Promoting choice and value
for all gas and electricity customers

The Retail Market Review – Final Impact Assessment for domestic proposals

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Overview:

This document contains Ofgem's final Impact Assessment on the Retail Market Review (RMR). The final RMR proposals set out new rules for energy retail markets that will make it radically easier for consumers to make better choices over their electricity and gas supply. If implemented the proposed new rules will enable more consumers to secure a better deal - and in so doing increase the competitive pressure on energy suppliers to deliver good customer service at efficient cost. A competitive retail market is of critical importance in helping to minimise the impacts of cost pressures from rising global energy prices and the need to invest in infrastructure to deliver a low carbon economy.

The proposed new rules strip away unnecessary complexity in tariff choices, arm consumers with better, more relevant information on the available choices and puts in place legally binding fairness obligations. We envisage that our rules will be implemented from the summer, largely in place by the end of the year and fully operational over the next twelve months, recognising suppliers’ requirements to amend their systems, products and marketing – and to manage the process of amending the contracts of some customers.

The accompanying consultation document includes also our consultation on the effect of the final domestic and associated licence condition drafting.

Context

Ofgem's principal objective is to protect the interests of both existing and future energy consumers. The RMR aims to make the market better at serving the interests of consumers and enable individuals to get a better deal from energy companies.

This document sets out our impact assessment on our proposals for domestic consumers in three policy areas, as well as a number of interrelated issues. We summarise their key elements below. Proposals for the non-domestic market were published earlier this month.

In conjunction with this final Impact Assessment we are publishing our consultation document on the proposals and the updated draft legal text for new and amended licence conditions. We also include a summary of responses to our previous consultation.

The RMR has links with our Consumer Vulnerability Strategy[1], Smarter Markets Strategy[2] and our work on liquidity[3]. We are working to ensure our RMR proposals work in a complementary manner to these initiatives.

Associated documents

All documents are available at www.ofgem.gov.uk

- The Retail Market Review – Final domestic proposals, March 2013, Reference: 40/13.
- The Retail Market Review – Envisaged legal drafting for the Retail Market Review Domestic proposals, March 2013, Reference: 42/13.
- Review of Ofgem's enforcement activities – consultation on strategic vision, objectives and decision makers, March 2013, Reference: 43/13.
- The Retail Market Review – Final non-domestic proposals, March 2013, Reference: 38/13.

[1] For more information see the following link: http://www.ofgem.gov.uk/Sustainability/SocAction/Pages/SocAction.aspx
[2] For more information see the following link: http://www.ofgem.gov.uk/Markets/sm/strategy/Pages/Strategy.aspx
[3] For more information see the following links: http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/Pages/CompandEff.aspx and http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx

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Contents

1. Introduction

Chapter Summary

In this chapter we describe the purpose of this document. We outline the key barriers to consumer engagement and effective competition in the energy retail markets for domestic consumers that we are proposing to address. We also summarise our proposed package of measures and highlight the key impacts.

1.1. This document supports our accompanying final proposals document on our package of measures to empower consumers and improve consumers' trust in the gas and electricity retail market and sets out our Impact Assessment (IA) for these measures.

1.2. The purpose of this IA is to explain our proposal to introduce a package of measures to make the market simpler, clearer and fairer. This includes measures covering the supplier cheapest tariff, a Tariff Comparison Rate (TCR), a cap on the number of tariffs, standardised tariff structures, rules on discounts, bundles and reward points, protection of consumers on fixed term offers, rules for collective switching, clearer and simpler information by prescribing information to be provided to consumers, and the Standards of Conduct (SOC). Our analysis indicates that our proposed package of measures is likely to provide a net benefit to consumers.

Barriers to consumer engagement and effective competition

1.3. In our previous Retail Market Review (RMR) consultations, we set out our concerns in relation to the number of consumers currently disengaged from the energy market.[4] Lack of appropriate information and growing complexity of pricing information is making engagement increasingly difficult. This has resulted in a large number of sticky consumers.[5]

1.4. Through our research and consultation process, we have identified a number of barriers that inhibit effective consumer engagement. Many consumers feel frustrated with the energy markets, especially in the face of price increases, have difficulty in identifying the best alternative for their circumstances and find it difficult to make well-informed decisions.

1.5. The key barriers that we have identified to effective consumer engagement and to competition in the energy retail market are:

[4] In our latest tracking survey approximately 63% of consumers report never having switched supplier for gas or electricity - Ipsos MORI, 'Customer Engagement with the Energy Market Tracking Survey 2012, p11, April 2012. This figure should be approached with some caution because it is reliant on respondents' ability to recall their past behaviours, and our analysis of trends over time suggests the tendency to under report previous switching behaviour is increasing. Nevertheless, it does suggest that a majority of consumers perceive themselves to have been largely inactive in the market.
[5] Sticky consumers are those that choose not to switch, cannot switch due to their circumstances, or are put off switching due to other features of the market such as tariff complexity.

- **Tariff complexity:** The quality of consumer engagement is contingent on consumers being confident they can navigate the market, and comfortable that they understand the options available to them. The complexity of tariffs contributes towards the perception of switching as a hassle and means that potential savings are unclear. It also contributes to the lack of consumer trust (see below) as some consumers believe this complexity is a deliberate measure to prevent consumers from finding the best deal for them.
- **Poor information**: Key information is not always provided to them, and the information that is provided is frequently generic or unclear. For example suppliers do not always bring the principal terms of a contract to their customers' attention. While this was a key issue leading to the introduction of some of the Standard Licence Conditions (SLC) following the 2008 Energy Supply Probe (Probe), we have identified only limited improvements in market practices since then.[6] Without the provision of sufficient relevant information, consumers are unable to engage effectively with the market and make well-informed decisions.
- **Lack of consumer trust**: Many consumers do not trust the energy market and have little confidence in how suppliers behave and treat their customers.[7] Lack of transparency can lead to consumers feeling powerless in the face of suppliers' changes to prices and terms of energy contracts. They have a generic negative perception of suppliers and the energy industry, and believe that suppliers are much the same. Many consumers are, for example, sceptical of the benefits of switching, as they believe that the levels of potential savings from switching will be minimal or will not be fully realised over time because the supplier they switch to may raise its prices.[8]

1.6. These barriers prevent consumers from engaging effectively in the gas and electricity markets. They represent a significant barrier to a fully effective competitive energy market. This is also likely to affect market participants, in particular smaller suppliers or potential new entrants, and effectively represents a barrier to entry and expansion in the energy market.

Our proposal

1.7. Following our October 2012 RMR, we have refined our proposals in light of the responses and the additional stakeholder engagement we promoted over the last months. Our present proposed package of measures for tariff simplification, rules on fixed term tariffs, improvements to information, the TCR, the supplier cheapest deal information and SOC is designed to avoid restricting choice for consumers without weakening the impact in addressing the barriers to engagement we have identified.

[6] This is based on Ofgem's internal evaluation of communications undertaken in 2010 and 2011. For SLC 23 and 31A we gathered evidence from the suppliers of the materials they were using for compliance with the conditions, and assessed them against the requirements of the licence conditions.
[7] Energy suppliers are more likely to be distrusted than trusted - Ipsos MORI (April 2012).
[8] Ipsos MORI (January 2012), 'Ofgem Consumer First Panel, Year 4 Findings from first workshops (held in October and November 2011)'. Ofgem's Consumer First Panel comprises around 100 consumers who are broadly representative of the British population. Panellists generally meet three or four times each year to explore a range of issues regarding Ofgem policy. Panel participants change every year.

1.8. Our IA indicates that this package of measures can contribute to building effective consumer engagement. Our proposal includes the following elements:[9]

- **Simpler tariffs**: Suppliers will be required to offer a limited number of tariffs to new customers. The charges and discounts for these tariffs must be simple and understandable. Where appropriate, we also propose that suppliers must close down tariffs not open to new customers where these offer poor value for consumers. We are also proposing to improve consumer protections by amending existing rules, and by creating new rules, particularly for fixed term offers. Automatic contract rollovers to fixed term contracts will be prohibited. In the absence of action on the part of the consumer, the supplier will be required to transfer the consumer to their cheapest evergreen tariff, with no exit fees or notification by consumers. We are proposing additional rules regarding communication/notification of the end of fixed term contracts. Price increases and other adverse unilateral variations will also be prohibited for fixed term contracts (subject to certain exceptions). We also propose to clarify and tighten some existing rules regarding notification of and consent to mutual variations.
- **Making the market clearer:** Our new rules will improve consumers' awareness of alternative tariffs. On routine communications[10] we will require suppliers to provide information on cheaper tariffs for a particular consumer, and a reminder that they can change their tariff or supplier. We are also proposing to create a new tool which is designed to prompt an initial comparison across a range of suppliers called the 'Tariff Comparison Rate'. To ensure consumers make accurate and consistent comparisons, we are also creating a new concept called 'Personal Projection'. In addition, to help consumers compare all features of a tariff we are introducing a 'Tariff Information Label'. The new rules will also ensure that consumers receive all the personalised information they need to switch on their routine communications. This includes details of the consumer's current tariff and their previous consumption over the last 12 months.[11] To ensure this information is clear and easy to understand, we will place some restrictions on how it is presented. For example, requiring suppliers to group similar information together and use clear titles.
- **Fairer treatment:** Our final proposal is to introduce the Standards of Conduct covering all interactions between consumers and suppliers (and their representatives) as a binding licence condition. The SOC is designed to provide greater reassurance to electricity and gas consumers that they will be treated fairly in their dealings with energy suppliers. The SOC are expressed with an overarching objective of treating consumers fairly. The SOC also contain a range of more specific principles covering; supplier behaviour, how suppliers are to provide information to consumers, and suppliers' business processes with the requirement of taking consumer needs into account. This represents a principles-based approach to regulation, as we are not prescribing the exact actions suppliers should take in relation to the SOC. Rather, it will be suppliers' responsibility to treat

[9] The detail on each of the measures we are proposing is included in chapters 4 to 9 of the consultation document.
[10] This includes the Bill (or statement of account}, the Annual Statement, the Price Increase Notification (including other unilateral variations to terms and conditions), and the new End of Fixed Term Notice
[11] Or a supplier's best estimate of consumption for a 12 month period.

consumers fairly and consider how best to meet consumer needs in the context of the SOC.

