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21 December 2012

Dear Mr Hunt

**Retail Market Review: Updated Domestic Proposals**

I am pleased to attach Energy UK's response to Ofgem's consultation on the Retail Market Review: Updated Domestic Proposals. It is not confidential.

If you have any questions, please do not hesitate to contact me on 020 7747 2962 or [alun.rees@energy-uk.org.uk](mailto:alun.rees@energy-uk.org.uk)

Yours sincerely

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# Ofgem's Retail Market Review: Updated Domestic Proposals

## Energy UK response

21 December 2012

### 1. Introduction

- 1.1. Energy UK is the trade association for the energy industry. Energy UK has over 70 companies as members that together cover the broad range of energy providers and supplies and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes and last year invested £10billion in the British economy.
- 1.2. Energy UK strongly believes in promoting competitive energy markets that produce good outcomes for consumers. In this context, we are committed to working with Government, regulators, consumer groups and our members to develop reforms which enhance consumer trust and effective engagement. At the same time, Energy UK believes in a stable and predictable regulatory regime that fosters innovation, market entry and growth, bringing benefits to consumers and helping provide the certainty that is needed to encourage investment and enhance the competitiveness of the UK economy.
- 1.3. These principles underpin Energy UK's response to Ofgem's Retail Market Review: Updated Domestic Proposals. This document covers a wide range of issues, on which our members may hold different views. We look forward to working with Ofgem over the coming months to refine the detail of this extremely important package of reforms.

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## Executive Summary

### 2. General comments

- 2.1. Energy UK wholeheartedly supports the aim of the Retail Market Review (RMR), which is to encourage and equip consumers to get the best deal from the energy market. To achieve this, we believe that Ofgem has developed a robust package of reforms. We hope that the proposals will help promote consumer engagement and build trust in the market, thus enhancing effective competition; with some additional measures and appropriate adjustments, we believe that they would be more likely to do so. We provide our detailed comments in the main body of this document.
- 2.2. Energy UK agrees with Ofgem that there are some problems in the retail energy market. We are concerned that many consumers perceive it to be complex, making it difficult to choose which option is best for them. As a consequence, some become frustrated and give up, whereas others are put off altogether. We are also worried about other factors that contribute to disengagement, such as distrust in suppliers and an apparent perception that they are “all the same”.
- 2.3. Energy suppliers have recognised these problems too. They have listened to what their customers have been telling them, and acted to address their concerns. As is documented in the appendices to Ofgem’s Updated Domestic Proposals, companies have made a number of changes to make tariffs easier to compare, such as reducing their number and simplifying their structures. Suppliers have also made their bills clearer and easier to understand and enhanced their customer services.
- 2.4. Energy UK has itself been at the forefront of developing reform which enhances effective customer engagement. For example, we have been working with our members and consumer groups to develop a standardised “key facts” template that will help customers compare tariffs, and with Ofgem and other stakeholders to simplify supplier communications. Energy UK has also facilitated a voluntary agreement for suppliers to publish their complaints data from early in 2013, which we hope will empower consumers to hold suppliers to account and drive improvements in customer service.
- 2.5. We can therefore conclude that progress has been made since the RMR first started, for which both Ofgem and industry deserves much credit. The key question now is: how do we ensure that progress continues?

### Standards of Conduct

- 2.6. Energy UK believes that the Standards of Conduct (SOCs) could be the most significant reform of the whole RMR package in terms of the benefits that they could bring to consumers, both by improving customer service and promoting trust in the market.
- 2.7. Energy UK applauds Ofgem for recognising that the effect of the SOCs partly depends on how they are enforced, and for its commitment to establish (and consult on) its approach prior to introducing the SOCs into the supply licence. After assessing the relative merits of different enforcement options, we conclude that the appropriate criteria against which compliance with the SOCs should be measured are:
  - a) Whether a reasonable person would adjudge a supplier to have been intent on complying with the SOCs; and
  - b) Whether the supplier took “reasonable steps” to implement them.
- 2.8. Energy UK also remains of the view that two-stage enforcement would be the right process. However, we recognise that its benefits may diminish if Ofgem’s discretion in interpretation is reduced. Therefore, Ofgem would be more justified in not implementing the former (two-stage enforcement) if it relinquishes control over the latter (interpretative discretion).

- 2.9. Energy UK also strongly recommends that:
- a) The way in which the SOCs are enforced is established as a formal written policy to which Ofgem must adhere, and that the enforcement regime and SOCs are established in parallel, with the commencement date absolutely clear;
  - b) Ofgem makes some adjustments to give suppliers reasonable time for implementation;
  - c) Ofgem is cautious in the way it measures success of the SOCs, given the broad range of factors that contribute to trust in the energy market; and
  - d) Ofgem and suppliers work together in communicating the SOCs to ensure that their messages are clear, positive and complementary.

### **Tariff simplification**

- 2.10. Energy UK supports Ofgem's efforts to simplify tariffs to make them easier for consumers to understand and compare.
- 2.11. Energy UK supports Ofgem's proposal to ensure that all tariff offers are structured with a standing charge and single unit rate set by the supplier, with appropriate adjustments for TOU. We believe that these standardised structures will help customers to compare tariffs and develop a better understanding of the energy market, without the adverse unintended consequences and practical difficulties of an Ofgem-set standing charge.
- 2.12. Energy UK supports Ofgem's proposal to oblige suppliers to automatically switch customers on dead tariffs to their cheapest evergreen equivalent, where they are likely to save money.
- 2.13. Energy UK is not convinced that there is sufficient evidence to allow Ofgem to be confident that the benefits of imposing the tariff cap as proposed will outweigh the adverse unintended consequences. We therefore consider that there is a serious risk that it will lead to a net reduction in consumer engagement. However, the cap may<sup>1</sup> help reassure consumers that the number of options they face is not intimidating, and give them confidence to engage.
- 2.14. Should Ofgem proceed with imposing a cap on the number of tariffs that suppliers are permitted to offer, we believe that Ofgem should take the following into account when setting the level and associated rules, to strike the right balance between simplicity and the scope for innovation:
- a) The higher the cap, the lower the risks of adverse unintended consequences;
  - b) A sunset clause should apply to the licence condition
  - c) An innovation reserve should be established for smart meter tariffs from the outset;
  - d) Different routes to market, such as collective switching, should be treated consistently.
- 2.15. Given the serious risk of the proposed tariff cap resulting in a net decrease in consumer engagement, we believe that Ofgem should monitor its effects, as benchmarked against clearly defined and transparent success criteria, extremely closely. In this regard, we would expect Ofgem to produce regular assessments of progress that are complete, honest and fair.

### **Information remedies**

- 2.16. Energy UK supports the provision of clearer and simpler information via supplier communications. We believe that this is important to help customers to effectively engage with their energy usage, their product choices, their supplier and the market as a whole.
- 2.17. Energy UK considers that, in general, suppliers are best placed to define the wording, design and format of their communications. However, there is a strong case for certain communications, such as the Annual Statement and Tariff Information Label, to be standardised. We do not agree that the same applies to bills, which are an important

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<sup>1</sup> providing perceived tariff proliferation is not a pretext for disengagement

differentiator in a competitive market and which are important communications for customers in terms of understanding what is needed to manage their accounts.

- 2.18. Where Ofgem does decide to prescribe the detail of a supplier communication, we believe that it would be sensible to establish a bespoke consultation process (including an iterative process of in-depth customer research) to ensure that the final policy outcome is fit-for-purpose.

### **Supplier Cheapest Deal**

- 2.19. Energy UK wholeheartedly supports Ofgem's efforts to encourage customers to engage with the tariffs that their supplier offers and switch to the one that is best for them. Overall, we believe that Ofgem's high-level proposals for "Supplier Cheapest Deal" are sensible and we support the direction of travel.
- 2.20. However, we currently believe that the messages contained in the summary box are too many and too complicated, and therefore difficult for customers to assimilate and understand. We are also concerned that the proposal will be extremely costly and challenging to implement. We are eager to work with Ofgem to discuss how Supplier Cheapest Deal might be made simpler and quicker and cheaper to apply.

### **Tariff Comparison Rate (TCR)**

- 2.21. Energy UK welcomes Ofgem's proposal to introduce a standardised metric, or "Tariff Comparison Rate" that allows simple at-a-glance comparisons of energy prices across the market.
- 2.22. We recognise that it is very difficult to reconcile the desire for a national TCR with the fact that prices vary from region to region in such a way that does not mislead customers. It is also very difficult to reconcile the desire to make TCRs as personalised as possible whilst enabling the customer to compare their tariff with generic advertised averages.
- 2.23. As to where to strike the balance in these trade-offs, Energy UK would favour simplicity and the solution that is most accessible and reliable for consumers. With this in mind, we believe that the TCR should be regional rather than national and expressed in £/year rather than p/kWh. It would probably be sensible to use a name for the TCR that clearly illustrates its generic nature to customers, leaving the personal projection to compensate for what the TCR lacks in personalisation.

### **Market Cheapest Deal**

- 2.24. Energy UK supports Ofgem's aims to do more to encourage sticky and vulnerable customers to engage in the market. However, we have serious concerns about Ofgem's Market Cheapest Deal proposal.
- a) It would confuse the role of market participants, potentially disconcerting consumers and exacerbating distrust in suppliers. As explained by lecturer in psychology interviewed by Ipsos MORI "if people cannot identify the motives of the messenger, they become confused and may not trust the message".<sup>2</sup>
  - b) It has a strong potential to mislead consumers, including some of the most vulnerable, for example if it failed to clearly highlight to a customer receiving the Warm Home Discount that they may lose out on a benefit of up to £140 if they switched to a non-obligated supplier. "Broader Group" customers may also lose out if they moved to another obligated supplier by virtue of differences in eligibility criteria.
  - c) It may not assist in delivering DECC's ambitions for the Green Deal, since customers might be signposted to suppliers who are not obliged to participate.

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<sup>2</sup> Ipsos MORI, Prompting engagement with and retention of written customer communications, p. 30

- d) It risks placing a disproportionate emphasis on price over other differences between tariffs and suppliers, such as whether electricity is generated from renewable sources. It would not seem appropriate to assume that “sticky” and vulnerable customers are not interested in anything but price. Indeed, there may be lots of different reasons why customers choose to stay with their supplier.
  - e) It may unfairly penalise investment in customer retention.
- 2.25. Energy UK believes that there would be more proportionate and effective ways of targeting vulnerable customers, such as through the network of voluntary organisations that DECC is considering establishing.

## Standards of Conduct

### 3. Summary

- 3.1. Energy UK believes that the Standards of Conduct (SOCs) could be the most significant reform of the whole RMR package in terms of the benefits that they could bring to consumers, both by improving customer service and promoting trust in the market. In addition, the SOCs could complement the customer-focussed initiatives that the suppliers have introduced over the past two years, and help to embed the culture that underlies them.
- 3.2. However, we believe that the success of the SOCs requires the relationship between Ofgem and suppliers to improve, with trust being built on both sides. We also think that the success of the SOCs largely depends on the way in which they will be enforced, since this will guide the way in which suppliers respond to them, and reduce regulatory risk.
- 3.3. Ofgem has recognised the significance of a transparent enforcement policy, and Energy UK applauds its commitment to establish (and consult on) its approach prior to introducing the SOCs into the supply licence. Following this welcome development, the majority of Energy UK's response is dedicated to assessing the relative merits of different enforcement options, and considering how Ofgem's proposed approach might be refined to maximise the benefits to consumers.
- 3.4. We conclude that, from those options considered, the appropriate criteria against which compliance with the SOCs should be measured are:
  - a) Whether a reasonable person would adjudge a supplier to have been intent on complying with the SOCs (based on the actions taken); and
  - b) Whether the supplier took "reasonable steps".
- 3.5. Energy UK also remains of the view that two-stage enforcement would be the right process. However, we do recognise that its benefits diminish as Ofgem's discretion in interpretation is reduced. Therefore, Ofgem would be more justified in not implementing the former (two-stage enforcement) if it relinquishes control over the latter (interpretative discretion).
- 3.6. Energy UK also strongly recommends that –
  - a) The way in which the SOCs are enforced is established as a formal written policy to which Ofgem must adhere, and that the enforcement regime and SOCs are established in parallel, with the commencement date absolutely clear;
  - b) Ofgem makes some adjustments to give suppliers reasonable time for implementation;
  - c) Ofgem is cautious in the way it measures success of the SOCs, given the broad range of factors that contribute to trust in the energy market; and
  - d) Ofgem and suppliers work together in communicating the SOCs to ensure that their messages are clear, positive and complementary.

