaper products, creating a loss as we sell out of excess forward hedges.

32. Taken together for a 12 month FPC these costs add around £10 incremental hedging costs per annum above that for a tariff customer, and at least £20 for a 24 month product.

33. Taking the impact on consumers as a whole, we believe Ofgem's failure to consider both direct and indirect costs to customers, still less to take reasonable steps to acquaint itself with the information necessary to undertake a cost benefit analysis of these potentially disadvantageous outcomes undermines its case for intervention. This is particularly

[16] Ofgem is statutorily required to have regard to the interests of vulnerable consumers: see section 4AA(3) of the Gas Act 1986 and section 3A(3) of the Electricity Act.
[17] The Retail Market Review: Draft Impact Assessments for Domestic Proposals, Page 38, Para 1.167.

serious given we estimate that some customers will face a potential £75 per annum increase in their energy bills as a result of these proposals[18].

34. We believe the proposals may also have a range of unintended consequences in terms of overall market impact. The proposed introduction of a mandated standing charge, at a level regulated by Ofgem, would prohibit suppliers from offering different levels of standing charge[19].

35. Regulating the level of standing charge will remove the ability of suppliers to compete on the basis of different levels of standing charge. This will limit choice for consumers, given some will prefer tariffs with lower standing charges with higher unit rates (e.g. low consuming customers), and some will prefer higher standing charges and lower unit rates (e.g. high consuming customers). Given suppliers will have less opportunity to differentiate under these proposals there is a risk that the resulting lower levels of competition could actually depress levels of switching.

36. The detailed standing charge proposals published on 6 February have increased these concerns further. We will be responding to this consultation separately; however we believe both of the options Ofgem suggest for varying the (supplier-set) unit charge by region will lead to additional complexity and confusion. The proposal to apply an Ofgem-determined "regional adjuster" to national unit rates would be particularly difficult to explain to customers, as it would mean customers paying a different rate to that which they select from their comparison of unit rates. This would require yet another line in customer bills, and run counter to current initiatives to simplify bills.

37. Regionally-set unit rates would be less confusing – yet would mark a significant departure from the December proposals (and on which the customer testing undertaken by Ofgem to date has been based).

38. Unintended consequences of the proposals would be magnified further were Ofgem to decide to mandate a level of standing charge and set it at a level that is below the level of fixed cost to serve customers – either now or in the future. This would cause further distortion in the market, resulting in higher unit prices (as suppliers seek to recover fixed costs from the unit rate), and create a set of unprofitable lower consuming customers for whom competition will deliver no benefit. In contrast, higher consuming consumers would become relatively more profitable, with intense competition between suppliers focusing on this narrow set of high consumption customers.

39. We also believe the proposals may have a detrimental impact on the UK's energy policy. Looking forward, these proposals will hamper the ability of suppliers to take a leading role in critical areas of Government policy – most notably the rollout of smart meters, and promotion of the Green Deal. Innovative propositions will be needed to engage customers to take up these initiatives. For smart meters, customers will expect to be able to obtain tariffs that reward them for switching consumption away from peak to off-peak periods. Time of use tariffs that encourage greater levels of demand side response will also become more critical in coming years given the changing generation mix, with much greater reliance being placed on intermittent forms of generation such as wind. Demand side response is also critical to reducing the nation's carbon emissions by limiting carbon intensive peaks in power generation.

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[18] Potential impact on a customer currently receiving online and dual fuel discounts, and who will be exposed to increases in prices as a result of higher indirect costs.

[19] However we acknowledge there is a growing consensus that the time is right to introduce proposals that will require suppliers to introduce simpler tariff structures (e.g. by prohibiting the use of multiple unit rates).

40. Without the ability to offer time of use tariffs, or innovative propositions to engage customers in the benefits that smart technologies can deliver for the majority of our customer base, one of the main ways in which we will be able to promote smart meters to our customers and encourage demand side response will be abolished. We would review our strategy of early rollout of smart meters if these proposals were implemented as they stand.