Summary of impacts

Quantitative impacts

1.9. We expect that the RMR proposals will change consumer and supplier behaviour which, over time, shall facilitate the transition of retail markets towards a more competitive equilibrium. To better understand the main drivers of this process, and to calculate the likely net benefits, we have carried out an ex-ante assessment of the costs and benefits of our proposal. This focuses on three types of effects:

- Engagement/switching effects – our proposals will encourage more consumer engagement, implying a higher number of consumers moving to better deals (provided by the same or another supplier), with bills reducing relative to the counterfactual scenario.
- Tariff narrowing effects – the tariff cap may lead to suppliers removing some of the very best and the very worst tariffs from the market. This will likely improve the situation of the consumers on the worst deals, but reduce the benefits to those who are currently on the cheapest deals.
- Pass-through of implementation costs – suppliers may pass some of these costs on to consumers, depending on the competition and scope for efficiencies existing in the industry.

1.10. These are covered in more detail in Chapter 3.

1.11. To conduct our analysis, given the uncertainty to predict both consumer and supplier future behaviour, we built three scenarios for how our proposals could potentially impact on consumers' behaviour:

- Low impact scenario, where consumers would be mostly unresponsive to our proposals to make tariffs simpler and information clearer. Under this scenario, post-RMR switching levels would not change in relation to pre-RMR levels.

- Medium impact scenario, where consumers would respond to our proposals and engage more with the market. Under this scenario, a higher number of consumers would switch.

- High impact scenario, where consumers would be significantly more responsive to the RMR proposals, and consequently switching rates would increase substantially.[12]

[12] Our analysis is based on the assumption that more engagement leads consumers to switch to better deals and save money.

1.12. These scenarios, while acknowledging the uncertainty in the estimates, aim primarily to indicate a range of potential effects for different outcomes (or different levels of success) related with the implementation of the RMR.[13] By balancing the different scenarios for the potential impacts on consumer behaviour with the different types of effects mentioned above, we estimate a range of possible net impacts from our proposal.

1.13. Our analysis suggests that under the low impact scenario (which assumes no change in the status quo), where levels of consumer engagement/switching would largely remain the same post-RMR, there would be a net cost from implementing our proposal ranging between £1.62 and £2.52 per customer per year (approximately £51 to £79m per year for the energy market). This range of costs assumes implementation costs exist, but there are no counteracting benefits from switching.

1.14. While this scenario represents no incremental change to the level of consumer engagement/switching in the market, there would still be scope for consumer benefits from our proposals.[14] For example, some of the measures we are proposing are designed to improve consumer protection rules. We expect that this would have a positive impact on consumers over time, and would also increase the level of consumer trust in the energy market. In summary, were this scenario to be the more likely one (which our analysis indicates it is not), a market with simpler tariffs, clearer information and that provides consumers with improved protections and a fairer treatment could increase individual consumer annual bills by £1.62 to £2.52.[15]

1.15. If we consider however that our proposed package of measures will lead to a positive impact on consumer engagement/switching (which our analysis indicates as a more likely scenario), the annual net benefit from our proposal linked to switching alone were estimated at around £1.54 to £10.60 per consumer (£49m to £334m per year for the energy market).

1.16. We consider that our proposal would still provide benefits to consumers in a scenario where there would be no material change to consumer switching levels. Our analysis indicates that, under a more likely scenario that our proposals will lead consumers to engage more, limited incremental changes in switching associated with increased engagement could lead to significant net benefits for consumers and the energy market.

Qualitative impacts

1.17. Our qualitative analysis also indicates that our proposed package of measures is likely to provide a direct net benefit to consumers. We expect that our proposal will have an overall positive effect in improving the ability of consumers to pick the best deal for them in the energy market and in widening the pool of consumers who are active in the market.

[13] The purpose of our analysis is not to accurately predict what will be the net impact of our proposal on the energy market, but to provide a range of potential impacts for different levels of success.
[14] These benefits could effectively mean that consumer engagement could increase under the low impact scenario, though the levels of consumer switching would largely remain unchanged.
[15] This excludes the benefits we have not attributed a financial value to.

1.18. Our proposed measures for the supplier cheapest tariff (requiring suppliers to include prompts to engage on all regular communications), and introduction of the TCR as a common currency for use in all marketing materials, are likely to impact positively in raising consumer **awareness** about the alternatives available in the energy market. Consumers are likely to have better **access** to market information as a result of the publication of best buy tables (using the TCR), introducing the Tariff Information Label and publishing information on suppliers' comparative performance.

1.19. Consumers are also likely to face **simpler** choices when they are looking for alternative offers, as a consequence of our measures to reduce the number of tariffs and to introduce rules on the tariff and discount structures. We propose to require suppliers to provide consumers with **clearer** information, including a personal projection of their annual energy costs on each bill, along with the Tariff Information Label and personalised information on the supplier's cheapest tariff. This will enable consumers to better **assess** the alternative offers available in the market, as will clear signposting to switching sites on key supplier communications. Finally, our proposals to introduce enforceable SOC and new rules on contract terms are likely to lead to consumers experiencing a **fairer** treatment in all their interactions with suppliers. The effect of these proposals should be that some currently disengaged consumers gain the confidence they need to look around for the best deal.

1.20. Our proposed package of measures should mean that individual consumers are able to get a better deal in the market. More effective engagement should increase competitive pressures in the market (see Chapter 4) so that the interests of consumers as a whole are better served. Furthermore, a number of our measures should reduce the scope for **individual harm**. For example, the rules on fixed term contracts will prevent consumers finding themselves on deals they did not sign up to. A range of our proposals should mean there is less scope for consumer harm arising from consumers unknowingly switching to tariffs which are more expensive for them. In addition, the standards of conduct should mean there is less individual harm arising from instances of poor supplier conduct.

1.21. We recognise that there is a risk our proposal may also bring some downsides for consumers, but we have looked to mitigate these risks. For example, the gap between engaged and disengaged consumers could widen if our proposed package of measures is not sufficiently robust. To mitigate this risk we have proposed several policies that are targeted at less informed consumers, including providing clear prompts to engagement, the supplier's cheapest tariff messaging on bills, and simplifying/standardising terminology. Given the qualitative benefits that we identified, and the measures that we are putting forward to mitigate risks and potential costs to consumers, our conclusion in this IA is that our proposed package of measures will provide a net benefit to consumers in the GB energy market. The figure below summarises the key impacts of our proposal on consumers.

Figure 1 Summary of impacts on consumers

Proposed measures		Aware of alternatives available	Access market information	Assess alternative offers	Confidence and incentives to Act
1. Simpler tariffs	Cap on tariffs			✓	✓
	Standardisation of structure			✓	✓
	Discounts, bundles, reward points			✓	✓
	Mutual variations, switching windows				✓
	Rules on auto-rollovers			✓	✓
	Rules on unilateral variations				✓
	Collective switching	✓	✓	✓	✓
2. Clearer information	TCR	✓			
	Best buy tables	✓	✓		
	Personal projection			✓	
	Supplier cheapest tariff on bills and Annual Statements	✓	✓	✓	✓
	Prompts on bill, Annual Statements, Price Increase Notifications, end of contract	✓			✓
	Tariff Information Label		✓	✓	
	Info on supplier performance		✓	✓	
	Price Increase Notification and notices for other variations		✓	✓	
	End of contract letter		✓	✓	
	Annual statement		✓	✓	
3. Fairer treatment	Enforceable Standards of Conduct	✓	✓	✓	✓

Source: Ofgem 2013

2. Objectives and approach

Chapter Summary

In this chapter we set out the objectives we aim to achieve with our proposed package of measures. We also describe the approach we follow in assessing the impacts of our proposal, and provide an outline of the structure of the document.

Objectives for the RMR proposals for domestic consumers

2.1. The key objective of our proposals is to enhance effective engagement by consumers, and to strengthen competition in the domestic retail energy market. Within the overall aim of improving effective consumer engagement, we are looking to achieve three objectives with our proposals:

- Make the market simpler, by helping consumers to make cross-market comparisons.
- Make the market clearer, by assisting and prompting informed switching decisions through improved information to consumers.
- Make the market fairer, by providing further consumer protection, promoting improvements in supplier conduct and ultimately building consumer trust, so that they have an incentive to engage in the market.