#### **About Principles-Based Regulation (PBR)**

- 3.7. The SOCs would be a shift in regulatory policy in terms of licence condition drafting compared to that which Ofgem has traditionally adopted; they are framed as overarching principles rather than prescriptive rules. There are pros and cons associated with these two very different regulatory approaches, as discussed at an Energy UK workshop in May this year, which Ofgem attended.
- 3.8. For example, prescription (i.e. the current form of licence conditions) generally provides more certainty as to what is required to comply, but can be criticised for engendering a tick-box approach (i.e. conformity with the letter rather than the spirit). Principles, on the other hand, can lead to greater substantive compliance within a more flexible framework, allowing regulated firms to meet consumers' needs in new and different ways. Prescriptive rules are inherently more conservative, since they need to be updated as the market evolves. However, principles are more subjective, and interpretative difficulties can have a number of



malign effects (as documented by the ERA<sup>3</sup>), unless the regulator and regulated firms develop a constructive working relationship founded on trust.

### **How should the SOC's be enforced?**

- 3.9. In order to ascertain which approach to enforcement Ofgem should adopt for the SOC's, it would appear to be sensible to evaluate the merits of each of the available options against pre-defined success criteria. This is what Energy UK attempts to do below.

### **The success criteria - what do we want from an enforcement approach?**

- 3.10. As noted above, there are a number of benefits and risks associated with Principle-Based Regulation (PBR). A suitable approach to enforcement would maximise the former and minimise the latter, and this is the starting point for choosing the success criteria. However, Ofgem has outlined one or two additional goals that it would like an approach to enforcement to achieve, or at least not undermine. Energy UK has taken these into account when we outline the following "success criteria":

a) **Suppliers take ownership for implementing the SOC's.**

Ofgem has said that it wants the SOC's to keep the "supplier's focus on the consumer and what consumer needs are" rather than "Ofgem and our definition of particular prescriptions"<sup>4</sup>. It does not want this responsibility to transfer from suppliers to Ofgem. Energy UK has commended PBR for its ability to foster a "hearts and minds" ethos of compliance under the direct leadership of senior management.

b) **Suppliers have the flexibility to innovate and differentiate themselves.**

Ofgem has said that it wants the SOC's to give suppliers "the space to be innovative and find solutions to challenges in the retail market, which would not be possible with a directives based approach to improving standards. Therefore, the SOC should allow for innovations in both service and technology within the energy industry"<sup>5</sup>. As stated above, Energy UK agrees that these benefits are both realistic and desirable.

c) **The subjective nature of the SOC's does not create undue regulatory risk.**

As stated above, principles-based rules are inherently more subjective than their prescriptive counterparts, meaning that suppliers and Ofgem could reasonably have different ideas for what constitutes compliance. Consequently, Ofgem has recognised that "suppliers could be exposed to risks if our expectations in relation to the SOC were not clear"<sup>6</sup>. The regulatory risk arises from subjectivity in interpretation.

d) **Ofgem's ability to take enforcement action in serious cases is not compromised.**

Ofgem has said that it wants to retain the ability to take enforcement action "where it appears the supplier had little or no regard to the requirement to treat customers fairly or to address past breaches and the associated financial gain"<sup>7</sup>. The Energy Retail Association (ERA) agreed that Ofgem should be able to take enforcement action where "licensee's account of its behaviour is plainly inconsistent with the principles and/or there is evidence of serious consumer detriment". Energy UK supports this position.

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<sup>3</sup> <http://www.energy-uk.org.uk/publication/finish/65-era-response-to-ofgem-market-review/473-era-final-standards-of-conduct-response-23-february-2012.html>

<sup>4</sup> IA, p. 100, para 8.154

<sup>5</sup> IA, p. 44, para 4.41

<sup>6</sup> IA, p. 63, paras 7.2 and 7.3

<sup>7</sup> IA, p. 102, para 8.165

e) **The costs of compliance are kept as low as possible.**

Compliance costs are likely to be passed on to consumers, so it is desirable to keep them as low as possible. However, where suppliers feel that flexibility to innovate is constrained because of subjective obligations, this is likely to increase the costs of compliance as suppliers seek to gain more prescriptive guidance from Ofgem.

**Approaches to enforcement – the options**

3.11. We now attempt to assess some different approaches to enforcing the SOC against the success criteria. The list is not exhaustive, but it does encompass those which Energy UK believes are most realistic. It is important to note that the approaches are not necessarily mutually exclusive, since some refer to process, whereas others refer to the benchmarks against which compliance is measured.

a) **Whether a reasonable person, intent on complying with the fairness objective of the SOC, would have acted in the way the supplier did in its interactions with customers.**

Despite Ofgem's best intentions, this method of assessing compliance does not seem to score particularly well against the third success criterion. By using the concept of a reasonable person, Ofgem is attempting to ensure that suppliers focus on consumer needs rather than the expectations of the regulator. However, this does not appear to remove Ofgem's ability to impose its own subjective interpretation as to what constitutes compliant behaviour. Indeed, Ofgem would remain the judge as to what a "reasonable person" would have done. In this sense, the potential for Ofgem to impose its own subjective interpretation is one step removed rather than being eliminated altogether.

Consequently, this approach to enforcement also suffers against the first and second success criteria. The greater Ofgem's scope to impose its own interpretation as to what constitutes compliance, the less confident suppliers feel able to take ownership of the SOC, the more they will seek prescriptive guidance from Ofgem and the less flexibility will be provided as a result. Added to this, Ofgem does not confirm that a "reasonable person" intent on complying with the SOC might act in more than one way in interactions with consumers. Should it do so explicitly in its approach to enforcement, this might provide more comfort.

This approach would not compromise Ofgem's ability to take enforcement action in serious cases.

Whilst the costs of compliance would partly be contingent on Ofgem's standards for how a "reasonable person" would act, this would not necessarily be higher or lower than otherwise. However, any reduction in flexibility would be likely to raise the costs.

b) **Whether a reasonable person would adjudge a supplier to have been intent on complying with the SOC**

Whilst this approach looks similar to the first, it may be nuanced in one key respect; compliance is focussed on intention. Ofgem would examine a supplier's behaviour and enforce on the basis of whether this reflected an intention to comply; it would not involve a subjective judgement about whether a reasonable person would have done precisely the same thing.

If this approach is different to the first in the way envisaged, it better meets success criteria a-c. Whilst Ofgem retains an ability to impose its own interpretation as to what a "reasonable person" would adjudge, the level of regulatory risk is lower because it is more obvious that intention can manifest itself in different ways. As such, a degree of flexibility is inherent, in turn allowing suppliers to take ownership of implementation in the way that they think best meets their customers' needs.

We do not see how Ofgem's ability to take enforcement action in serious cases would be compromised by this approach, and we believe that compliance costs would if anything be lower because of the additional flexibility permitted.

c) **Suppliers must take “all reasonable steps” to comply with the SOCs**

The standard against which compliance will be measured is an important factor in determining whether the SOCs meet the success criteria listed above.

Energy UK understands that there has been some debate as to where the obligation to take “all reasonable steps” sits in relation to the more common legal standards of “best endeavours” and “reasonable endeavours”. It would appear from the terminology that “all reasonable steps” is similar to “all reasonable endeavours”. According to Wragge & Co, this “has been viewed as a middle ground between best and reasonable endeavours”<sup>8</sup>.

Apparently it has “largely been accepted” that the all reasonable endeavours obligation does not require “a party to sacrifice its commercial interests”<sup>9</sup> in the same way that best endeavours would. However, where there are “several reasonable courses of action open to the obligor, the obligor is likely to have to pursue “all” (or at least some number) of these to fulfil its obligation”<sup>10</sup>.

If suppliers are indeed obliged to pursue all of several reasonable courses of action, this would appear to limit the flexibility they might have to meet their customers' needs in different ways (although this would depend on how similar the firms in question are). There is a risk that the greater the similarities between the reasonable courses of action that are open to regulated companies, the more homogeneity Ofgem might expect in approaches to compliance.

If this is indeed the expectation created by “all reasonable steps”, then the subjective nature of “all” would heighten regulatory risk, in turn reducing suppliers' confidence to take ownership of the SOCs. The potential of the behaviour of other firms to influence what constitutes a breach will add to this problem.

d) **Suppliers must take “reasonable steps” to comply with the SOCs**

Introducing the obligation to take “reasonable steps” would appear to lessen the downsides of “all reasonable steps” without compromising Ofgem's ability to take enforcement action in serious cases. Suppliers would still have to take one or several reasonable courses of action open to them.

One might argue against “reasonable steps” on the basis that a lesser standard might reduce protections for consumers. This is not necessarily the case; companies would be free to go over and above. Energy UK strongly believes that incentives to compete on customer service should be retained as far as possible.

e) **Formal two-stage enforcement**

Thus far, Ofgem has objected to two-stage enforcement for two main reasons, firstly because it would “reduce incentives for suppliers to take ownership of the implementation of the SOC”<sup>11</sup> and secondly because it would reduce their “ability to take enforcement action

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<sup>8</sup> [http://www.wragge.com/analysis\\_7875.asp#.UMb3kmefcdU](http://www.wragge.com/analysis_7875.asp#.UMb3kmefcdU)

<sup>9</sup> Ibid

<sup>10</sup> Ibid

<sup>11</sup> IA, p. 102, para 8.165

in serious cases (e.g. where it appears the supplier had little or no regard to the requirement to treat customers fairly) or to address past breaches and the associated financial gain”<sup>12</sup>.

However, as long as Ofgem retains the discretion to impose its own interpretation of what constitutes compliance (as we have seen with enforcement option 1 above), it cannot totally divorce itself from the ownership of the SOC. In this sense, the first objection may be artificial. In addition, Ofgem’s view would seem to misalign with the direction of travel that Government would like regulatory enforcement to take. For example, in December 2011 BIS stated that it wants the “culture of enforcement” to be “transformed” so that businesses become “more like customers, rather than simply [being] on the receiving end of the regulatory enforcement system”<sup>13</sup>.

BIS has also called for more “regulatory conversations”<sup>14</sup>; and “effective partnership working between the regulator and the regulated”<sup>15</sup>. Energy UK believes that two-stage enforcement would involve this kind of dynamic, and that the discussions would ultimately lead to better outcomes for consumers.

As noted by the ERA, two-stage enforcement could have other benefits for consumers. For example, it could help prevent continuation of a detrimental policy - sophisticated dialogue helps to prevent against positions “hardening” by allowing parties room to be persuaded without reputational consequences or it being seen as evidence of a breach. It could also help to promote trust in the industry by ensuring an appropriate balance of public disclosure, given that investigations cause lasting reputational damage even when no breach is found.