41. Ofgem has suggested that the risk to smart meter rollout is limited as customers will be able to obtain time of use tariffs in the FTC segment of the market. However

- auto-rollovers in this segment are also banned. Unless customers positively opt into new time-of-use contracts at the end of each contract term, they will therefore roll onto standard tariffs (missing out on lower energy prices they should have been receiving as a reward for switching their consumption away from peak periods). This significantly reduces the appeal of time of use FTC; and

- as set out more fully below, we have concerns that many customers prefer flexible contact types, and do not want sign up to fixed term deals in order to be able to access time of use pricing.

42. The introduction of smart meters will make switching easier and therefore these proposals, which are likely to reduce the scale and pace of roll out, will have a negative impact on switching and market competitiveness.

43. We have similar concerns over the promotion of the Green Deal. If suppliers are unable to offer even a basic green tariff or any tariff-specific discounts, then creating propositions that will engage customers in energy efficiency and the Green Deal will be constrained, given that many customers will be averse to committing to fixed term contracts. It is unjustified, illogical, and indeed perverse that Ofgem is proposing to remove the ability for suppliers to innovate for the majority of our energy customers at a time when developing and marketing innovative propositions will be critical if Government policy objectives are to be met.

44. Ofgem is statutorily required to have regard to the interests of consumers in the reduction of greenhouses gases and the achievement of sustainable development.[20] Moreover, the importance of securing energy efficiency and the roll out of smart metering is expressly identified in DECC's guidance to Ofgem, to which Ofgem is also statutorily required to have regard.[21] The proposed remedies will frustrate those objectives and Ofgem has not adequately analysed or quantified these negative impacts.

45. As proposed, and without clear measures of success, there is a risk that the core RMR proposals will be viewed as being a failure, and reflect poorly in the eyes of customers on both energy companies and Ofgem. We therefore believe that should Ofgem press ahead with the proposals as they stand, there is a real risk that we will be faced with a further review of the retail market post-RMR. The uncertainty that such reviews create in the market should not be underestimated – and is particularly unhelpful for vertically integrated energy companies, who are currently being called upon to make crucial investments in upstream infrastructure. That the RMR proposals follow so soon after the 2009-10 reforms (and before their effects on dynamic competition has been fully assessed) is evidence of this risk.

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[20] Gas Act 1986 ss.4AA(1A)(a) and 4AA(2)(c) and Electricity Act 1989 ss.3A(1A)(a) and 3A(2)(c).

[21] See DECC's *Social and Environmental Guidance to the Gas and Electricity Markets Authority* at §§14, 16. Ofgem is statutorily required to have regard to this guidance, which has been laid before Parliament, under section 4AB of the Gas Act 1986 and section 3B of the Electricity Act 1989.

Consumer response to the proposals

46. Ofgem has suggested that costs to customers from the core RMR proposals will be minimal. This is because it suggests that all innovation will be free to continue unconstrained in the FTC segment (with customers able to switch to FTCs if they want to continue to receive the discounts and offerings they currently enjoy in the flexible tariff segment).

47. FTCs have been available to customers for many years, yet around 80% of our customers still choose to have their energy supplied on more flexible terms. To the extent that customers do not want to switch to FTCs to retain the discounts and other product offerings as would be required as a result of RMR, they will be worse off as a result of these proposals. Moreover, those customers who conclude they want to retain the discounts and offers they currently enjoy on flexible tariffs will be forced to move away from their preferred form of contract to do so.

48. We have undertaken some research to explore customer views on FTCs further. Overall, we believe that many customers would not welcome Ofgem's reforms as drafted, and that they would have a detrimental impact on trust in the sector. The key findings of our research are:

   - customers tend to prefer flexible tariffs to fixed term contracts. Our research suggests that, once customers understand that fixed term contracts may result in termination fees (if they want to leave the contract early), only 28% of customers have a preference for FTCs[22];
   - interest in online, dual fuel discounts, time of use and green tariffs falls by around 50% if customers are told that they would have to sign a FTC in order to get them; and
   - twice as many customers would prefer suppliers to be able to offer existing discounts and propositions on all tariffs, compared to the core RMR proposals, where such discounts are prohibited.