2.2. We expect that the market will become simpler with the introduction of a limit on the number of tariffs, the standardisation of tariff structures and with the introduction of additional tariff simplification rules (including rules on discounts, bundles and reward points offerings).

2.3. We aim to make the market clearer by providing consumers with personalised information on the cheapest deal offered by their current supplier, and by introducing a TCR and a personal projection, which will make market comparisons easier. We look to achieve a clearer market also through prescribing to some extent the content and format of the key information provided on Bills, Annual Statements, End of Fixed Term Notices and Price Increase Notices, and requiring suppliers to introduce a Tariff Information Label.

2.4. Our proposal to achieve a fairer market includes introducing enforceable SOC, as well as new rules on contract terms around fixed term and evergreen tariffs.

Approach to the IA

2.5. In this section we set out our approach for conducting this IA. We also outline our approach to the qualitative and quantitative assessments of the impacts.

2.6. Our analysis is based on the assessment of our proposal against the counterfactual scenario. The counterfactual (or base case) represents the alternative situation that would exist if our proposal was not implemented.[16]

2.7. The next chapters set out the results of our qualitative and quantitative assessment. The latter, covered in Chapter 3 and 4, is based on possible consumer benefits that come from more engagement and switching, as well as estimates of the cost of RMR implementation. In addition, we consider a range of qualitative impacts, covered in Chapters 3 to 6.

2.8. Our analysis on risks and unintended consequences (see Chapter 7) shaped our proposed package of measures. Our present proposed package considers and, where possible, is designed to mitigate, the risks and unintended consequences that are identified.

Approach to the qualitative assessment

2.9. The purpose of this IA is to assess the impacts of our proposal, and in particular to assess the net impact on consumers. We do this by assessing how likely our proposed package is to achieve the objectives that we set out above. We start by analysing how different aspects of our proposed package of measures are likely to address the barriers to consumer engagement and effective competition. We also assess the distributional effects of our proposal, and how it may impact on competition, sustainable development, and health and safety.

2.10. In defining each one of the measures to include in our proposed package, we have looked at a number of different options. We have analysed each option to decide the optimal measures to include in the package, and/or the optimal design for any specific measure. Chapter 8 sets out the assessment of the different options we have considered for each one of the measures that we include in our proposal.

2.11. In assessing our proposal we look at the impacts that our proposed package of measures may have on effective consumer engagement in the energy market.[17] This includes the impact that our measures have on the incentive on consumers to engage. It also looks at the indirect impact this engagement has on competition and outcomes for consumers.

Approach to the costs and benefits analysis

2.12. We expect that our RMR proposals will produce changes in the behaviour of consumers and suppliers, which, over time, shall facilitate the transition of retail markets towards a more competitive equilibrium. In order to better understand the

[16] The counterfactual is a hypothetical alternative situation that reflects the best judgment as to what would have occurred in the absence of the RMR proposal. This includes, for example, the impacts of policies that have been implemented, but have a delivery date in the future (e.g. the smart metering rollout, the green deal, etc.).

[17] Effective engagement is measured by the level of awareness that consumers may have about alternative offers and potential savings, and their ability to access relevant information, assess this information, and act on it.

main drivers of this process, as well as the main obstacles that may undermine it, we carry out an ex-ante assessment of the costs and benefits potentially associated with our proposal.

2.13. Our approach builds on Ofgem's overall mission to protect consumers' interests, as we assess the impact of our RMR proposals primarily on consumers' welfare.

2.14. We must stress that the quantitative assessment is aimed to better understand/highlight the main drivers of RMR impacts on consumers and competition. To serve this purpose, we make use of stylised assumptions and scenarios which inevitably drive the exercise resulting figures. Therefore, these should not be taken as precise measures of the RMR effects.

2.15. The quantitative analysis is related and complementary to the detailed qualitative assessment. Whereas the qualitative assessment focuses on each individual proposal, the quantitative assessment is concerned with the impact of the overall domestic RMR package. This is measured against a counterfactual scenario reflecting a continuing status quo situation, where RMR proposals are not being implemented.

2.16. To conduct our analysis we consider three key effects:

- Engagement/switching effects – We expect that simplification of tariffs, together with clearer information and more trust in the markets functioning, will encourage, to different degrees and by different channels, more consumer engagement. As a result, a higher number of consumers will be placed on more competitive deals. This could happen through the choice of a cheaper tariff provided by the same supplier, through the customer switching to another supplier offering a cheaper tariff or simply through a price reduction initiated by a supplier to retain its customers.

- Tariff narrowing effects – From a different perspective, our simplifying proposals may lead to the trimming of the cheapest and the most expensive tariffs. Customers who are currently actively engaged may have to move to less competitive deals and could suffer an increase in their bills relative to the counterfactual scenario.[18]

- Pass-through to customers of suppliers' costs for the implementation of RMR proposals – Depending on the level of competition and the scope for efficiencies existing in the industry, suppliers may be able to decide to pass through some of these costs on to consumers.

[18] Conversely, this may also entail a positive impact, as some disengaged customers could be moved off the worst tariffs, improving their situation without taking any action. Actively engaged consumers would still be better off in a post-RMR world when compared with disengaged consumers. However, if this effect is observed, the level of savings they could find in a post-RMR world is likely to be lower than pre—RMR implementation.

2.17. In order to deal with the complexity of these effects, we adopt a stylised scenario approach and other related simplifying assumptions. Also, for simplification and as a result of the high degree of uncertainty surrounding our assumptions, we conduct our analysis as a comparative static exercise, where the calculation of benefits refers to a point in time at which RMR will be fully implemented, and the costs figures reflect the ongoing costs only. The post-RMR scenarios are compared with the counterfactual scenario using previous pricing data, along with implementation cost estimates provided by suppliers.

2.18. After examining several options, we have focused on three post RMR scenarios for the possible benefits:

- Under a "low impact" scenario, we assume that consumer engagement/switching remains unchanged relative to the counterfactual and there is no tariff narrowing effect.
- Under a "high impact" scenario, our proposals will generate a strong positive engagement/switching effect, inducing a significant proportion of consumers to switch to more competitive tariffs relative to the counterfactual.
- Under a "medium impact" scenario, we assume that there will be an increase in the level of engagement/switching, although this will not be as great as that seen under the "high impact" scenario.

2.19. Both the low and high impact scenarios reflect quite extreme representations of the RMR impacts, which provide useful boundaries to the possible range of quantitative outcomes.

2.20. To calculate the costs of our proposals, we extrapolated from those the suppliers provided to us in response to our October 2012 consultation. Considering the range that these covered, we have considered the ongoing costs through 'zero', 'medium' and 'high' scenarios, based on the possible efficiency gains that could be achieved and the level of competition.

2.21. By combining our estimated costs and benefits under different scenarios, we develop a matrix of possible net impacts of our proposals, and come to a conclusion about which scenarios are most likely.

Structure of the document

2.22. The remainder of the document is structured as follows:

- Chapter 3 assesses the impacts on consumers.
- Chapter 4 assesses the impacts on competition.
- Chapter 5 assesses the impacts on sustainable development.
- Chapter 6 assesses the impacts on health and safety.

- Chapter 7 considers risks and unintended consequences.
- Chapter 8 sets out the different options assessed in each of the measures in our proposed package.

3. Impacts on consumers

Chapter Summary

This section sets out the potential benefits for consumers of the domestic RMR proposals. We set out the results of our quantitative assessment, identify the key barriers to consumer engagement, and assess the likely impacts on consumers by analysing how our proposed package of measures addresses these barriers.

3.1. In this section we assess the likely impacts of our main proposals on consumers. We start by assessing qualitatively the impacts of our proposed package of measures on consumers. Based on quantitative and qualitative research, we evaluate how likely our proposals are to mitigate the key barriers to consumer engagement (tariff complexity, poor information and lack of consumer trust) and consider how this will impact consumer engagement and switching behaviour.

3.2. We also consider, in the final section of this chapter, the quantitative assessment of the impacts that our proposed package of measures could have on consumers.

Tariff complexity

3.3. Many consumers perceive that tariffs in the domestic energy market are too complex, with a high number of tariffs and a range of price structures. Those consumers who do attempt to engage have difficulties in assessing their current circumstances against the options available in the market. We have identified a number of causes of complexity in Great Britain's energy tariffs:

- Number of tariffs.
- Structure of tariffs.
- Discounts and bundles.
- Exploitation of limited consumer capacity.

Number of tariffs

3.4. At present, the retail energy market in GB is characterised by a small number of suppliers offering a large number of tariffs. A recent information request to suppliers suggested that the number of tariffs, as of Summer 2012, was around

900.[19] This poses a particular challenge for consumers who are unable or unwilling to use comparison websites to filter options.