Notwithstanding these points, Energy UK acknowledges Ofgem’s concerns that two-stage enforcement could compromise its ability to take enforcement action in cases of serious breach, or that it could lead to protracted discussions and prevarication. This does not have to be the case. For example, the ability for a supplier to remedy without enforcement action could be inapplicable where its actions are plainly inconsistent with the SOC principles and/or the actions have caused material harm to a number of consumers. Ofgem could also impose a time limit by which the “stage 1” discussion must be completed.

In summary, with respect to two-stage enforcement:

- It clearly scores well against the “regulatory risk” success criterion;
- Whilst it might not appear to be conducive to suppliers’ taking ownership of the SOC, it is questionable whether any approach would do so, given Ofgem’s discretion in interpretation;
- Exceptions to the process could be made in cases of serious breach;
- It could help to promote trust and a mature dynamic between the regulator and regulated firms that BIS sought;
- Costs of compliance would not necessarily be higher or lower than with alternative processes;
- Whilst Ofgem’s “regulatory conversations” might influence its attitudes as to what constitutes compliance across the board, key lessons could be shared publicly and it might be able to adopt a “without prejudice” principle for stage 1.

### **Conclusion – how the SOC should be enforced**

- 3.12. The above analysis leads Energy UK to conclude that, from the options considered, the appropriate criteria against which compliance should be measured are:

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<sup>12</sup> Ibid

<sup>13</sup> <http://www.bis.gov.uk/assets/biscore/better-regulation/docs/t/11-1408-transforming-regulatory-enforcement-government-response.pdf>

<sup>14</sup> Ibid

<sup>15</sup> Ibid

- a) Whether a reasonable person would adjudge a supplier to have been intent on complying with the SOC's (as opposed to whether a reasonable person "would have acted in the way the supplier did in its interactions with customers"); and
  - b) Whether the supplier took "reasonable steps" (as opposed to "all reasonable steps").
- 3.13. Energy UK also remains of the view that two-stage enforcement would be the right approach. However, we do recognise that its benefits may diminish if Ofgem's discretion in interpretation is reduced (and suppliers' empowerment to take ownership is increased). Therefore, Ofgem would be more justified in not implementing the former (two-stage enforcement) if it relinquishes its scope over the latter (interpretative discretion).
- 3.14. One way of achieving this could be for Ofgem to establish a right of appeal to an independent "reasonable person" that is not subject to any political influence. Energy UK would be keen to discuss with Ofgem what such a regime might look like. This would be particularly beneficial, since licensees are not currently able to appeal Ofgem's enforcement decisions on the merits of the case.

#### **What do the SOC's encompass?**

- 3.15. Ofgem has helpfully clarified that "for the avoidance of doubt, the SOC do not impose restrictions on the level of supply prices that energy suppliers charge as a means of ensuring fair treatment"<sup>16</sup>. Energy UK would encourage Ofgem to also confirm whether the SOC's would encompass other charges, and if so how this would relate to Ofgem's proposed new rules on surcharges. For instance, we would like reassurance that if a supplier follows prescriptive licence conditions then it cannot be in breach of the SOC's (i.e. there can be no conflict), and ask whether the SOC's encompass distributive effects of cost recovery.

#### **Embedding the enforcement approach**

- 3.16. As stated above, Energy UK applauds Ofgem for recognising that the effects of the SOC's will partly be determined by how they are enforced and for developing a bespoke approach as part of the RMR process. We strongly believe that it should be established as a formal written policy to which Ofgem must adhere. We also believe that Ofgem should not be able to launch SOC enforcement actions until the policy is in place.
- 3.17. Energy UK has no real preference as to whether the policy is included in the supply licence, the enforcement guidelines or elsewhere, as long as it is written, transparent and binding.

#### **Implementation timescales**

- 3.18. Ofgem has said that it does not intend to provide suppliers with a transition period within which to implement the SOC. One justification it provides is that "consumer expectations are that any reasonable supplier should comply with the Standards at a minimum. Therefore, any supplier should be doing this as a matter of course"<sup>17</sup>. At the same time, Ofgem says that "We expect that over time the proposed SOC should result in very significant changes in culture and practice within supply businesses"<sup>18</sup>.
- 3.19. Whilst Ofgem have helpfully recognised that implementation of the SOC's will be an evolutionary process, we still believe that there is a tension between the two positions laid out above. Compliance with the SOC's is expected as a "matter of course", yet suppliers are also expected to "transform their processes and systems" so as to produce "very significant

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<sup>16</sup> RMR, p. 106, para 8.7

<sup>17</sup> IA, p. 41, para 4.22

<sup>18</sup> RMR, p. 111, para 8.28

changes in culture and practice”. Like with any new licence condition, if change is expected, then Energy UK believes that suppliers should be given a reasonable time to achieve it.

- 3.20. Not only is implementation time required to allow suppliers to review their practices and make any appropriate changes, they will also need to ensure that they can “demonstrate via contemporaneous documents that they acted reasonably during all of these stages”<sup>19</sup>. Complying with the SOCs, and being able to evidence that compliance, are two different but interrelated processes, both of which will require time to develop.
- 3.21. We welcome the fact that Ofgem has gone some way to addressing these concerns by confirming that “what is reasonable for a supplier to have accomplished in transforming its processes and systems to meet the fairness principle will change over time”, and that they will “take this into account in dealing with any licence breach allegations”<sup>20</sup>. However, Energy UK believes that greater reassurance is required. For example, Ofgem could specify that the SOCs come into force after a reasonable period of implementation time, refine its enforcement approach in the ways outlined above, and/or enshrine the principle that “what is reasonable to have accomplished... will change over time” in the licence itself.
- 3.22. Notwithstanding these points, we recognise Ofgem’s view that “it is important for rebuilding consumer trust that the SOC come into force as soon as possible”<sup>21</sup>. Whilst Energy UK shares that view, we would be surprised if consumers’ awareness of the SOCs proposal was high. Therefore, a grace period between the SOCs being added to the supply licence and their coming into force might be unlikely to substantially affect consumers’ perception of the market. If you combine this with the fact that suppliers and Ofgem have a degree of control over the way in which the SOCs are communicated, the marginal benefits of immediate implementation in terms of consumer perception would seem to be low.

### **Measuring success**

- 3.23. Energy UK wholeheartedly agrees with Ofgem’s aims for the SOCs, which are to improve supplier behaviour and increase levels of consumer trust in the industry<sup>22</sup>. Ofgem narrows this down further to a single “key aim”, which is to “rebuild consumer trust and confidence in suppliers so [that consumers] are more confident to engage in the market.”<sup>23</sup>
- 3.24. Energy UK shares Ofgem’s aspirations. Indeed, we believe that the SOCs could be the most significant reform of the whole RMR package in terms of the benefits that they could bring to consumers.
- 3.25. Nonetheless, we would caution Ofgem against using overall consumer trust in the market as the sole measure of the success of the SOCs. There are many different factors which contribute to this perception, and we must be realistic about what the SOCs can do to address this. For example, Ofgem has stated that “the overall perception of the energy industry is fairly negative and rarely rises above neutral. The negativity on the whole is less about personal experience as an individual consumer and more as a result of perceptions of excess profits.”<sup>24</sup>
- 3.26. Since the perception of excess profits appears to be the most important driver of consumer distrust, we would urge Ofgem to include proposals to address this as part of the RMR process for example by addressing, more prominently, the issue of perceived profits and the

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<sup>19</sup> RMR, p. 108, para 8.13

<sup>20</sup> RMR, p. 111, para 8.28

<sup>21</sup> RMR, p. 110, para 8.27

<sup>22</sup> RMR, p. 106, para 8.3

<sup>23</sup> RMR, p. 105, para 8.2

<sup>24</sup> RMR, p. 122, para 1.43

factors that contribute towards the bill.<sup>25</sup> In addition, we do not believe that the second chapter of Ofgem’s consultation document fairly reflected the current state of the energy retail market, and were disappointed that it was not more objective.

### **Communicating the SOC’s**

- 3.27. Energy UK agrees that communication of the SOC’s should help raise consumer awareness of the new Standards that apply in the industry, in turn helping to build consumer trust. In this regard, Energy UK supports Ofgem’s proposal to introduce minimum requirements for the communication of the SOC’s, including the use of a common label such as the “Treating Customers Fairly Statement”.
- 3.28. Energy UK believes that Ofgem should do more with respect to the communication of the SOC’s. In order to increase trust in the market, we believe that it is vital for Ofgem and suppliers to work closely to ensure that their respective messages are loud, positive and complementary so as to help build trust in the market.

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<sup>25</sup> In this regard, it is important to note that Ofgem commissioned BDO to look into the publication of companies’ external accounts, further enhancing transparency.

## Tariff Simplification – the proposed cap

### 4. Summary

- 4.1. Energy UK agrees that Ofgem has correctly identified a problem with the energy retail market; many consumers believe that there are too many tariffs, thereby deterring effective engagement. Some consumers say they are “put off... from searching for better tariffs in the first place”, some “abandon their search” and others lack confidence that they made the “right” decision<sup>26</sup>. Energy UK is also worried that the perceived number of tariffs contributes to distrust in energy suppliers and the market as a whole<sup>27</sup>.
- 4.2. Energy suppliers have recognised these problems too. They have listened to what their customers have been telling them, and acted to address their concerns. As is documented in the appendices to Ofgem’s Updated Domestic Proposals, companies have made a number of changes to make tariffs easier to compare, such as reducing their number and simplifying their structures. Suppliers have also made their bills clearer and easier to understand and enhanced their customer services. These are just some of the initiatives that we hope will help to promote trust in the industry we represent.
- 4.3. These developments show that companies want to respond to consumer demand. Markets can learn and adapt. Energy UK believes that this is what has happened over the last two years or so, for which Ofgem deserves credit. The market is in a very different place to where it was when the RMR first started. This is not a static process however; our members have plans in place for continued and ongoing improvement. The key question now however is: what is the best way to ensure that progress continues?
- 4.4. As part of its robust package of reforms, Ofgem has proposed to place a cap on the number of open tariffs that energy suppliers are allowed to offer to domestic customers. Ofgem has proposed to set that cap at four “core tariffs”<sup>28</sup>.
- 4.5. If Ofgem were to impose a cap, it would be dictating the balance between simplicity and choice that consumers have access to. Energy UK does not believe that, based on the evidence produced, Ofgem can have confidence that the benefits of introducing the cap as proposed will outweigh the adverse unintended consequences. We are therefore extremely concerned that the tariff cap could result in a net decrease in consumer engagement, and would urge Ofgem to consider options to mitigate these risks, which we outline in 4.7 below.
- 4.6. However, Energy UK accepts that just because it is difficult to “prove” the cause of a problem, or quantify the benefits of a solution in advance, it does not mean that the proposed remedy will not work. We also recognise that whether the problem of “too many choices” is more one of preconception may be immaterial if the effects – distrust and disengagement – are the same. We therefore believe that, providing perceived tariff proliferation is not a pretext for disengagement, a cap may help reassure consumers that the number of options they face is not intimidating, and give them confidence to engage.
- 4.7. Should Ofgem proceed with imposing a cap on the number of tariffs that suppliers are permitted to offer, we believe that Ofgem should take the following into account when setting the level and associated rules, to strike the right balance between simplicity and the scope for innovation:
  - a) The higher the cap, the lower the risks;
  - b) A sunset clause should apply to the licence condition
  - c) An innovation reserve should be established for smart meter tariffs;

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<sup>26</sup> RMR, p. 25

<sup>27</sup> Ipsos MORI found that some people “suggested the growing number of tariff options is a sign of an unhealthy market and proof that suppliers operate against the best interests of consumers”.