49. This is consistent with Ofgem's own research that indicates consumers are uneasy about being locked in for a contract term and that when given the choice most customers actually favour being able to choose a standard tariff and receive the benefits listed above[23]. It is therefore highly likely that driving more customers towards FTCs will reduce switching in the longer term (particularly given the unpopularity of termination fees).

50. Our research has also shown that 37% of customers would have a worse opinion of the energy industry if they need to move to FTCs in order to obtain the discounts they currently receive on more flexible contract types. As a consequence, these proposals could have a seriously detrimental impact on trust in the sector.

51. Furthermore, the massive disruption and systems upgrades necessitated by these proposals would require extensive agent training, customer education and communication. It is likely that during the transitional period (which comes at a time when many suppliers are already upgrading their systems), service levels and trust in the industry could be adversely impacted.

An alternative approach

52. For the reasons set out above (and those given in the attached appendices), we do not believe the case for regulatory intervention on this scale has been made. However, in

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[22] Termination fees are necessary to cover the costs of being left with a hedged account if the customer switches away from the FTC.

[23] Tariff Comparability Qualitative Research, October 2011, page 37

order to respond constructively, we suggest the following alternative measures, which we believe to be more proportionate.

53. Rather than press forward with such a radical and high risk intervention in the retail market, we would suggest that Ofgem refocuses its efforts on securing agreement to a set of more targeted measures. It is more likely that these can be clearly demonstrated to be in the interests of consumers, given these are more directly targeted (minimising the risk of unintended consequences as a result).

54. We believe there are three changes Ofgem should introduce that would improve tariff comparability considerably (without eliminating customer choice) so long as these are introduced in a standardised way across all suppliers.

55. Firstly, we would suggest Ofgem requires all suppliers adopt tariff pricing structures that are based on a "standing charge" and "single unit rate" format. Consistency in tariff structures will improve comparability considerably. However, the advantage of this more measured approach in comparison to the core RMR proposal is that suppliers will still be able to compete on the level of standing charge offered to customers.

56. This will benefit lower consuming customers in particular who are likely to prefer a relatively low level of standing charge, as well as those who want to retain more control over their bills through a lower "fixed" element. It is also important that any restriction on the number of tariffs suppliers are permitted to offer customers strikes an appropriate balance between choice and simplicity. Customers will expect to be able to access distinct online, "green", affinity and time-of-use tariffs (as well as discounts for dual fuel and prompt payment).

57. Secondly, we would suggest Ofgem standardises the way in which suppliers offer discounts to customers on tariffs. For example, Ofgem could require discounts to be structured as a simple percentage, or a fixed annual £ discount per customer. While this would enable customers to easily compare discounts available on tariffs, it would also give suppliers the flexibility to offer discounts tailored to the needs of customers (for example, offering a discount if customers favour paperless billing, or if customers are supplied with both fuels). This would also further enhance the comparability improvements delivered by all suppliers moving to a standing charge / unit rate tariff structure.

58. Thirdly, we believe additional information measures similar to those already suggested by Ofgem would improve comparability considerably. We would fully support a requirement for suppliers to express all tariffs in a standardised (mandatory) comparator metric, such as a simple £ per year value for low, average and high levels of consumption. We would also support a version of the proposed tariff information label (that describes all non-price elements of tariffs in a standardised way).

59. We believe these measures would deliver real and targeted benefits to consumers, while avoiding the significant downsides of Ofgem's proposals. We would be happy to work with Ofgem and industry (potentially through the ERA) to develop these proposals further if that would be helpful.

<u>Domestic Probe remedies</u>

60. The 2008 Probe made a number of recommendations aimed at improving supplier conduct across the industry. We have been very resolute in ensuring that we have implemented solutions which are compliant with both the letter and the spirit of the Probe. As set out above, we continue to look for ways to increase consumer engagement and rebuild trust in the sector and to that end a number of our recent initiatives have focused on reviewing customers' bills and annual statements to make them easier to understand.