3.5. Information provided by suppliers suggests there are over 650 dead tariffs,[20] contributing to complexity in the market and making tariff comparisons more difficult, as it makes it harder to identify the details for current tariff (e.g. on a switching site).[21]

Structure of tariffs

3.6. Suppliers currently structure their tariffs in a number of different ways, for example: with a standing charge and single unit rate, without a standing charge, with two-tiered unit rates, as well as more complex structures such as multi-tiered unit rates. It is estimated that over a third of open non-time of use tariffs (Non-ToU) offered in the market have unit rates that vary by level of consumption.[22] Overall, our understanding from our work in the RMR is that complexity in price structures constrains tariff comparisons, and prevents consumers from understanding their tariff and how their bill relates to the amount of energy consumed.[23]

Discounts and bundles

3.7. Discounts and bundling practices add further complexity to energy tariffs. Suppliers employ a range of discounts, which are often applied inconsistently across different tariffs, and differ between suppliers. Bundling takes multiple forms, as energy products are combined with other products or utilities, vouchers, reward point schemes and insurance premiums such as heating maintenance. Research from Ofcom suggests that bundled markets have the highest levels of switching difficulty.[24] Comparisons across the market become more difficult, due in part to the increased number of variations, and because the bundles available differ across (and within) suppliers.

[19] Source: Ofgem analysis of supplier tariff permutations as at 28 August 2012 using information available from our information request to suppliers. Total includes both large suppliers (including white labels) and six of the small suppliers, all meter types, and payment methods. Numbers are based on London region. Under our updated tariff cap rules, the number of 'core' tariffs would be 500, which relates only to gas and electricity tariffs, and does not double-count where a tariff is available both online and offline.
[20] A dead tariff is an evergreen that serves existing customers but is not open to new customers. We do not include fixed term tariffs in this definition. The rules used for calculating the number of dead are similar to live tariffs, though we include tariffs from all regions. Under our updated definition of a core tariff, the number of dead tariffs as at 28 August 2012 was approximately 360.
[21] Opinion Leader, Report from the Second Set of Workshops, p.26 and 35, 2011.
[22] Ofgem analysis of impact of our tariff structure proposals on availability of current tariffs, as at 28 August 2012, using information available from our information request to suppliers. This analysis was undertaken across both large and small suppliers (including White Labels), all payment types, for standard meters only. Numbers are based on London region. It should be noted that this analysis was undertaken in consideration of percentage reduction in original tariff data, as opposed to reduction in 'core tariffs', which we define in our consultation document.
[23] Ibid.
[24] Ofcom (December 2011), 'The Consumer Experience 2011'. Ofcom suggest that this may be explained by the fact that switchers have to manage multiple processes at the same time.

Exploitation of limited consumer capacity

3.8. Behavioural biases can help explain why consumers find it challenging to engage in the domestic energy market. Our research suggests that consumers exhibit behavioural biases[25] such as loss aversion (a loss has a significantly greater impact on an individual than the equivalent gain)[26] and inertia (consumers are less likely to switch than traditionally suggested).

3.9. These biases, coupled with the issue of tariff complexity, can deter consumers from engaging in the market, cause them to abandon a search if they start one, and leave them unsure if they have chosen correctly (reducing the incentive to engage again).[27]

3.10. Suppliers may have an incentive to take advantage of behavioural economics biases. They may obfuscate prices, increase choice or complexity,[28] or use price promotions to distract consumers and distort decision-making. Suppliers may also take advantage of consumer inertia by increasing switching costs.[29]

Impact of proposals on tariff complexity

Tariff simplification

Number of tariffs

3.11. Our consumer research has shown that many consumers think there are too many tariffs,[30] and consumer group responses to our December 2011 consultation, suggested the high number of tariffs was a significant factor contributing to consumer disengagement.[31,32]Table 1 provides a summary of the number of open core tariffs for non-ToU meters that are available in the market.[33, 34]

[25] Ipsos MORI, (August 2012), 'Consumer engagement with the energy market, information needs and perceptions of Ofgem, findings from the Ofgem Consumer First Panel Year 4: second workshops (held in March 2012)'.
[26] Kahneman, D., Knetsch, J. And Thaler, R. (1990), 'Experimental tests of the endowment effect and the Coase Theorem', *The Journal of Political Economy*, 98: 1325-1348.
[27] Ipsos MORI, (August 2012), 'Consumer engagement with the energy market, information needs and perceptions of Ofgem, findings from the Ofgem Consumer First Panel Year 4: second workshops (held in March 2012)'.
[28] Office of Fair Trading (March 2010), 'What does behavioural economics mean for competition policy?' p.16.
[29] X. Gabaix and D. Laibson, (2006), Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets, Q.J. Econ., 121(2), 505-40.
[30] Ipsos MORI, Ofgem Consumer First Panel, Year 4 Findings from first workshops (held in October and November 2011), January 2012.
[31] Research has shown consumers with limited numeracy/literacy in particular, prefer less choice – FDS International (February 2011), '2011 Vulnerable Customer Research', p.38.
[32] Opinion Leader, Report from the Second Set of Workshops, 2011, p.26 and 35.
[33] Numbers shown for core tariffs are for payment by direct debit. Not all small suppliers offer direct debit as a payment method, hence some core tariff numbers for small suppliers are zero in the table. Also, some small suppliers only offered to sell gas and electricity together as dual fuel rather than individually, hence some named tariff numbers are zero in the table.
[34] We only received data for six of the small suppliers, hence the illustrative cap of 24 core tariffs.

Table 1 Tariff numbers for non-ToU tariffs by supplier type

		Live core tariffs	
		Electricity	**Gas**
Previous incumbent suppliers (incl. White Labels)	Min	6	4
	Max	32	35
	Median	9.5	8.5
	Current total	83	78
	Cap total	**24**	**24**
Small suppliers	Min	0	0
	Max	2	2
	Median	1.5	0.5
	Current total	7	4
	Cap total	**24**	**24**

Source: Ofgem, 2012

3.12. We expect that, under our proposed tariff cap, up to 72 core tariffs per fuel may be available to any particular consumer.[35] Our proposals would reduce the current total of 90 core tariffs by around two-thirds for direct debit electricity standard meter consumers.

3.13. We expect that capping the number of tariffs will reduce complexity. While we recognise that consumer choice can be beneficial, we consider that this is only the case if choice provides products that consumers value. Our evidence shows that consumers think there are too many tariffs, suggesting that the current level of choice is *reducing* consumer engagement.[36,37] Ultimately, we expect a reduction in the number of tariffs will make consumers more receptive to investigating tariffs, and will contribute to increased engagement.

Dead tariffs

3.14. We consider that the number of dead tariffs can hinder consumers from effectively comparing their current tariff with others available in the market, for example when attempting to identify that tariff on a switching site. Table 2 provides a summary of the number of dead core tariffs for non-ToU meters. Analysis suggests that around a third of previous incumbent suppliers' dead tariffs are more expensive than the equivalent live evergreen tariff.[38] Under our proposals, affected consumers would be transferred onto the cheapest evergreen tariff for them. Suppliers will also be required to monitor consumers still on these tariffs to see if they could save money by moving to a live tariff.

[35] This equates to 4 core tariffs x 18 current domestic electricity suppliers = 72 core tariffs in the market. More tariffs could be offered if suppliers make use of the additional tariff allowed for collective switching.
[36] Opinion Leader, Report from the Second Set of Workshops, 2011, p.26 and 35.
[37] Ipsos MORI, Consumer views on Tariff Comparison Rates, Findings from the Ofgem Consumer First Panel Year 4 and new participants: Fourth workshops (held in August 2012), October 2012.
[38] Data based on bill values for the previous incumbent suppliers' evergreen tariffs on a standard meter for median consumption (16,500kwh Gas, 3,300kwh electricity) for all three payment methods.

Table 2 Number of dead non-ToU tariffs by supplier type

		Dead core tariffs	
		Electricity	Gas
Previous incumbent suppliers	Min	3	4
	Max	86	14
	Median	5.5	6
	Current total	112	41
Small suppliers	Min	0	0
	Max	1	0
	Median	0	0
	Current total	1	0

Source: Ofgem, 2012

Structure of tariffs

3.15. Our research showed consumers are confused by the structure of tariffs, and the format and presentation of tariff information.[39,40] Qualitative research undertaken in Summer 2011 considered a number of options for limiting the structure of tariffs.[41] Restricting standard tariffs to the standing charge and single unit rate method of charging, and eliminating more complex methods, was considered to be a helpful change. A standing charge presented as a fixed cost was seen as being in line with how consumers budget. Our proposal to standardise tariff structures to a standing charge and unit rate will help to make the presentation of tariffs simpler, which will match consumer preferences. The Tariff Comparison Rate (TCR) is being introduced alongside this to provide a single number that consumers can use to compare tariffs.

Discounts and bundles

3.16. Evidence from October 2012 consultation responses suggests that a balance needs to be struck between reducing complexity and maintaining those discounts valued by consumers. Our final proposals will thus allow certain types of discounts to be offered if they are set out in compliance with are rules which our outlined in the March 2013 RMR consultation document. We expect this will give suppliers a sufficient degree of commercial freedom to offer the discounts that consumers' value.

[39] Opinion Leader (March 2009), 'Ofgem Consumer First Panel: Research Finding from the Second Events – Billing Information and Price Metrics' and Opinion Leader (October 2009), 'Ofgem Consumer First Panel: Research Finding from the Third Events'.
[40] Ipsos MORI, Consumer engagement with the energy market, information needs and perceptions of Ofgem, Findings from the Ofgem Consumer First Panel Year 4: second workshops (held in March 2012), August 2012.
[41] Creative Research (October 2011), 'Tariff Comparability Models, Volume 1 - Consumer qualitative research findings'.