<sup>28</sup> Per fuel, meter type and payment method, with certain derogations



- d) Different routes to market, such as collective switching, should be treated consistently.
- 4.8. Given the serious risk of the proposed mandated tariff cap resulting in a net decrease in consumer engagement, we believe that Ofgem should monitor its effects, as benchmarked against clearly defined and transparent success criteria, extremely closely. In this regard, we would expect Ofgem to produce regular assessments of progress that are complete, honest and fair.

### **Assessing Ofgem's cost/benefit case**

#### **Rationale for intervention**

- 4.9. The aim of the tariff cap is to help address what is said to be a key barrier to consumers engaging effectively in the energy retail market; currently “many perceive there are too many tariffs”, and find this array of options “off-putting”<sup>29</sup>. Ofgem argues that tariff proliferation contributes to a broader problem of complexity, which “puts off many consumers from searching for better tariffs in the first place”, “leads some consumers to abandon their search” and “may result in an increased frequency of poor switching decisions”<sup>30</sup>.

#### **The analytical framework**

- 4.10. Like Ofgem, Energy UK wants to see more and improved consumer engagement. However, the tariff cap would have pros and cons. Ofgem has recognised that there are some risks attached to this policy. For example, it highlights the possibility that “suppliers remove their cheapest deals from the market”<sup>31</sup>.
- 4.11. Therefore, in order to determine whether Ofgem should proceed with the proposal as an absolute, we need to weigh up:
- The likelihood that the cap will reduce barriers to engagement; against
  - The risk that it will unintentionally:
    - increase other barriers to engagement; and/or
    - lead to a reduction in incentives to engagement.
- 4.12. In short, in order to support the tariff cap as is, Energy UK needs to be convinced that there is sufficient evidence to be confident that it will produce a net increase in consumer engagement.

#### **The risks of reducing engagement - amounts to be saved from switching**

- 4.13. In its report published alongside the RMR, Ipsos MORI characterises disengaged customers as those who “see little incentive to review their tariff options” because they “perceive little price differentiation in the market”<sup>32</sup>. Price differentiation is referred to as the “most important factor”<sup>33</sup> for disengaged customers in choosing a tariff. More generally, Ipsos MORI’s tracking survey found that the desire to save money was by far the most common trigger – at 76% for gas and 77% for electricity - for consumers to switch their energy supplier.
- 4.14. We can therefore conclude that if the tariff cap led to less differentiation in prices and propositions, through, for example, a reduction in the introduction of innovative special offers, then it may have a detrimental impact on consumer engagement, both on the potential for the inactive to become active and the likelihood that the active remain so. In

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<sup>29</sup> RMR, p. 65, para 4.24

<sup>30</sup> RMR, p. 25

<sup>31</sup> IA, p. 39, para 4.11

<sup>32</sup> Ipsos MORI, *Consumer engagement with the energy market, information needs and perceptions of Ofgem*, 30/08/2012, p. 17

<sup>33</sup> Ibid

this regard, it is worth noting that the average minimum that non-switchers say would encourage them to switch is £167<sup>34</sup>.

- 4.15. Energy UK cannot say how likely it is that a reduction in differentiation will result from the proposed tariff cap. However, Ofgem itself admits that “we might see some convergence of prices”<sup>35</sup> and “a short-term reduction in the availability of deeply discounted deals”<sup>36</sup>. We would also point to warnings given by independent commentators<sup>37</sup>.

#### **The risks of reducing engagement - responding to consumer demand**

- 4.16. Ipsos’ research showed that consumers would see switching as a worthwhile process when they can move to deals that are “better matched to their circumstances”<sup>38</sup>. Indeed, Ipsos state that a “key part of encouraging consumers to engage in the market is showing them that it is possible to find a tariff that matches their specific needs”<sup>39</sup>.
- 4.17. By definition, the tariff cap would restrict suppliers’ ability to tailor products to the needs and preferences of different customers and customer groups, potentially depressing the incentive to engage described above.
- 4.18. Consumers’ needs and preferences also change over time. The proposed tariff cap would make it more difficult for suppliers to experiment with new tariffs, test and meet consumer demand for them, with results that could potentially reinforce the perception that “energy is not a particularly engaging topic”<sup>40</sup>, which Ipsos describes as perhaps “the hardest barrier (to engagement) to overcome”<sup>41</sup>.

#### **The risks of reducing engagement - reassurance of “cheapest tariff” reforms**

- 4.19. Ofgem has proposed to oblige suppliers to automatically move customers on dead tariffs onto their cheapest open evergreen equivalent, where they are likely to save money. Similarly, customers who “do nothing” at the end of a fixed-term contract would be automatically defaulted onto the supplier’s cheapest evergreen tariff for their payment method and meter type.
- 4.20. There is a risk that these reforms combine with the proposed tariff cap to give consumers the impression that engagement is not worthwhile because they believe they are already getting a decent deal, and there is little to be gained in the way of savings, choice or innovation. However, Energy UK recognises the importance of protecting all consumers, not just those who are active in the market.

#### **The risks of reducing engagement - summary**

- 4.21. As Ofgem and others have appreciated, there is risk that the proposed tariff cap could unintentionally dampen important incentives and raise barriers to consumer engagement. Whilst it is not possible to quantify these risks, they appear to be serious. In order to proceed with the mandated cap as proposed, one would need to be confident that it will reduce barriers to engagement, to the extent that said reduction will outweigh any adverse consequences.

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<sup>34</sup> Ipsos MORI, Customer Engagement with the Energy Market – Tracking Survey 2012, p. 59

<sup>35</sup> IA, p. 71, para 7.48

<sup>36</sup> IA, p. 39, para 4.12

<sup>37</sup> Stephen Littlechild, Ofgem and the Philosopher’s Stone, 20 November 2012

<sup>38</sup> Ibid, p. 22

<sup>39</sup> Ibid, p. 29

<sup>40</sup> Ibid, p. 22

<sup>41</sup> Ibid, p. 22

### **The potential benefits of a tariff cap**

- 4.22. In order to be sure that the tariff cap in its current form is an appropriate intervention, one would need to be able to evidence two things:
- Whether and the extent to which the number of tariffs contributes to consumer disengagement with the energy market; and
  - Whether and the extent to which consumers will respond to a tariff cap by engaging more with the market.

The following section explores whether Ofgem has produced sufficient evidence to be confident that the benefits of the proposed tariff cap will outweigh the risks outlined above.

### **The nature and extent of the problem**

- 4.23. Some consumers say that there are too many tariffs, and say that the “sheer number of options they are faced with” makes them “lose faith that locating a good deal is a real possibility”<sup>42</sup>. Ofgem elaborates on the root of the issue by stating that “due to the high number of tariffs, consumers are likely to encounter a large range of choices when looking for a new tariff”<sup>43</sup>.
- 4.24. According to findings from Ofgem’s Consumer First Panel, the problem of the number of tariffs affects different consumers in different ways. However, in terms of tendency to disengage, it appears that they can be split into two categories:
- Some “consumers switch off from engaging completely”; while others
  - “Engage to a point but then “give up” because it becomes too difficult”<sup>44</sup>.
- 4.25. It would therefore seem to be instructive to look at these groups separately.

### **Consumers who “switch off from engaging completely”**

- 4.26. In order to increase confidence in the ability of the proposed tariff cap to increase consumer engagement, Energy UK considers that Ofgem would need to answer the following questions:
- a) Have the consumers who “switch off completely” ever attempted to look for a new tariff, and if so how many?
  - b) How do perceptions about tariff numbers contribute to consumer disengagement relative to other factors such as ease of comparison or mistrust in the switching process?
- 4.27. Energy UK does not believe that Ofgem has fully answered these questions with sufficient robust supporting evidence. As a consequence, we are concerned that Ofgem has not conclusively rebutted the possibilities that (a) consumers who say that they are put off by the range of choice available do so because they hold certain preconceptions about the marketplace, which may be incorrect or (b) the number of tariffs is not the main reason for disengagement by these customers. In view of these uncertainties, it would be preferable to take a cautious approach and not set the cap too tight.
- 4.28. It is self-evident that if a consumer has not attempted to shop around, they cannot have encountered “too many” choices. Ipsos MORI found that some of the Consumer First Panellists who believe that switching will be too much of a hassle “just assume it will be difficult”<sup>45</sup>. Ofgem also highlighted the propensity of preconceptions to affect consumer behaviour in its Probe Report: “*Findings suggest there are many aspects of the market and the suppliers that people know little about for sure, and that many judgements... may be*

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<sup>42</sup> Ibid, p. 21

<sup>43</sup> Ofgem, The Retail Market Review – Draft Impact Assessment for the updated domestic proposals, para 3.5, p. 17

<sup>44</sup> Ibid, p. 21

<sup>45</sup> Ibid, p. 21

*made based on gut feelings and perhaps media coverage, as much as experience and reliable information”<sup>46</sup>.*

### **Consumers who engage to a point but then “give up” because it becomes too difficult**

- 4.29. In order to increase confidence in the ability of the proposed tariff cap to increase consumer engagement, Energy UK considers that Ofgem would need to say where this group of consumers encounters a “large range of choices” in practice, and many are influenced in this way. Energy UK does not believe that Ofgem has fully answered this question with sufficient robust supporting evidence. Again, in view of these uncertainties, it would be preferable to take a cautious approach and not set the cap too tight.

### **Where do consumers encounter too many tariffs?**

- 4.30. Ofgem assigns several different figures to the number of tariffs available to consumers, including:
- a) 410 using the methodology used for the March 2011 RMR document<sup>47</sup>;
  - b) Around 900, using their “definition of a tariff”<sup>48</sup>; and
  - c) 161 “core tariff choices from the incumbent suppliers”<sup>49</sup>.
- 4.31. The lack of transparency in how these figures were produced means that they are not possible to verify.
- 4.32. More importantly, the number of tariffs that exist and the number of choices that consumers actually encounter in practice are two different things, as demonstrated by Ofgem’s own research:
- 4.33. *“Looking at each of the previous incumbent suppliers’ websites we found there to be between four and eleven high level tariff options presented for five of the suppliers and for another no high level option was presented and instead consumers were led through the process (internet research, September 2012).”<sup>50</sup>*
- 4.34. These findings demonstrate the positive steps that suppliers have made since the RMR first started. Tariffs are now fewer, simpler and easier to compare than they were two years ago.
- 4.35. Consumers will obviously encounter a broader range of tariffs on price comparison websites than suppliers’ websites since the former cover the entire market. However, judging from the Consumer First Panel findings, this does not appear to be a huge problem; they are perceived to “make the wealth of tariff information available more manageable”<sup>51</sup>. Indeed, Ofgem states that a large range of choices is less of an issue for those who use online comparison sites because they can “filter options”<sup>52</sup>. In addition, price comparison sites are the most common place for switchers to find out about their new tariff, and are becoming increasingly popular, (up 13 points for gas to 34% and up seven points for electricity to 31%<sup>53</sup>). At face value, this would not seem to support the proposition that the number of

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<sup>46</sup> <http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Energy%20Supply%20Probe%20-%20Initial%20Findings%20Report.pdf> p. 173

<sup>47</sup> Ofgem, Updated Domestic Proposals, p. 24, para 2.6

<sup>48</sup> Ibid, p. 24, para 2.7

<sup>49</sup> Ibid, p. 25, para 2.9

<sup>50</sup> Ofgem, The Retail Market Review – Draft Impact Assessment for the updated domestic proposals, p. 17, fn. 14

<sup>51</sup> Ipsos MORI, *Consumer engagement with the energy market, information needs and perceptions of Ofgem*, 30/08/2012, p. 29

<sup>52</sup> Ofgem, The Retail Market Review – Draft Impact Assessment for the updated domestic proposals, para 3.5, p. 17

<sup>53</sup> Ipsos MORI, *Customer Engagement with the Energy Market – Tracking Survey 2012*, pages 27 & 28

tariffs presented makes comparison sites too difficult to use. However, there may be other evidence that suggests otherwise.