61. While we support the aim of promoting clearer energy bills and statements, we do not think the benefits to customers of a number of the proposals set out in the consultation document will outweigh their cost. In particular, providing bespoke customer information in pricing notifications will significantly increase the costs and lead times associated with price change events. We estimate system changes will require investment of £5-10m for British Gas and will take approximately one year to develop (plus substantial ongoing costs).

62. We also believe Ofgem has failed to consider the costs of the proposed ban on joint mailing. The proposal requiring bills and annual statements to be sent out separately will increase the cost to serve our customers considerably. Postage costs alone will increase by around £3m for British Gas for each new mailing we send, but the final cost will be much higher once the cost of managing subsequent customer enquiries is included.

63. Furthermore, suppliers should be free to communicate to their customers why prices are changing at the same time as notifying them of the change. They should be able to inform customers of alternative tariffs, money-saving initiatives such as energy efficiency (including insulation) and cheaper payment methods (e.g. Direct Debit). This is in the customer interest. A ban on joint mailing would require suppliers to contact customers separately in order to highlight alternative options such as these, incurring significant additional costs but also limiting their effectiveness in engaging customers.

64. By prescribing rules and content requirements for customer communications, the proposals will limit suppliers' ability to meet customers' evolving needs. We fear the proposals will actually decrease consumer engagement while significantly increasing costs. Ofgem needs to demonstrate through a quantified impact assessment why it believes the information remedy proposals will deliver benefit.

Standards of Conduct

65. We fully support the consistent application of existing Standards of Conduct across all suppliers. However, we have some concerns that the proposal to move existing Standards of Conduct into the licence may create significant uncertainty over precisely what Ofgem considers necessary for suppliers to comply with their license obligations. We therefore ask Ofgem to consult on clear guidance to support the proposed licence changes.

66. We have specific concerns regarding the proposal for a new requirement for "fit for purpose" customer service. Even with guidance, this requirement would lead to an implied "correct" level of service (and therefore resource), risking the homogenisation of service levels with potentially detrimental impacts on competition.

Conclusion

67. Any regulatory intervention must be targeted only at areas where action is clearly needed, and be based on the identification of a clearly defined and well evidenced market failure. The regulator must demonstrate that the proposed remedy will promote the objectives identified and that the proposals are internally consistent and rational. Only remedies that are a necessary and proportionate means of addressing the objective may be imposed. The remedy must be compatible with Ofgem's statutory objectives and must be preceded by adequate enquiry as to the likely advantageous and disadvantageous outcomes that will result from the proposals.

68. Ofgem's proposals meet none of these criteria and we therefore object to the introduction of the core RMR proposals. In particular:

- It is unclear exactly what problem Ofgem is attempting to remedy through its proposals, or what would constitute a successful outcome

- The proposals represents a very radical change, but have not undergone the rigorous quantified impact assessment that such radical change would merit
- If imposed, the proposals would have negative consequences for consumers, the market, and UK energy policy. These have not been considered fully by Ofgem. In particular:
    1. The proposals would limit choice and impose a range of direct and indirect costs on consumers, and would not clearly improve comparability
    2. They would lead to market distortion
    3. They would hamper the delivery of UK energy policy
- Many consumers would not welcome the reforms, and trust in the sector many be damaged as a consequence.

69. Instead, we would favour the consideration of a series of more targeted measures that can be demonstrated more clearly to be in the interests of consumers, while carrying nothing like the same risk of unintended consequence.

70. As discussed bilaterally, we would be very happy to work with Ofgem and industry to develop these proposals further if that would be helpful and/or contribute to the development of a quantified impact assessment. Our detailed response to each of the questions Ofgem has asked in the consultation is attached as Appendix A to this letter (alongside confidential Appendix B). We will be in contact shortly to arrange a suitable time to discuss these points in more detail.

Yours sincerely,

Ian

Ian Peters