3.17. Our proposals also allow suppliers to freely offer bundled products and services in the energy market, provided they are available to all consumers as an optional bundle available with all core tariffs or tied to a specific core tariff. For bundles which are also considered a discount (i.e. a non-cash product/service which a consumer receives but does not have to pay an additional amount for) will also be allowed however, they must be applied continuously and the bundle rules, as set out in the consultation document, will apply.

3.18. Our September 2012 information request to suppliers showed there are 44 different bundles and services in the market, with energy services bundled with other products and services such as insurance products for home care, reward points, vouchers and charity donations. Many of these are offered as 'tied' bundles, i.e. they are only available with specific tariffs. We consider that this causes undue market complexity. Under our tariff simplification proposals we will require suppliers to offer these tied products and services to only one specific core tariff to help consumers navigate through choices in the market more effectively.

Protecting consumers on fixed term offers

3.19. It was noted in our Tariff Comparability Quantitative Research that the consumers questioned would probably choose fixed term tariffs if they were available. When asked which they would probably choose, 53 per cent of consumers chose fixed, 11 per cent chose tracker and 6 per cent chose variable price tariffs.[42]

3.20. Prohibiting price increases and other adverse unilateral variations will simplify the fixed-term tariff market for consumers. However, we do not want to constrain innovation in the fixed term market, so our proposed rules will allow suppliers to offer tracker and variable price tariffs, provided the details of how the tariff will vary is set out clearly in advance.

3.21. Our rules will prevent suppliers from automatically rolling consumers from one fixed term offer to another when their existing fixed term deal ends. This will standardise and simplify the process across the industry and protect consumers from uncompetitive fixed term offers that may charge a termination fee.

3.22. These proposed rules provide additional benefit to consumers by reducing barriers to accessing fixed price products, providing additional predictability and certainty, and reducing complexity in this market.

TCR

3.23. Evidence from our consumer research and behavioural economics studies[43] tells us that consumers have limited capacity when it comes to comparing pricing

[42] Ipsos MORI 'Consumer reactions to varying tariff comparability, Quantitative Research conducted for Ofgem', October 2011.
[43] Ofgem, What can behavioural economics say about GB energy consumers?, March 2011.

information.[44] The TCR is intended to remedy this by providing consumers with a single number that will give them an indication of the relevant price of a tariff.

3.24. The introduction of this generic metric is intended to simplify the initial point of comparison for consumers. Overall, many consumers we consulted found the TCR concept appealing and our research indicates it will increase awareness of alternative offers and potential savings.[45]

Poor information

3.25. Unclear, incomplete or complex information is a significant barrier to consumers' effective engagement. Research by Consumer Focus suggests that many consumers are not aware they have received key information about their energy tariff and key terms on their Bill and Annual Statements.[46] Even once engaged with the market, consumers require certain information, such as their consumption level, to help them make appropriate choices.

3.26. To engage effectively with the market consumers need to be **aware** that there are alternative offers available, and to be incentivised and able to **access** and **assess** these alternatives.[47]

3.27. However, we have identified a number of barriers that prevent effective consumer engagement. These include:

- Insufficient quality of information provided to consumers by suppliers.
- Consumer misconceptions about suppliers and the energy market.
- Insufficient trigger points for consumers to engage with the energy market.

3.28. Suppliers are in most cases the only source of key energy information for consumers. However, a review of the information provided by suppliers to domestic consumers in recent years has shown that important information is often generic or incomplete.[48] Some suppliers provided information in a way that did not appear to meet the spirit of the Supply Licence Condition (SLC) introduced as part of the Probe, and in some cases key information was not being provided on communications.[49]

[44] Ibid.
[45] Ipsos MORI (October 2012), 'Consumer views on Tariff Comparison Rates, Findings from the Ofgem Consumer First Panel workshops held August 2012'. The research tested the overall TCR concept and four distinct scenarios which illustrated different options for how the TCR might work in practice. Participants were asked to comment on each scenario separately, on individual elements of scenarios, and on the potential impact of the TCR on their switching behaviour and overall engagement.
[46] Consumer Focus (October 2010), 'Informing choices – consumer views of energy bills'.
[47] OFT (2010), 'What does behavioural economics mean for competition policy?', p.15-16. See also Chapter 1 in the consultation document.
[48] Ofgem's internal evaluation of communications undertaken in 2010 and 2011. For SLC 23 and SLC 31A we gathered evidence from the suppliers of the materials they were using for compliance to the conditions, and assessed them against the requirements of the licence conditions.
[49] Ofgem's internal evaluation of communications undertaken in 2010 and 2011.

3.29. Information barriers are significant: approximately one in five of those who have never switched supplier are unaware that they can do so.[50] Similarly one third of those who report they have not switched to a different tariff or payment method in the last year were not aware that they could do this with their current supplier,[51] with some consumers believing that suppliers would have already put them on the best available tariff.[52] Even consumers who do switch suffer from some confusion, for example, it is often assumed that fixed term tariffs have a fixed price, when this is not necessarily the case.[53]

3.30. Due to this lack of awareness and confusion, many consumers feel powerless[54] when faced with price increases and other adverse changes made by suppliers, therefore these changes do not act as triggers for consumers to engage in the market.

3.31. The lack of complete, relevant information in supplier communications has resulted in information asymmetry on the consumers' side, and constrained their ability to engage effectively with the market.[55]

Impact of proposals on poor information

Supplier cheapest deal

3.32. As noted above, some consumers are unaware that they could switch to a cheaper tariff or payment type with their current supplier. Requiring suppliers to provide information about their cheapest tariff will directly address this issue. Consumers will receive information on the best priced options available to them. Tailoring this information to the consumer, for example by considering their current circumstances, will also help raise a consumer's awareness of different features of their energy supply. The cheapest tariff messaging and signposting will need to be clear and self-explanatory to be effective, and this is one of the reasons for its inclusion on the front page of the Bill and Annual Statement.

3.33. Our research suggests that providing consumers with information on cheaper tariffs that are available from their own supplier is regarded as helpful by some and is likely to act as a trigger, encouraging moving to better deals with their current supplier[56]and potentially other forms of market engagement.[57] We expect that with improved understanding of the costs of different offerings, more consumers will

[50] In 2012, 80% of those who had never switched reported being aware it is possible to switch supplier. Ipsos MORI (January 2012), 'Customer Engagement with the Energy Market - Tracking Survey', p.52
[51] Ipsos MORI (January 2012), p.52.
[52] SPA Futurethinking (October 2012b), 'Energy Bills, Annual Statements, Price Increase Notification letters and tariff information labels: proposals for consumer testing'.
[53] Evidence on the misunderstanding of fixed term tariffs is available in qualitative and quantitative research. See Creative Research (October 2011) and Ipsos MORI (October 2011).
[54] Ipsos MORI, Ofgem Consumer First Panel Year 4, Findings from first workshops (held in October and November 2011), January 2012.
[55] Anecdotal complaints/contacts information to Ofgem, Consumer Direct and Ombudsmen also indicated that some consumers received mis-information or insufficient information from suppliers (e.g. unclear information, price increase information was not personalised, etc.).
[56] SPA Futurethinking (October 2012b).
[57] Ibid.

compare the product they receive with others on the market. This may help them realise that better options are available, thus making the market more transparent and / or prompting them to consider switching.

Clearer and simpler information

3.34. Consumers need to be confident that they can navigate the energy market, and understand the options available to them. To achieve this we are making communications simpler and more consistent by standardising elements of the format, content and language of key documents. This will address some of the gaps we identified above, where consumers were provided with generic, incomplete or unclear information, to ensure that a communications' purpose is clear and key information is better understood.

3.35. The following section outlines the impacts of our proposals on consumer knowledge.

Prescribing content of key information channels

3.36. Requiring suppliers to provide additional information that currently is not readily available, such as personalised tariff details and key contract terms, will help empower consumers to understand their tariff and energy options. Reinforced requirements for signposts to switching and impartial advice will provide consumers with additional trigger points for considering their energy options and engaging with the market.

3.37. The proposals will also ensure key communications are distinct and their purpose clear, for example by requiring a title. Our research shows that if a purpose of a communication is unclear then consumers are less inclined to engage with it. Similarly, overly complex and lengthy information also acts as a barrier.[58]

3.38. Consumer testing of required content on our proposed communication templates showed that most consumers considered them effective in two key respects: firstly in conveying the priority information they expected to see and felt they needed, and secondly in providing key messaging and information that could prompt them to engage in the energy market.[59]

Tariff Information Label

3.39. The Tariff Information Label (TIL) is designed to help consumers compare energy tariffs. Academic language research provided insight into appropriate

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[58] Ibid.