- 4.36. Alternatively, consumers may choose to telephone one or more suppliers to explore their options. Some Consumer First Panellists felt that their current supplier was “a good place to start to find out information about other tariffs”<sup>54</sup>. It seems unlikely that consumers who choose this route would be presented with a greater number of choices during a phone call than they would if they visited the supplier’s website. Rather, we would expect that the supplier’s representative would first ask the consumer about the kind of tariff they were interested in, so as to narrow down the options and make any decision more straightforward. The same would presumably apply to face-to-face sales.

#### **How many “give up”, and to what extent is this because of “too many choices”?**

- 4.37. Ofgem does not quantify the extent to which it was the number of tariffs that led this group of consumers to “give up” their search relative to other factors such as ease of comparison.
- 4.38. However, the Ipsos MORI Consumer Engagement Tracking Survey may provide some indirect insights. On one hand, a significant majority of people who switched – 72% for gas and 75% for electricity – agreed with the statement that “I found it easy to decide which deal to switch to”<sup>55</sup>. On the other hand, the number of switchers who disagreed with this statement rose, pointing to “a general feeling that switching decisions are getting harder”<sup>56</sup>.
- 4.39. Whilst this trend demonstrates that steps should be taken to make it easier for consumers to identify the best deal, these statistics do not tell us much about the consumers who say that they engage to a point and then give up, how many of them react in this way, and to what extent it is to do with the number of tariffs on offer or other factors such as savings available or mistrust in the switching process.

#### **Assessing the efficacy of the solution – would a tariff cap promote engagement?**

- 4.40. Energy UK accepts that even if it is difficult to quantify the nature and scope of the problem, this does not necessarily mean that the problem is any less serious. Therefore, we need to assess the likelihood that the proposed tariff cap would encourage those who have not yet switched to engage, and those who abandoned their search to re-engage.
- 4.41. This is an extremely difficult question to answer. Clearly, it is not possible to know the effect of the tariff cap on these consumers until after it is introduced. Therefore, we can only put forward a “best guess” as to what the result will be. But this is still very challenging; as behavioural economics shows us, what consumers say that they would do and what they actually do are not always the same<sup>57</sup>.
- 4.42. Nonetheless, the quantitative data available provides some grounds for caution. For instance, the majority – 78% - of consumers who have never switched said that they did not do so because they are happy with their current supplier<sup>58</sup>. This reflects what Ofgem found during the Probe:

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<sup>54</sup> Ipsos MORI, 30/08/2012, p. 29

<sup>55</sup> Ipsos MORI, Customer Engagement with the Energy Market – Tracking Survey 2012, p. 34

<sup>56</sup> Ibid, p. 35

<sup>57</sup> In this respect, we think it would add weight to Ofgem’s argument if it was able to demonstrate that tariff proliferation was a reason, rather than pretext, for disengagement.

<sup>58</sup> Ipsos MORI, Customer Engagement with the Energy Market – Tracking Survey 2012, p. 22

*“When we sought to understand why many of them do not proactively switch, the vast majority said that they saw no compelling need. Nearly three-quarters were happy with their supplier and saw no benefit from changing”.*<sup>59</sup>

- 4.43. It is also worth noting that none of the consumers surveyed in 2012 attributed their decision not to switch specifically to the number of tariffs to choose from (although 20% said that switching is a hassle – unfortunately this reason was not broken down into categories).

#### **Do the marginal benefits outweigh the risks?**

- 4.44. Energy UK agrees that the market became overly complex and has been difficult to navigate for some customers, which contributed to mistrust of suppliers and consumer disengagement. However, as we have seen, suppliers have made a number of changes to make tariff comparison and switching easier. On top of this, Ofgem has proposed a whole raft of measures as part of the RMR. Given these proposals constitute a robust and coherent package, Energy UK believes that the benefit of the proposed tariff cap is questionable given -
- a) The contribution that the number of tariffs makes to the problem of market complexity has not been quantified; and
  - b) Judging from the quantitative evidence, there are other explanations for consumer disengagement.
- 4.45. Having said this, the diminished benefit of the proposed tariff cap would not be a problem unless it carried risks of unintentionally depressing incentives to engagement. But as we have seen, independent commentators believe that the tariff cap as proposed could lead to a reduction in price differentiation, innovation and the availability of products that meet the needs of different consumers. Energy UK is also worried that the tariff cap as proposed could combine with the “cheapest tariff” reforms to unintentionally give consumers the impression that there is “no need to engage”.
- 4.46. Given these warnings, Energy UK believes that there is a serious risk that the proposed tariff cap could result in a net reduction in consumer engagement. Overall, we are concerned that Ofgem has overestimated its ability to encourage the inactive to become active and underestimated its depressive impact on those who are already engaged. We therefore believe that, if it introduced a cap, Ofgem would need to consider ways to mitigate the potential negative effects.

#### **An alternative solution**

- 4.47. As stated above, Energy UK accepts that consumers describe the number of tariffs as a barrier to engagement, and agree that this is problematic.
- 4.48. In the longer term, it may be possible, via very carefully drafted principles, to ensure that suppliers only offer tariffs that meet existing and future customer needs and preferences. This could help address the perception of tariff proliferation without unduly compromising choice and innovation. The SOCs could also be used to help ensure that tariffs and choices are clearly presented, including on suppliers’ websites, to allow full and easy comparison, thus addressing the problem of complexity. It would also better synergise with the other RMR proposals.
- 4.49. Under a tariff cap without a sunset clause, Ofgem would have to amend licence conditions if they concluded that it should be raised, adjusted or removed. Principles-Based Regulation

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<sup>59</sup> <http://www.ofgem.gov.uk/Markets/RetMkts/ensuppro/Documents1/Energy%20Supply%20Probe%20-%20Initial%20Findings%20Report.pdf> p. 56, para 5.18

would avoid this rather cumbersome process, one that also has the potential to become politicised (although the same could be said for PBR).

- 4.50. Ofgem has considered this route however, and rejected it for two main reasons.
- 4.51. Firstly, they are concerned that it might not do “enough to address tariff proliferation, perhaps reinforcing feelings of frustration and affecting their willingness to engage in the market”<sup>60</sup>.

Energy UK recognises that consumers may see tariff proliferation as a market-wide problem, which is symptomatic of suppliers being perceived as “the same”. However, we do not necessarily agree that limiting all suppliers to four core tariffs is the best way of addressing perceptions of homogeneity. Perhaps an alternative approach might be for Ofgem to publish the number of tariffs that each supplier offers, empowering consumers to make informed decisions based on their individual priorities. This would also avoid the undesirable consequence of conveying that choice in energy tariffs is inherently “a bad thing”, particularly given the rollout of smart metering, as discussed below.

- 4.52. Ofgem’s second main objection to a principles-based approach was that it “does not guarantee that the market will take the direction we want to see”<sup>61</sup> and that suppliers did not simplify tariffs as part of the Probe. Energy UK would highlight the fact that the market has already taken the direction that Ofgem wants to see as part of the RMR; suppliers have listened and there is a real appetite for change.

#### **Considerations in proceeding with a tariff cap**

- 4.53. Energy UK recognises that Ofgem believes a tariff cap will bring broader benefits than simply making it easier for customers to navigate the market. These include:
- a) Reducing the ability of “suppliers to segment the market”<sup>62</sup>; and
  - b) Improving trust in suppliers and the market<sup>63</sup>.
- 4.54. With respect to the latter, whilst we believe that consumers value choice, and that distrust and complexity are problems that can be dealt with in other ways and with fewer risks, we sympathise with this particular rationale. We also understand that Ofgem sees the proposed tariff cap as part of a longer term plan to create a body of confident and engaged consumers, of which the first step is simplifying and building trust in the market.
- 4.55. As to whether the number of choices that consumers face when they search is more of a problem of perception than reality, one might argue that this distinction is immaterial if the effects – distrust and disengagement – are the same. Also, the pervasiveness of the opinion that there are “too many tariffs”, including amongst politicians and the media, may lead Ofgem to conclude that the only way of dealing with it is through a cap. As to whether the number of tariffs is used as a pretext for not engaging, we can only really know whether this is the case once it is introduced.
- 4.56. Given these points, Energy UK acknowledges that Ofgem still sees value in implementing a cap. On that basis, Energy UK would make a number of observations that Ofgem should take account of, and recommendations that we strongly believe Ofgem should adopt.

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<sup>60</sup> IA, p. 91, para 8.110

<sup>61</sup> IA, p. 91, para 8.111

<sup>62</sup> RMR, p. 66, para 4.29

<sup>63</sup> Ipsos MORI found that some Consumer First Panellists “suggested the growing number of tariff options is a sign of an unhealthy market and proof that suppliers operate against the best interests of consumers”

### The higher the cap, the lower the risks

- 4.57. For the reasons explained above, Energy UK believes that there is a possibility that the unintended adverse consequences of the proposed tariff cap will outweigh the benefits, leading to a net reduction in consumer engagement.
- 4.58. As commentators (and indeed Ofgem) have observed, the two main drivers of this risk are (a) reductions in price differentials and (b) inability to meet the existing and future needs of different customers and customer groups. If these risks are created by imposing the proposed mandated cap, one would presume that the same risks would be alleviated if the cap was raised, though in what proportions is unclear<sup>64</sup>.
- 4.59. A sensible response might be to set the level of any tariff cap according to the degree of confidence Ofgem has that the benefits will outweigh the risks; the more uncertain the benefits, and the more serious the risks, the higher the cap should be.
- 4.60. Given the scarcity of evidence produced to suggest that the benefits are either certain or substantial, Energy UK would recommend that the cap be raised above the current proposal of four. To what level is difficult to say. In any case, it is not for Energy UK to second-guess how consumers' needs will evolve over time, or try to predict the variety of benefits that new products and technologies might bring.

### A sunset clause should be applied to the licence condition

- 4.61. Ofgem has said that whilst it will monitor the impact of its RMR reforms, it intends to keep them in place without further upheaval for three years. By this time, the consequences of the tariff cap could lie anywhere across a spectrum of possibilities. For example, it might result in a net reduction in consumer engagement, a net increase in consumer engagement, or it might be too difficult to tell.
- 4.62. In all cases, Energy UK believes that there is an extremely strong case for applying a sunset clause to the tariff cap. We have attempted to illustrate this in the table below, using "extreme" or "ideal-type" scenarios.

	Scenario	Why a sunset clause is needed
1	The tariff cap has helped to create a broad pool of confident and engaged consumers.	The tariff cap has become obsolete. The market is ready to continue its journey from simplicity to sophistication.
2	Consumer engagement has improved, partly thanks to the tariff cap, but not to the extent hoped for.	If this is the case, Ofgem should have little difficulty in justifying the continuation of the cap.  In any case, it should be incumbent upon Ofgem to demonstrate why such a level of intervention and restriction on innovation is necessary, given their statutory duties.
3	The tariff cap has resulted in reduced consumer	The tariff cap was

<sup>64</sup> But neither has Ofgem quantified the marginal benefits of different levels of a tariff cap; a cap of four was justified on the basis that it was broadly in line with current supplier practice.



	engagement.	counterproductive to innovation and competition. It should be removed.
4	<p>It is unclear whether consumer engagement has improved overall, because there are lots of different measures which sometimes contradict each other.</p> <p>Even if we did know whether engagement has improved, it is extremely difficult if not impossible to tell which impacts can be attributed to which reforms.</p>	<p>If Ofgem cannot demonstrate whether the tariff cap has resulted in a net improvement in consumer engagement, then it should be allowed to lapse.</p> <p>This would better align with the Principles of Better Regulation and the broader convention of “competition where possible and regulation where necessary”.</p>

4.63. In addition to the requirement for a sunset clause, the fourth scenario in the table demonstrates that there is a clear need for Ofgem to do more<sup>65</sup> to define (a) what success looks like and (b) how they are going to measure success and (c) how they are going to ascertain the contribution that each plank of the RMR reforms makes to this goal. Without such clear accountability mechanisms, there is a risk that policies that are ineffective or counterproductive to the consumer interest are allowed to continue unchecked. Even more worryingly, it could lead to the causes of developments in the market to be misattributed; at worst leading to calls for remedies that are precisely the opposite of what is required<sup>66</sup>. For these reasons, we believe that Ofgem should design a transparent evaluative framework for its RMR proposals via public consultation urgently.