[59] We tested with consumers our information templates for the Bill, Annual Statement, TIL and Price Increase Notifications. They were also effective in allowing the consumer to see key information that they would expect to be able to find very easily and quickly (such as how much to pay and by when on a bill). For more information see SPA Futurethinking (October 2012), 'Energy bills, annual statements, price increase notification letters and tariff information labels: proposals for consumer testing'.

terminology and structure of the Label.[60] Consumer research indicated that the items included in the Label are useful to consumers (such as tariff end date, if applicable, information on their spend and usage, and information that would help them easily compare one tariff against another), and that many consumers see value in a tool that allows them to compare tariff features more easily.[61]

Standardisation of key terminology

3.40. To improve the quality and accessibility of the information available to consumers, we are making recommendations for the language and terminology used by suppliers to be clear and understandable.

3.41. This draws on the findings of linguistic experts,[62] design experts and findings from our consumer research.[63] Our recent consumer testing – alongside the wider evidence base - suggests communications should be clear, easy to read and understand, and free from jargon.[64] Our Consumer First Panel research suggests that improving the design and content of supplier communications will not have a radical effect on market engagement until the majority of the terms and concepts used are properly understood by consumers.[65]

3.42. However, instead of prescribing the exact wording of all documents, in most cases we are only strengthening requirements for content to be communicated in plain and intelligible language, and making recommendations for industry to standardise some of the terminology used across key documents. Language is only prescribed in cases where consistency and clarity are most crucial for consumer understanding, such as the title of some documents and the provision of an impartial switching reminder. We are also introducing a glossary of key terms on the Annual Statement and a 'Frequently Asked Questions' box on the Tariff Information Label to increase consumer literacy of their energy information. This should ensure that there is clarity in the communication of key information but sufficient flexibility for suppliers to tailor communications to their specific customers and apply style and tone as they see appropriate.

3.43. The Consumer Bills and Communications Round Table Group[66] is in the process of identifying those terms which are particularly hard for consumers to understand, as well as those which suppliers use in different ways, and drawing up a short list of standard terms to be used across the industry.

[60] Lawes Consulting and Lawes Gadsby Semiotics (November 2011a) and Lawes Consulting and Lawes Gadsby Semiotics (November 2011b), 'Notes on the Tariff Information Label' (as yet unpublished).
[61] Ipsos MORI (January 2012) and SPA Futurethinking (October 2012a).
[62] Lawes Consulting and Lawes Gadsby Semiotics (November 2011a).
[63] Ipsos MORI (January 2012).
[64] SPA Futurethinking (October 2012a).
[65] Ipsos MORI (January 2012).
[66] Please find information on the Consumer Bills and Communications Round Table Group and published documents on our website: http://www.ofgem.gov.uk/Markets/RetMkts/consumer-bills-and-comms-round-table/Pages/index.aspx.

Standardising format of key information channels

3.44. Our proposals to prescribe and standardise the format of some elements of communication channels will ensure important information is presented clearly to consumers.

3.45. Our research indicates that consumers have the potential to benefit from initiatives to standardise and improve communications from energy companies. Introducing standardised formats for key information, such as the tabular format developed for the pricing information on a Price Increase Notice and the Tariff Information Label, can increase transparency and facilitate easier comparisons of suppliers and tariffs on a like-for-like basis.[67] Prescribed layout for the content on an Annual Statement enables this to be differentiated from a Bill and for consumers to gain familiarity with its purpose and content over time.

3.46. However, allowing some flexibility in the format and layout of these communications will allow the presentation of this information to be optimised and adapted by suppliers over time to ensure the content remains engaging, relevant to the consumer and can adapt to evolving market developments.

Summary of information improvements

3.47. Our research has identified the key steps consumers go through when assessing their energy options.[68] We have designed our proposals having regard to how they will impact upon the various stages of a consumer's 'journey': the stages can be characterised in terms of the steps a consumer may take to explore their energy options, the information they would require, and the sources from which they could get this information.[69] Each of the communications for which we are proposing changes may have an impact on multiple stages of the consumer journey, and will act as prompts to engage in the market.

3.48. While we recognise certain pieces of information will appear on multiple communications as a result of our proposals, repetition is necessary in some circumstances in order to reinforce particular messages and to meet the needs of a diverse set of consumers.

3.49. By looking at the overall purpose of the communications, and combining this with our understanding of different consumer journeys,[70] we can see the strength of

[67] These formats were produced through an incremental development process, informed by work with design and language experts, findings from consumer research and various rounds of testing. See SPA Futurethinking (October 2012), 'Energy Bills, Annual Statements, Price Increase Notification letters and Tariff Information Labels: proposals for consumer testing'.
[68] Ipsos MORI, Consumer engagement with the energy market, information needs and perceptions of Ofgem, Findings from the Ofgem Consumer First Panel Year 4: second workshops (held in March 2012), August 2012.
[69] Broadly speaking, these stages are mapped out in terms of triggers/prompts, current tariff features, energy usage information, alternative tariff options, best fit for the consumer, savings or gains available, and ultimately the decision to switch or not.
[70] Ipsos MORI, Consumer engagement with the energy market, information needs and perceptions of Ofgem, Findings from the Ofgem Consumer First Panel Year 4: second workshops (held in March 2012), August 2012.

the package at delivering more effective consumer engagement. Our final proposals, which balance consistency and prescription with flexibility and room for adaptation to consumer needs and market developments, have been informed by ongoing dialogue with stakeholders at working groups[71] and the output from the Consumer Bills and Communications Round Table Group.[72]

Introducing a TCR and personal projection metric

3.50. By expressing the tariff price as a single number, the TCR will make it easier for consumers to access tariff information and look at the differences between a range of tariffs. The TCR is intended to act as an initial (generic) point of comparison for a consumer, whereas the personal projection provides a more accurate, personalised figure of what a consumer is likely to pay on a given tariff.

3.51. By improving the understanding of the costs of different tariffs, the TCR and personal projection will make it easier for consumers to compare tariffs on a like-for-like basis. This may help consumers realise when better options are available from other suppliers, thus affecting their perception of satisfaction and / or prompting them to consider switching. This should also improve consumers' knowledge of the market and, in particular, of which tariffs might save them money if they were to switch. Over time, we expect the TCR and personal projection to become familiar concepts to consumers and boost their confidence when engaging with the market.

3.52. Engaging with suppliers is an important step in increasing consumers' knowledge about the energy market. As a single metric included on a number of key communications, and potentially available more widely in best buy tables, the TCR will increase the number of triggers for consumers to engage, empowering consumers to compare different tariffs easily. In addition, the personal projection will reinforce these triggers by tailoring the metric to a consumer's level of energy usage. The personal projection is also a key feature of the 'cheapest tariff' messaging, providing additional prompts to consumer engagement. Our rules require that the personal projection must be used in direct sales, which will increase consumer confidence that the quote they are given is tailored to their circumstances.

3.53. Respondents to our October 2012 RMR consultation document were concerned that the proposed national TCR would be confusing for consumers and could lead to strategic responses from suppliers. Under our final proposals, the TCR will be set on a regional basis, providing the costs for a medium energy user. This will ensure that the TCR is tailored specifically to the costs in consumers' local area, and reduces the risk that consumers will be misled with regard to the relative price of tariffs. Furthermore, regional TCRs will require fewer 'health warnings' than national

[71] Ofgem has held a range of working groups with stakeholders since the publication of the October 2012 RMR consultation to further develop our proposals. Agendas and minutes of these meetings are available here: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/stakeholder-engagement/Pages/index.aspx .
[72] Please find information on the Consumer Bills and Communications Round Table Group and published documents on our website: http://www.ofgem.gov.uk/Markets/RetMkts/consumer-bills-and-comms-round-table/Pages/index.aspx .

average TCRs, and so the risk of consumers disengaging due to dense, confusing text is mitigated somewhat.[73]

Standards of Conduct (SOC)

3.54. Under the proposed SOC, suppliers (and their representatives) will be required to consider consumer needs and to treat all consumers fairly. As outlined in the licence condition, this includes providing information to a consumer (whether in writing or orally) that is complete, accurate and not misleading. Suppliers will also be required to communicate effectively to consumers. They will be required to present information which is relevant to the consumer and is fair in terms of content and how it is presented. The SOC will therefore contribute to the improvement of the quality of information consumers receive from their suppliers. This in turn can help consumers to understand their energy tariff and the options available to them.

Protecting consumers on fixed term offers

3.55. Our proposals related to auto-rollovers, particularly End of Fixed Term Notices, address the lack of information and clarity in suppliers' communications to consumers on these tariffs. First and foremost, the notification that will be provided no earlier than 49 calendar days and no later than 42 calendar days before the end of the contract will ensure consumers understand what will happen if they do not take action. It will also prompt consumers to act, providing them with the TCR, information on the cheapest tariff available from their supplier, and a signpost to switch or seek independent advice.

3.56. The prohibition on price increases and other adverse unilateral variations within fixed term contracts will directly target the lack of predictability for consumers who are on these deals. It will contribute to improving consumers' understanding of the fixed term market.

Lack of consumer trust

3.57. Our research suggests that some consumers do not trust energy suppliers to be open and transparent when they deal with them.[74] In the 2008 Probe, we outlined that the energy market had the lowest consumer confidence of 50 surveyed sectors. A similar report for Consumer Focus in 2009 also found energy as the lowest ranked sector for customer service.[75]

3.58. The causes of the lack of consumer trust that we have identified include:

- Consumer perception of suppliers' excess profits.