4.64. Based on the evidence produced, it is difficult to see how Ofgem can be confident that its proposed tariff cap will result in a net increase in consumer engagement. Therefore, if Ofgem decides to proceed with the tariff cap, we believe that a sunset clause would therefore appear to be a sensible precaution against such confidence being misplaced.

#### **An innovation reserve should be established for smart meter tariffs**

4.65. The rollout of smart meters promises a multitude of benefits to Britain’s citizens and consumers, both present and future, as evidenced in the Government’s own Smart Metering Impact Assessment<sup>67</sup>. For example, smart meters will –

- a) Enable customers to better understand how much energy they are using, and when, empowering them to adapt and change their consumption behaviour as they see fit; and
- b) Enable customers to manage their usage according to how expensive it may be at different times of day via Time of Use (ToU) tariffs, thereby reducing their overall energy costs.

4.66. These behaviours, which impact on energy demand, will also help facilitate the electrification of heat and transport and efficient investment in grid and generation infrastructure. In turn, these will help to meet the UK’s carbon reduction targets and result in cost savings that can be passed on to consumers.

<sup>65</sup> Than Appendix 8 of the Supplementary Appendices

<sup>66</sup> Of particular concern would be a simplistic approach which, if customers are still disengaged, concludes that regulation needs to be even more restrictive. For example, if Ofgem were to allow only two tariffs rather than consider whether the appropriate response might instead be to abolish the restrictions.

<sup>67</sup> Government’s Smart Metering Impact Assessment – April 2012:

<http://www.decc.gov.uk/assets/decc/11/consultation/smart-metering-imp-prog/4906-smart-meter-rollout-domestic-ia-response.pdf>

- 4.67. Government has estimated that the net consumer-related benefits of smart metering are £4.43 billion.
- 4.68. Clearly, these benefits are more likely to be realised if consumers take-up time of use (TOU) tariffs. But it is up to suppliers to determine which tariffs they should offer, so as to encourage consumer take-up. Like any process of product development, this will require testing of different ideas and trade-offs. For example, they might need to ascertain where the right balance lies between cost and convenience, or how many different prices for different times consumers can manage.
- 4.69. Some of these ideas may work, and some may not. But in this context, success often follows failure; markets learn and adapt over time. Energy UK is convinced that the proposed tariff cap would constrain this experimentation and evolution to such a degree that smart metering will not realise its full potential.
- 4.70. It is also vital to recognise that whilst suppliers are not obliged to complete the rollout until 2019, smart meters are already here; hundreds of thousands have already been installed in homes across Britain, with some consumers already taking part in trials involving innovative tariff structures such as Time of Use tariffs. The optimum time for suppliers to begin to ascertain what consumers want, and what they don't, is in the earlier stages of rollout. The sooner the market for smart tariffs begins to develop according to consumer preferences, the greater the take-up will be in the future, and the greater the benefits.
- 4.71. For these reasons, we strongly believe that an "innovation reserve" should be established that applies, as a minimum, to smart meter tariffs, including both contingent deals and TOU.
- 4.72. Whilst we recognise that this derogation might not fit conveniently with Ofgem's plan to simplify as a first step in the journey to sophistication, we do not believe that this should come at the expense of the benefits of smart metering.

**Different marketing channels, such as collective switching, should be treated consistently**

- 4.73. Energy UK is extremely supportive of the concept of collective switching as another tool to help engage consumers, and has been a keen participant in discussions with DECC and others about how to address any barriers to its effective functioning.
- 4.74. However, it is important to recognise that collective switching could be regarded at its most fundamental level as a route to market, albeit a different one to those that have been seen traditionally. It appears that this particular route to market has been given special treatment, whereby those customers who choose this route are able to access an extra tariff that others are not.
- 4.75. We therefore ask Ofgem to explain its rationale for singling out collective switching schemes, and ask it to consider applying the rationale consistently across other routes to market; it may not be appropriate for Ofgem to "pick winners".

## Information Remedies

### 5. Introduction

- 5.1. Energy UK supports the provision of clearer and simpler information via supplier communications. We believe that this is important to help customers to engage effectively with their energy usage, their product choices, their supplier and the market as a whole.
- 5.2. It was for these reasons that Energy UK, in partnership with consumer groups, asked Ofgem to initiate a holistic review of the information that has to be included on bills and other supplier communications by virtue of regulation and legislation. The aim of doing so was to examine where these requirements could be rationalised or reduced, and together make corresponding recommendations to the appropriate decision-makers.
- 5.3. We commend Ofgem for subsequently establishing the Consumer Bills and Communications Roundtable Group (CBCRG), which is comprised of representatives from the regulator, DECC, Consumer Focus, Citizens Advice, Which?, Energy UK and large and small suppliers. We believe that this forum has been extremely constructive in both evaluating Ofgem's RMR information proposals and undertaking the wider review described above. With respect to the latter, progress has been made in developing a shared understanding of the purpose(s) of each supplier communication and the regulated information contained therein. We hope that this can be used as a platform to draw conclusions about where rationalisation might be possible, and look forward to further discussions in the New Year.
- 5.4. With the shared aim of clearer and simpler information in mind, it is important to recognise that several suppliers have recently redesigned their bills to make them more customer-friendly and easier to understand, and others are in the process of doing so. Before making such changes, suppliers generally undertake a significant period of development and testing through direct consumer research. Energy UK would urge Ofgem to take these initiatives into account when designing their proposals, partly to help ensure that the resources already deployed do not go to waste but also because the consumer research findings will be highly instructive. This type of in-depth customer research will be vital as part of an iterative process of development if Ofgem's proposed information remedies are to meet their aims.

### General comments on prescription

- 5.5. In line with Energy UK's contribution at the CBCRG, most of our comments focus on points of detail. For this reason, we believe that it would be most useful to consider each communication individually. We do so after making some high-level observations.
- 5.6. Generally speaking, Energy UK believes that suppliers are best placed to prescribe the precise design, content and format of their communications. Aside from the fact that they employ professionals with years of experience for specifically this purpose, they are able to secure regular direct feedback from their customers, and can make efficient adaptations according to what is most effective, in line with their individual company brand and change processes.
- 5.7. Energy UK believes that there would need to be a strong case for communications to be designed in fine detail via regulation. Since bills and other communications are one form of customer service by which suppliers differentiate themselves, it is questionable whether this level of intervention is wholly appropriate in a competitive market. In addition, even if regulators have the necessary expertise to conduct this kind of work, we would be concerned about the ability of prescriptive licence conditions to be sufficiently adaptable to changing consumer preferences, particularly given the need to refresh designs to maintain consumer interest.

- 5.8. In light of these points, Energy UK feels that it might be more sensible for regulators, as a general rule, to use a less prescriptive approach to defining what firms' communications should contain and look like.
- 5.9. Having said this, we agree that there is a strong case for certain communications, such as the Annual Statement, to be standardised, and we believe that the degree of prescription should be defined according to the purpose of each. For example, since the purpose of the Tariff Information Label is to help consumers compare the key features of tariffs and work out which one is best for them, it would clearly be most beneficial if these were common across all suppliers.
- 5.10. In the event that Ofgem does decide to prescribe the detail of supplier communications, we believe that it would be sensible to establish a bespoke consultation process to ensure that the final policy outcome is fit-for-purpose. We do not think that Ofgem's standard consultation process is able to take into account the fact that the development of effective communications is a rich iterative process of testing and learning based on consumer research, conducted with the parallel input of those who understand the costs and practicalities of implementation. We would therefore be keen to discuss with Ofgem what process might work better for this unique area of policy development.
- 5.11. It is vital to recognise that adding complicated calculations into the production of supplier communications has significant IT infrastructure costs. We would strongly urge Ofgem to take these into account when designing their proposals and the implementation time provided.

### **Summary box on bills**

- 5.12. Energy UK agrees with the objective of using the bill to tell customers how they could save money by switching tariff or payment method, or by reducing their consumption, and prompting them to do so. We believe that consumers would value this information; for example, they may find it particularly useful when the bill is higher than expected and they would like to offset these costs in future. Energy UK also agrees that, provided it is not cost prohibitive or confusing, the bill should contain the necessary information to allow consumers to compare their current tariff with others in the wider market, including their historical consumption data and that information should be personalised as far as possible, to make it meaningful for the customer in question.
- 5.13. However, Energy UK believes that, of all the supplier communications that Ofgem is considering as part of the RMR, the case for standardising parts of the bill in detail via regulation is weakest. Firstly, the bill is one important brand touch-point in suppliers' written communications. But perhaps more importantly, suppliers are experts in ensuring that the multiple messages and information that have to be included are meaningful in the context of the whole; a logical flow helps to create a coherent customer journey, which in turn encourages engagement.
- 5.14. Conversely, messages that are out of sync with the whole, either because of content, language, design or positioning, may cause frustration, confusion or be ignored altogether. Indeed, as SPA Future Thinking said in their research for Ofgem, "it is essential... that the inclusion of additional information – e.g. on opportunities to switch tariffs or suppliers – does not make it more difficult for consumers to find and understand the information they regard as key"<sup>68</sup>, such as how much to pay and when, or if they are in debit or credit<sup>69</sup>. Since "the whole" of the bill is the responsibility of suppliers, and all suppliers are different, a standardised summary box may risk undermining that coherency that they have spent so long trying to establish. We therefore believe it would be preferable if suppliers were able to

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<sup>68</sup> SPA Future Thinking, October 2012, p. 25

<sup>69</sup> SPA Future Thinking, October 2012, p. 49

determine the precise positioning of the summary box and the narrative that surrounds it, with regulations providing that it must be both clear and prominent.

- 5.15. We now provide some detailed comments on the Summary Box. We provide views on the “supplier cheapest deal” and the “personal projection” elsewhere in this consultation response.
- 5.16. **Summary Box on Bills – comments on the front page**
- a) It is rather text-heavy. This is particularly concerning when we consider that the aim of the summary box is to encourage customers to engage with their supply. It is reasonable that a very text-heavy summary box is likely to have little or no impact on consumers, or worse, cause increased confusion or distress through the presentation of inaccessible information.
  - b) The heading “paying more than you need to?” is quite negative. “Can you save money on your bill” might be a more positive alternative. We believe that suppliers should be free to determine their own wording for this.
  - c) We do not believe that “We are required to give you this information by the regulator” should be included, since it is not particularly customer-friendly and, as we have seen from consumer research, could contribute to feelings of mistrust. We believe it would be preferable for customers to be given the impression that the supplier is providing this information because it is good customer service, rather than because their hand is forced by the regulator. In addition, we question why the summary box deserves special treatment given suppliers are required to provide lots of information on bills by virtue of licence conditions made by Ofgem.
  - d) We believe that it would be more appropriate for the message about impartial advice to sit alongside the section of the box that relates to wider market comparisons (i.e. “about your tariff”, currently on the second page), rather than intra-supplier comparisons, to which the supplier’s own contact details are most relevant.
- 5.17. **Summary Box on Bills – comments on second page**
- a) The second page of suppliers’ bills usually contains a detailed breakdown of the customer’s charges. We believe that there is a risk of confusion between the Tariff Comparison Rate (TCR) and this information. We therefore urge Ofgem to allow suppliers to place this box where they believe it fits best, given their bill as a whole, provided it is in a prominent place.

## **Annual Statement**

- 5.18. Although consumers may not compare annual statements from different suppliers in large numbers, Energy UK agrees that there is a strong case for standardising these communications to help ensure that they are perceived as formal document that should be retained. We also recognise that the Probe Remedies were not always implemented in the way that Ofgem hoped.
- 5.19. Overall, we believe that Ofgem’s proposals for the Annual Statement are a good start and we look forward to hearing how consumers react to it in the planned trial. In particular, we agree that including an explanation of (a) what the Annual Statement is and (a) why consumers have been sent it is vitally important to encouraging engagement with and retention of the document.
- 5.20. Please see our more detailed comments below.
- 5.21. We believe that suppliers should be allowed to send gas and electricity annual statements for the same customer in the same envelope, potentially as a single Dual Fuel Annual Statement. Where a customer has actively selected to manage their account on a Dual Fuel basis, a Dual Fuel Annual Statement would help the customer to realise the efficiencies of Dual Fuel, such as a single bill and single payment method. In this case, it is likely to make less sense to a customer to receive two separate statements. Sending statements separately would increase costs significantly and risk upsetting customers who may

consider it to be (a) unnecessary wastage and/or (b) inconvenient because they would like to review their accounts for both fuels concurrently.

- 5.22. If the usage summary in the bottom left corner of the first page is reflective of Ofgem's policy intent (as opposed to the draft licence conditions), then we would make the following comments –
- a) Where suppliers do not hold consumption data two years in arrears, system changes would be required.
  - b) The two-year comparison would only be possible for customers who have been with the supplier for that period of time.
  - c) Some customers provide regular meter readings, some do so intermittently, and some do not do so. In any case, even where customers provide regular and frequent meter readings, these are rarely ever likely to coincide with the start and end of each quarter as set out in the graph. This means that for many the quarterly comparisons are likely to be based on estimates, actual readings, or a mixture of the two, with the latter being provided at different times. As a consequence, the comparisons are likely to lose their meaning, and provide an inaccurate picture of actual usage. It also makes the nature of the change increasingly complex, since suppliers will have to 'assume' bill values for 8 quarters, compared to bills actually sent. It may be preferable to provide a more robust annualised version.
  - d) Overall, we believe that the costs associated with implementing these changes are unlikely to be outweighed by the benefits. Therefore, we would urge Ofgem to base its proposals on SLC 31.A.2 (a), but ensure that this is presented in graphical form, aligning with findings from the consumer research.
- 5.23. We do not support the envelopes containing Annual Statements to be co-branded with Ofgem, partly because we believe that consumer awareness of the regulator is likely to be low and it could consequently confuse customers. Secondly, we believe that supplier-only branding is more conducive to building trust in suppliers.
- 5.24. We agree with the view that additional contractual information can be included on an additional page of the Annual Statement.
- 5.25. We believe that it would be a lost opportunity if suppliers were not permitted to offer energy efficiency advice on Annual Statements. This could be particularly important for prepayment meter (PPM) customers, who may not be able to access the same array of tariffs, or receive as many communications, as other customers.

### **Price Increase Notice (PIN)**

- 5.26. We believe that the level of prescription proposed for the PIN (i.e. the presentation of the comparison between current and new prices) seems appropriate. We therefore only have two main points; our members will undoubtedly cover additional detail.
- 5.27. We strongly believe that suppliers should be able to highlight the benefits of their fixed-price products in this communication. Consumers on variable tariffs may wish to protect themselves against future price rises via a fixed price product. Under current proposals, suppliers will only be allowed to provide information on the "cheapest tariff" at that particular snapshot in time. This tariff is likely to be a standard variable because the calculation does not take into account future price changes. However, a fixed-price product may be cheaper over the long term and its predictability could give consumers peace of mind. The Standards of Conduct would ensure that any such products would be presented fairly to consumers.
- 5.28. We believe that consumers particularly value information about how to reduce their energy costs at a time when they are being affected by a price rise. One way to achieve this for many customers would be by reducing their consumption. For this reason, we strongly believe that suppliers should be allowed to send energy efficiency advice in the same envelope as the PIN. Providing this kind of information could also help promote trust in the supplier if they are seen to be providing additional assistance at a potentially difficult time.

### **Tariff Information Label**

- 5.29. Energy UK is extremely supportive of a standardised Tariff Information Label being developed to help consumers compare the key features of tariffs and work out which one is best for them. Indeed, Energy UK developed its own “key facts” document in conjunction with consumer groups, and commissioned consumer research from Ipsos MORI to ascertain the optimum contents, order and language to be contained therein. We were pleased to be able to provide the outputs of this work to Ofgem to assist them in the development of the Tariff Information Label.
- 5.30. We believe that the Tariff Information Label is particularly important to help illustrate the non-price elements of tariffs, since the TCR and supplier cheapest deal proposals are skewed towards price being the driver of choice (potentially to the detriment of other factors such as customer service or the generation mix).
- 5.31. Similarly to our comments on the Annual Statement, we believe that Ofgem’s proposals for the Tariff Information Label constitute an excellent start, and look forward to hearing how consumers respond in the trial. We do have a few relatively minor comments.
- a) We do not believe that the estimated monthly costs should be included. Although we understand that this is the way that many people budget, we believe that doing so could create consumer confusion and frustration depending on whether these are more or less than what their existing Direct Debit is set at.
  - b) We believe that the unit rate and standing charge should be included, since these are important parts of any tariff.
  - c) We do not believe that the differences between low, medium and high consumption levels should be illustrated by different numbers of people, since the number of inhabitants in a property is only one factor that contributes to consumption.

### **End of Fixed Term Notice**

- 5.32. Subject to our comments on “Supplier Cheapest Deal” proposals, we have no high-level comments on the End of Fixed Term Notice and believe that Ofgem’s proposals are broadly sensible. We do think that the proposed requirement to send this to a customer 42 days in advance of the end of the fixed term seems a bit too far in advance. A careful balance should be struck to ensure that the communication acts as a reasonable call to action for the customer and that the customer has sufficient time to act. But sent too far in advance, the customer may overlook the notice, thinking that there is no urgency or need to act. In addition, we believe that the phrase “Statement of Renewal Terms” could be made more customer friendly and more clearly indicative of the purpose of the communication.

### **Standard Language**

- 5.33. We strongly agree with Ofgem that standardising key terms used in supplier communications will help consumers familiarise themselves with, understand and navigate the market. Ofgem has asked Energy UK to assist them in taking this work forward, and we would be delighted to help. We plan to set up an initial workshop in the New Year to discuss, as a first step, which terms should be standardised. We are keen for these discussions to be as inclusive as possible, with participants representing a variety of interest groups.

### **Supplier Customer Service Performance**

- 5.34. Ofgem has proposed to “publish regular updates on suppliers’ customer service performance, for example in handling complaints, or supplier satisfaction survey results.”<sup>70</sup>

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<sup>70</sup> Ofgem, RMR Updated Domestic Proposals, p. 75, para 5.24

Their aims are to “assist consumers in making better informed switching decisions” and “incentivise improvements in customer service”<sup>71</sup>.

- 5.35. Energy UK fully supports the publication of information that will drive improvements in customer service and build trust in the industry. Indeed, following discussions with Ofgem the incumbent suppliers have voluntarily agreed to publish their complaints statistics, starting early in the New Year. This enhanced transparency will enable customers to hold their supplier to account, provide a backdrop for suppliers to tell customers what they plan to do to improve, and provide consumer representatives with more information about the market.
- 5.36. However, it is vital that any information that Ofgem publishes does not mislead consumers. As has been recognised by Consumer Focus and others, the complaints data that suppliers record is not comparable on a like-for-like basis. This is at least in part due to the fact that the definition of complaint in the Complaints Handling Standards Regulations (CHSRs) is subjective, as Ofgem has recognised. Therefore, if Ofgem intends to publish complaints information for comparison purposes, or in such a way that might facilitate comparison by third-parties, it must first ensure that the information is comparable on a like-for-like basis, including by reducing the subjectivity of the definition of complaint within the CHSRs. We have provided further thoughts on this to Ofgem separately and look forward to continuing the dialogue.

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<sup>71</sup> Ibid



## Supplier Cheapest Deal

### 6. Introduction

6.1. Energy UK wholeheartedly supports Ofgem's efforts to encourage customers to engage with the tariffs that their supplier offers and switch to the one that is best for them. In this regard, we recognise that the most common reason that consumers have for switching is the desire to save money (although this is heavily influenced by the amount), so we agree that highlighting potential savings could act as an effective prompt to engagement. We also agree that consumers are most likely to respond to information that is personalised to them, so basing the calculations on their consumption is likely to help. Overall, therefore, we believe that Ofgem's high-level proposals for "Supplier Cheapest Deal" are sensible and we support the direction of travel.

6.2. Energy UK has three main concerns with respect to Supplier Cheapest Deal.

a) **It will be costly to implement**

As paragraph 6.5 of the consultation document illustrates, suppliers will effectively need to do a billing run for each customer for all eligible tariffs that the supplier offers, as opposed to the one that the customer is on (as is currently the case). We understand that this will require significant IT changes, both in terms of hardware and software. In addition to this up-front investment, there will be additional running costs such as through increased calls made to suppliers.

b) **It is information-heavy and complicated, making it difficult to read and understand**

The best illustration of the complexity of the information provided is contained in Figure 5 of the Supplementary Appendix to Ofgem's Updated Domestic Proposals, which is a Standard Dual Fuel Template for the Summary Box on Bills. Amongst other things, this includes:

- six personal projections;
- four figures showing estimated savings;
- four tariff names;
- descriptions of three different calculation methodologies; and
- an explanation about terms and conditions.

Given the amount of time that consumers spend reading their bills, it seems optimistic to expect consumers to assimilate and understand all of this information. In addition, where a customer has actively opted for a Dual Fuel offering it is more complex and more confusing for the customer to separate tariff savings messages on a per fuel basis. This also actively overlooks the customer's previous preferences. Messages will also need to carry caveats so that customers are not misled into thinking that they imply a guarantee.

c) **The calculation is based on a snapshot in time, potentially skewing the prompt towards variable evergreen products**

Under current proposals, suppliers will only be allowed to provide information on the "cheapest tariff" at that particular snapshot in time. This tariff may be likely to be a standard variable because the calculation does not take into account future price changes, and consumers are commonly charged a premium to fix. However, a fixed-price product may be cheaper over the long term and its predictability could give consumers peace of mind. In addition, a recurring reminder to customers who have chosen the fixed-price option for these reasons may cause irritation or frustration.

6.3. In light of these concerns, Ofgem may wish to explore the following ideas, to see if they might assist in making the information easier to understand and cheaper to implement:

a) **Might Ofgem's tariff rules, if implemented, allow the information to be simplified?**

Under Ofgem's current proposals, all customers on "dead" tariffs will be automatically moved onto the supplier's cheapest open evergreen tariff for their payment method and meter type, where they are likely to save money. Similarly, all customers who "do nothing" at the end of their fixed-term contract will be automatically moved onto the supplier's cheapest evergreen tariff for their payment method and meter type. In addition, whenever a supplier closes an evergreen tariff they must move all customers from that tariff to the cheapest open evergreen tariff for their payment method and meter type.