[73] Where possible, we have sought to simplify the information provided alongside the TCR. Where a TCR is presented to a consumer for a tariff that is not their own, a more extensive field of supporting information will be required to feature alongside the TCR.
[74] Ipsos MORI, Customer Engagement with the Energy Market - Tracking Survey 2012, April 2012.
[75] Ipsos MORI (August 2008), 'Customer Engagement Survey Report prepared for Ofgem' and Ipsos MORI (March/April 2009), 'Report on the 2009 Consumer Conditions Survey' p.4.

- Negative consumer experiences in their interactions with suppliers in the energy market.
- Poor information available to consumers.

Consumer perception of suppliers' excess profits

3.59. The overall perception of the energy industry is fairly negative and rarely rises above neutral.[76] The negativity on the whole is a result of perceptions of excess profits, which is seen as particularly unfair because suppliers provide an essential service. Where consumers feel their energy supplier has treated them poorly, this exacerbates their negative feelings regarding profits.[77]

Negative consumer experiences

3.60. Experiences that are not in line with consumer expectations with regard to their interactions with suppliers are a driver of lack of trust in energy suppliers and the market. Many consumers cannot understand why suppliers do not improve customer service, and feel this should be a basic aspect of the energy service they provide.[78] As noted above, this frustration is closely linked to lack of trust in individual energy suppliers and with the industry more broadly. This may lead to reduced engagement amongst consumers and ultimately lower competitive pressure.[79]

Poor information available to consumers

3.61. In the previous section we discussed how the lack of clear information contributed to low levels of consumer knowledge about the energy market. Consumers may therefore lose interest in the energy market, and lead to the end product being viewed as 'all the same'.[80]

Impact of proposals on lack of consumer trust

SOC

3.62. Requiring suppliers to treat consumers fairly and take their needs into account will improve supplier behaviour and ensure consumers are better protected. Enforceable SOC will also help improve consumers' experience of interactions with suppliers and the market, and consequently improve levels of consumer trust in the industry. Additionally, the principles-based approach to regulation provides suppliers with the ability to be flexible, innovative and outcomes-driven in delivering the SOC.

[76] Insight Exchange, Consumer research and collaborative engagement on the proposed Standards of Conduct – Domestic Customers (October 2012).
[77] Ibid.
[78] Ipsos MORI, Ofgem Consumer First Panel Year 4, Findings from first workshops (held in October and November 2011), January 2012.
[79] Ibid.
[80] Ibid.

3.63. In our consumer research, we found that most consumers agree that the SOC should be introduced, and were surprised such protections were not already in place.[81] For those that have had poor experiences, they felt that if suppliers adhered to the SOC, supplier conduct should improve. There was some cynicism about whether these SOC will be sufficient and consumers noted the need for 'government' (or some other body) to ensure supplier actions are in line with such practices.[82]

Clearer and simpler information

3.64. We consider our proposals to improve the quality and accessibility of information in the energy market will have a positive impact on consumer trust. As discussed above in the context of market complexity, consumers value communications from their energy suppliers that are: short (and succinct), easy to read and understand, personalised, and free from jargon.[83] We have designed our information remedies with these preferences in mind, to create a market consumers will understand and as a result are more likely to trust.

TCR

3.65. We consider that as consumers use and become more familiar with the TCR and personal projection, they will gain confidence that they can assess and access the best offer for their circumstances, though they will not be able to do this with as much confidence if they are a low or high energy user. This increased understanding, empowerment and confidence should have a positive impact on consumer trust in the market.

Tariff Simplification

3.66. It is clear from our research that tariff complexity and the number of tariffs causes frustration amongst consumers.[84,85] They find it difficult to determine if they are on the best deal for their circumstances. Our proposals to simplify tariffs will help to distinguish between suppliers' unit prices, discounts and bundled offers and services. It will be easier for consumers to compare tariffs (and suppliers) against each other. In addition, the tariff cap will reduce the risk of suppliers introducing multiple tariffs that are not distinct from one another, meaning the scope to confuse consumers will be reduced.

3.67. We expect that our proposals will help consumers feel confident that tariffs are transparent and that tariff information (in terms of discounts and the structure of tariffs) is standardised. If consumers are satisfied that Ofgem, as a body independent from suppliers, has led and directed tariff simplification, there is a greater chance that they will have faith in the process and its outcomes. Over time,

[81] Insight Exchange (October 2012).
[82] Ibid.
[83] SPA Futurethinking (October 2012a).
[84] Insight Exchange (October 2012) p.3 and 14.
[85] Ipsos MORI, Consumer views on Tariff Comparison Rates, Findings from the Ofgem Consumer First Panel Year 4 and new participants: Fourth workshops (held in August 2012), October 2012.

we expect that tariff simplification will lead to more consumers engaging in the market.

Protecting consumers on fixed term offers

3.68. A prohibition on price increases and other adverse unilateral variations, together with our proposals to tighten the rules for mutual variations, will provide additional protections for consumers on fixed term offers. Our proposals for improving communication of the terms of fixed term contracts should also increase consumer trust in the market.

3.69. The impact of our proposals on auto-rollovers will also increase the trust of consumers in the market. It will protect consumers from being rolled onto an inappropriate or more expensive fixed term tariff, and create a space ('trigger point') for consumers to be able to change tariff without incurring switching costs such as termination fees. We will also require a price protection window covering the entire switching process. In addition, our proposals will prevent consumers from being 'locked in' to another fixed term tariff, in the case that they do not act by the end of their contract period.

Engagement: quantity and quality

3.70. Our latest consumer engagement tracking survey shows 63 per cent of gas and 65 per cent of electricity consumers say that they have never switched supplier.[86] A fifth of those who say they've never switched for either fuel believe switching is a hassle.[87] Qualitative research suggests this is a commonly held belief among all but a minority of engaged consumers: many believe it will be a time consuming and potentially problematic experience, either because they have experienced this in the past, know others who have struggled or not gained, or just assume it will be difficult.[88]

3.71. Our evidence shows that many consumers find it difficult to assess whether they will gain financially from switching their supplier. Around a quarter of those who have switched are not confident that they saved money.[89] Many believe financial gains will be small or temporary, and so do not investigate further. Many simply feel that the amount of time and effort required to navigate their energy options is disproportionate to what they believe they would ultimately gain.[90]

[86] Ipsos MORI (April 2012). We recognise that these figures are reliant on the respondents' ability to recall their past behaviours, and our analysis of trends over time suggests the tendency to under-report previous switching behaviour is increasing. Nevertheless, it does suggest that a majority of consumers perceive themselves to have been largely inactive in the market.
[87] Ipsos MORI (April 2012).
[88] Opinion Leader (March 2011), Ipsos MORI (January 2012), (August 2012).
[89] Ipsos MORI, Customer Engagement with the Energy Market - Tracking Survey 2012 (April 2012).
[90] Ipsos MORI (March 2012).

Impact of proposals on engagement

Consumers' ability to assess alternatives

3.72. Our proposals to standardise tariff structures and discount and bundling practices will help to simplify the price comparison exercise. When choosing between different offers, consumers will have less variation to consider and be more confident in the market. We expect that this will help them assess more easily which tariff offers the best price including any discounts and / or bundled offers.

3.73. Presenting key tariff information in a Tariff Information Label should also help to improve consumers' ability to compare tariffs. Research aimed to test the Tariff Information Label with consumers showed that while some less engaged consumers may find the Label to be too much information, others respond well to the concept and say that the information would be useful if they were considering switching.[91]

3.74. By requiring the existing supplier to provide information about their cheapest tariff, we effectively present a default option for consumers, prompting them to engage with their supplier and move to the cheapest tariff or to use this information to search for more options in the rest of the market. If aiming to engage consumers and prompt them to consider their energy options, the key aspects of any improvements to supplier communications should be providing personalised saving messages, signposting impartial switching advice and consumer rights information.

3.75. By making comparisons between tariffs easier, the TCR tackles directly the 'hassle' factor (i.e. time and effort required) in exploring the market. This could lead to increased rates of regular switching and decrease the proportion of consumers that report they have never switched.

3.76. Furthermore, as a generic metric, the TCR can feature in non-personalised advertisements or best buy tables. This allows the information to come to the consumer, and should prompt more frequent engagement.

3.77. In addition, if a consumer decides to switch - in response to a price increase, or at the end of a fixed term contract - we are proposing to remove the requirement that they must notify their supplier of their intention to switch. This should also simplify the process for consumers.

3.78. Our proposals for the SOC will also support engagement, ensuring that consumers are confident to interact with suppliers in a market where they know they will be treated fairly.

3.79. Collective switching has potential to increase levels of engagement especially amongst vulnerable and disengaged consumers. Our rules will facilitate the development of this mode of engagement, whilst meeting the broader aims of RMR.

[91] SPA Futurethinking (October 2012a) and DECC (March 2010), 'Quarterly Energy Trends', p.48-49.

Incentives for consumers to act

3.80. Our quantitative evidence suggests many consumers could save money by switching tariff or supplier. For instance, according to figures from 2010, 75 per cent of domestic consumers were on standard variable tariffs with their supplier. These tariffs generally feature in the middle of the price range at any one point in time.[92] These levels of potential savings indicate that there are real benefits to consumers from engagement. We expect that this, boosted by the effects of our proposal on the consumers' ability to access information and assess alternatives, should provide a strong enough incentive to make consumers overcome the hassle of switching.