As a consequence of these three rules, one might presume that many customers on any given payment method and meter type will be on the cheapest evergreen tariff unless (a) they made an active choice otherwise (i.e. they saw their four tariff options, including the TCR for each, and decided not to choose the cheapest) or (b) if they are less active customers on still-open evergreen tariffs that bridged the pre and post RMR divide. Rather than add an entire calculation (the "narrow" definition) that is only relevant to already actively engaged customers and this "grandfathered" group, perhaps it might be easier to target the latter more directly?

With respect to the "wide" definition, we would strongly advocate considering alternative options which would avoid the need for a further complex calculation and presentation. For example, it would be worth considering whether (i) a standardised application of Direct Debit and online discounts might be used to calculate projected savings, or (ii) a reminder to the customer that further savings are (may be) available if they change payment method or account management style, would be more appropriate.

More generally, we believe that Ofgem should reconsider whether all customers should receive both the narrow and wide calculations, and whether they should be displayed on the array of communications that Ofgem is proposing.

b) **Addressing the natural skew against fixed-term products**

We believe that the rules should not prevent suppliers from highlighting the benefits of fixed-term alongside whatever happens to be "cheapest" at that point in time. In addition, we believe that Ofgem should carefully consider whether this information needs to be included on every bill of customers who are on fixed-term products. Rather, it might be more appropriate to limit this information to more natural "decision points" such as End of Fixed Term Notices.

- 6.4. We would also ask Ofgem to ensure that messages about potential savings do not mislead customers. For example, a supplier should not be obliged to hypothesise about whether a Time of Use tariff would be cheaper for a customer on a standard meter, since they would not know their consumption patterns, which may also change.

## Tariff Comparison Rate (TCR)

### 7. General Comments

- 7.1. Energy UK welcomes<sup>72</sup> Ofgem's proposal to introduce a standardised metric that enables simple, "at a glance" comparisons of energy tariff prices across the market.
- 7.2. We recognise that it is very difficult to reconcile the desire for a national TCR with the fact that prices vary from region to region in such a way that does not mislead customers. It is also very difficult to reconcile the desire to make TCRs as personalised as possible whilst enabling the customer to compare their tariff with generic advertised averages.
- 7.3. As to where to strike the balance in these trade-offs, Energy UK would favour simplicity and the solution that is more likely benefit customers. With this in mind, we believe that the TCR should be regional rather than national and expressed in £/year rather than p/kWh. It would probably be sensible to use a name for the TCR that clearly illustrates its generic nature to customers, leaving the personal projection to compensate for what the TCR lacks in personalisation.

#### National TCRs and the weighted average

- 7.4. Ofgem has proposed for TCRs to be calculated as a weighted average where the proportion of a supplier's customers in each region at a fixed date in the year would act as the weights. It says that "this would ensure that the TCR would be based on the typical consumer in Great Britain that has chosen the tariff"<sup>73</sup>.
- 7.5. Energy UK believes that any national TCR would create a risk of misleading consumers, since the rankings on any national TCR "best-buy" table would not necessarily reflect the rankings in any given region, in light of the regional differences in prices. Indeed, it may be worth Ofgem speaking to the Advertising Standards Authority (ASA) to ascertain how its current proposal fits into ASA guidelines. We therefore recommend that the TCR should be introduced on a regional basis only.
- 7.6. However, should Ofgem decide to proceed with a GB-wide TCR, then we believe that it would be fairer if the average was weighted according to the number of meters, rather than the number of customers supplied, in each region. With this change, those suppliers who had more customers in areas with higher network charges would not be unfairly penalised.

#### Unit in which the TCR will be expressed

- 7.7. Whilst we recognise that there are strong arguments on both sides in the debate between expressing the TCR in p/kWh rather than £/year, overall we think that the latter is more likely to promote effective consumer engagement, at least in the short term. We believe that consumers will find £/year easier to relate to, and they would be more likely to respond to the larger savings shown. Whilst we agree that p/kWh would better illustrate that the amount consumers pay depends on their consumption, this benefit may be outweighed by the signals given by a lower TCR for those who lie in the higher consumption bracket.

#### Consumption banding

- 7.8. It is difficult to say whether providing TCRs for low, medium and high users strikes the right balance between simplicity and accuracy. On one hand, it may be preferable to have a single "medium user" figure because this might help to convey to consumers that the TCR is a generic indicator. However, this could risk misleading low or high users, depending on the structure of the tariff. The Standards of Conduct may go some way to alleviating this

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<sup>72</sup> It is important to note that npower does not support the TCR

<sup>73</sup> Ofgem, Updated Domestic Proposals, p. 94, footnote 148

concern in how deals are advertised by suppliers, although the SOCs would not cover Third Party Intermediaries such as switching sites.

### **Non-contingent discounts and penalties**

- 7.9. We agree that non-contingent discounts and penalties should be included in the TCR. We agree that, should dual fuel tariffs have separate TCRs for gas and electricity elements, the discount should be split evenly across them, thus alleviating concerns about unintentional market distortions. We agree that the TCR should include the cost of the non-energy element for tariffs that include a mandatory bundle or where the bundle is default.

### **Contingent discounts and penalties**

- 7.10. We agree that the TCR should exclude contingent discounts and penalties. We agree that, for bundled products, the TCR should not include the non-energy element where it is opt-in.

### **Communication of TCRs**

- 7.11. We agree that raising awareness of the TCR, and what it can be used for (including its limitations), is a vital part to ensuring that it is effective. For this reason, we agree that TCRs should appear on Annual Statements, Price Increase Notifications and Tariff Information Labels<sup>74</sup>. However, we are not convinced that the TCR should appear on bills owing to the confusion that it is likely to cause in its current form.
- 7.12. It would not be possible to include a regional TCR on nationwide advertisements. If Ofgem proceeds with a national TCR, we would be concerned that requiring suppliers to place it on “all advertising materials”, irrespective of the context, risks confusing consumers. For this reason we would ask Ofgem to clarify which kind of advertisements they believe are appropriate for the inclusion of the TCR. Careful consideration must also be given to the volume of supporting detail that would also need to be provided with a TCR. Currently the draft Licence Condition suggests that this would need to be heavily supported with text, which is likely to undermine the basic premise of the ‘at a glance’ nature of the TCR.
- 7.13. Whilst we understand Ofgem’s reasons for wanting the TCR to be “the most prominent form of price information” on advertisements, we believe that the case is considerably weakened if the unit remains p/kWh rather than £/year, which is much more meaningful to consumers.
- 7.14. We also sympathise with the rationale underlying the proposal to publish other TCRs where relative claims are made. However, there may be a large number of other tariffs encompassed by the relative claim. It would seem to be impractical to publish that many, unless suppliers were permitted to do so in smaller print.

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<sup>74</sup> For Tariff Information Labels on suppliers’ websites, this would imply an interactive element (i.e. insert postcode) so the regional TCR can be included. The same applies to standing charges and unit rates.

## Tariff Rules - supplementary

### 8. Summary

- 8.1. Energy UK wholeheartedly supports Ofgem's efforts to simplify tariffs to make them easier for consumers to understand and compare.
- 8.2. In section 4 of this response we provided feedback on the proposal to impose a cap on the number of core tariffs that suppliers are permitted to offer. We would now like to take the opportunity to offer some views on the other tariff simplification proposals.

#### Prohibition on tiered rates

- 8.3. Energy UK fully supports Ofgem's proposal to ensure that all tariff offers are structured with a standing charge and single unit rate set by the supplier, with appropriate adjustments for TOU. We believe that these standardised structures will help customers to compare tariffs and develop a better understanding of the energy market, without the adverse unintended consequences and practical difficulties of an Ofgem-set standing charge.

#### "Dead" tariff rules

- 8.4. Energy UK supports Ofgem's proposal to oblige suppliers to automatically switch customers on dead tariffs to their cheapest evergreen equivalent, where they are likely to save money. It is important to distinguish "dead tariffs" from legacy and preserved tariffs that will remain open to customers who move into the relevant property. This is a technical point that we or our members would be happy to discuss with Ofgem in greater detail.

#### Appropriate surcharges

- 8.5. Rather than having a list of appropriate surcharges (i.e. those that do not count as a core tariff) enshrined in the supply licence, we believe that it would be preferable if Ofgem was able to govern this, and how they are calculated, by a general principle. Under current proposals, there is a risk that some surcharges that would be appropriate are missed-off accidentally and that the licence is not future-proofed.

#### Exclusions from the tariff cap

- 8.6. Energy UK believes that preserved tariffs and legacy social tariffs should be excluded from any tariff cap. Preserved and historic tariffs exist in the market. These can feature specific heating systems and equipment or be connected to different time of use patterns. Customers on such tariffs could lose out if they were moved onto a more generic offering, and vice-versa.
- 8.7. Including legacy social tariffs in the cap could also unfairly impact on those companies who offer these as part of the Warm Home Discount scheme.

#### Fixed-term tariffs

- 8.8. As discussed earlier, Energy UK would not want to see Ofgem's tariff rules unduly stifle innovation, and believe that a robust case is required before prohibiting any particular type of product offering.
- 8.9. Ofgem has proposed to prohibit price increases and other adverse unilateral variations on fixed-term offers, with certain tightly-prescribed exceptions. A consequence of this is that suppliers would not be permitted to offer fixed discounts against their standard variable

offering<sup>75</sup>, products which we understand many consumers have chosen. The only justification we can see for this is Ofgem's statement that "consumers generally assume that fixed term tariffs are also fixed price". However, this is only based on qualitative research. We believe that Ofgem would need to adduce more evidence to support their proposed prohibition; currently we are unconvinced that there are obvious consumer benefits attached to it.

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<sup>75</sup> EDF Energy supports Ofgem's proposed prohibition on suppliers offering fixed discounts relative to their standard variable tariff in the fixed-term market.

## Market Cheapest Deal

### 9. General Comments

- 9.1. Energy UK supports Ofgem's aims to do more to encourage sticky and vulnerable customers to engage in the market. However, we have serious concerns about Ofgem's Market Cheapest Deal proposal.
- a) It would confuse the role of market participants, potentially disconcerting consumers and exacerbating distrust in suppliers. As explained by lecturer in psychology interviewed by Ipsos MORI "if people cannot identify the motives of the messenger, they become confused and may not trust the message".<sup>76</sup>
  - b) It has a strong potential to mislead consumers, including some of the most vulnerable, for example if it failed to clearly highlight to a customer receiving the Warm Home Discount that they may lose out on a benefit of up to £140 if they switched to a non-obligated supplier. "Broader Group" customers may also lose out if they moved to another obligated supplier by virtue of differences in eligibility criteria.
  - c) It may not assist in delivering DECC's ambitions for uptake of the Green Deal, since customers might be signposted to suppliers who are not obliged to participate.
  - d) It risks placing a disproportionate emphasis on price over other differences between tariffs and suppliers, such as whether electricity is generated from renewable sources. It would not seem appropriate to assume that "sticky" and vulnerable customers are not interested in anything but price. Indeed, there may be lots of different reasons why customers choose to stay with their supplier.
  - e) It may unfairly penalise investment in customer retention.
- 9.2. Energy UK believes that there would be more proportionate and effective ways of targeting vulnerable customers, such as through the network of voluntary organisations that DECC is considering establishing.

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<sup>76</sup> Ipsos MORI, Prompting engagement with and retention of written customer communications, p. 30

## Licence Condition Drafting - process

### 10. General Comments

- 10.1. Given the complexity of Ofgem's proposals, and the interdependencies between them, we strongly believe that a separate, dedicated consultation process should be applied to the draft licence conditions between the closing of this consultation and the statutory phase.
- 10.2. We also have concerns about the extent to which Ofgem is undermining the intended protections around licence changes by giving itself the powers to make a substantial number of modifications via directions rather than the standard consultation process.