Quantitative assessment of costs and benefits to consumers

3.81. Throughout the RMR process we have emphasised the need to improve the level of consumer engagement in the energy market. The level of consumer engagement feeds into the competitive pressure felt by suppliers, which is considered in greater detail in Chapter 4.

3.82. In this section we set out our quantitative assessment of the costs and benefits to consumers from the introduction of the RMR package. We start by setting out our framework for conducting this assessment. We then asses both the costs and benefits to consumers that are likely to result from implementing the RMR. Finally, we weight these against each other in order to assess the anticipated net impact of our RMR package.

Framework

3.83. The RMR package as a whole is intended to facilitate greater, and improved, consumer engagement in the retail energy market. We consider that our package of remedies will bring significant qualitative benefits to consumers. However, we acknowledge that the implementation of RMR will impose costs on suppliers, which may be passed through, in whole or in part, to consumers. Offsetting this, we consider that greater consumer engagement has the potential to have quantitative benefits to consumers, achieved through improved switching.

3.84. Predicting how consumers' behaviour will change in response to our proposals is an extremely difficult exercise. In order to overcome these difficulties, we build different scenarios based on the level of engagement amongst consumers in order to produce a range of potential outcomes or RMR, and their quantitative impact on consumers.

3.85. The results of these stylised scenarios are not intended to represent an accurate picture of the net monetary impact of RMR, but rather to act as an indicative estimate of the range of potential outcomes.

[92] See DECC's energy Trends and Quarterly Prices. Dataset available at: www.decc.gov.uk/assets/decc/statistics/source/prices/qep271.xls.

Approach to costs

3.86. We first assess the implementation costs suppliers are likely to incur. We do this by analysing data provided to us by suppliers in which they set out their estimated costs for each of our separate proposals.[93]

3.87. We did not receive data from all suppliers, and parts of certain responses were incomplete. Further, the estimated costs were inconsistent in certain cases. To address this, we used the information we did receive to extrapolate for the industry as a whole. We also explored the possibility that suppliers could make efficiency savings by calculating the 'median' industry costs. Both of these approaches represents a 'best guess' and we discuss the advantages and disadvantages of both in the costs section.

Approach to benefits

3.88. We then look at the quantitative benefits likely to be seen by consumers as a result of RMR. Our assessment of quantitative benefits is based on the level of engagement we expect to see in the market after implementation.

3.89. We make the assumption that the more engaged a consumer is, the less they are likely to be paying for their energy in £/annum terms. We make this assumption on the basis that the more engaged a consumer is, the more likely they are to be able to identify savings and make effective switching decisions.

3.90. Research conducted by Ofgem has shown that the most active customers tend to have access to the internet,[94] and pay by direct debit. From analysis of the price of tariffs available in the market, we know that the cheapest available tend to be online direct debit tariffs.

3.91. We acknowledge that more engaged consumers may not necessarily choose a tariff based on price, but may choose to switch to a more expensive green tariff, or a niche supplier. We know that a certain proportion of consumers do not make switching decisions based primarily on price.[95] However, we consider that, for their preference, the majority of consumers will look to find the minimum cost option.

3.92. The levels of engagement we use for our scenarios are intended to be indicative of how consumers are likely to respond to our RMR package of remedies. We recognise, however, that there are numerous factors in the wider market that may influence this outcome, including the degree of energy policy fatigue amongst consumers, who may have disengaged from energy entirely. While this issue is, to a certain extent, outside of our control, we consider that the research we conducted on our package of measures indicates that they are likely to have a positive impact on

[93] This data comes from a Request for Information (RFI) to suppliers, the details of which are covered later in this chapter.
[94] Ipsos Mori, 'Customer Engagement with the Energy market' – Tracking Survey 2012, April 2012.
[95] Ibid. Our research shows that for 77% of electricity switchers, and 76% of gas switchers, price was the primary factor that influenced their decision.

the majority of consumers. Further, given the high profile of energy issues in the media at present, we consider this will reinforce consumers' recognition of the changes introduced by Ofgem.

Net impact

3.93. We then compare our annual costs and benefit results to assess, firstly, if we think it likely that RMR will have a positive quantitative impact on consumers, and secondly to establish an order of magnitude for what the benefit is likely to be.

3.94. To facilitate the comparison of costs and benefits, we conduct our analysis based on annual figures, at a point in time in which RMR has been fully implemented. Our cost-benefit analysis therefore relies on comparative statics, comparing the state of play at present to the 'post-RMR world'. We recognise that this does not take account of timing factors such as the length of time it will take for policies to be implemented or for changes to permeate consumers' awareness. There is a risk, therefore, that consumers may feel the costs of our policies before they feel the benefits. However, we consider that this is unlikely to change the overall balance between costs and benefits in the long term.

3.95. In the scenarios considered, our counterfactual is that without the RMR, the current status quo will prevail. While we acknowledge that there are a large number of factors in the energy industry that could influence the market and bring about change, for the purpose of this assessment we consider our approach to be appropriate.

3.96. We consider the costs and benefits of the RMR package as a whole, rather than attempting to assess the net impact of each of our separate proposals. This is partly due to the fact that the implementation costs data we have received from suppliers is insufficiently detailed to conduct such an assessment, and partly due to the fact that a number of our proposals have similar aims. In order to simplify the exercise we therefore consider it prudent to take an overarching view of the package.

Costs from implementing our proposal

3.97. Our RMR package is composed of a wide variety of remedies aimed at tackling the problems facing consumers in the retail market. The introduction of these remedies is likely to result in significant costs, both initially and on an ongoing basis, to suppliers. In this section we assess the likely magnitude of these costs, and what the potential impact per customer will be.

3.98. Firstly, we set out the costs that suppliers have estimated they will incur through implementing RMR and an approach for extrapolating these costs to industry level. Secondly, we assess suppliers' rationale for the costs they have submitted, focusing on high-cost outliers. Finally, we discuss whether any efficiencies could be achieved on total extrapolated costs.

October 2012 RMR

3.99. In the October 2012 RMR consultation document and accompanying Impact Assessment, we posed a series of questions on RMR implementation costs. We asked suppliers to identify where they may incur incremental costs as a result of implementing RMR and what their magnitude could be. We requested this information to allow us to estimate the impact of our proposed package of measures on suppliers.

3.100. We asked suppliers to provide granular estimates of one-off and ongoing costs according to the following definitions:

- **One-off costs:** hardware, system updates, process updates, and other one-off costs.

- **Ongoing costs:** responding to customer queries, auditing/monitoring, running new processes, and other ongoing costs.

3.101. We also asked suppliers to estimate these costs against each of the main RMR proposals. These are: Supplier Cheapest Deal, TCR, Personal Projection: Tariff Simplification, Customer Bill, Annual Statement, Price Increase Notification, End of Fixed Term Notification, Tariff Information Label, Standards of Conduct, and Fixed Term Rules.

Request for information

3.102. This established the framework for our cost assessment. However, we recognised the risk of suppliers not providing any cost estimates, which could undermine the breadth and robustness of the quantitative assessment. To ensure that suppliers provided the required information, we issued them with a formal Request for Information (RFI) in November 2012, with a deadline on 18 January 2013. We considered that this would give suppliers additional time to develop their estimates outside of the consultation response period.

3.103. The RFI asked for information according to the framework we specified in the October 2012 Impact Assessment. We received submissions from 11 suppliers in total: all 6 previous incumbent suppliers, 4 small suppliers and 1 white label supplier.

Analysis of suppliers' actual cost estimates

3.104. We provide two sets of analysis in this section. The first is a summary of the actual cost information that we received. The second is an estimate of these costs extrapolated for the industry as a whole.

3.105. We have focused the analysis on ongoing costs. Although suppliers will incur one-off costs, these will have a reduced impact on RMR implementation costs in the future.

Overview of actual costs submitted

3.106. In total, suppliers submitted ongoing costs of £47.0m per year. Unsurprisingly, there was a wide range in the submissions, from £0.2m to £22.7m Table 3. This range reflects the differences in customer numbers that each supplier has but also the completeness of the cost information they submitted. Incomplete information was less of an issue around one-off costs, and the majority of suppliers were able to provide these for the majority of our proposals. However, there were many gaps in suppliers' ongoing cost returns. Only two suppliers provided both one-off and ongoing costs estimates for each RMR proposal.

3.107. In total, suppliers submitted costs of £98.2m. This comprised £51.2m of one off costs in addition to the £47m of ongoing costs. It is important to reiterate that this is based on 11 suppliers' returns and therefore does not fully represent the industry as a whole.

Table 3: Overview of cost information received

Cost category	Minimum	Maximum	Average	TOTAL Year1*
One-off costs	£0.05m	£20.6m	£4.7m	£51.2m (52.2%)
Ongoing costs	£0.02m	£22.7m	£4.3m	£47.0m (47.8%)
TOTAL	**£0.2m**	**£43.3m**	**£10.4m**	**£98.2m**

Note: Total minimum costs is the figure for the lowest cost individual supplier. The one-off and ongoing components do not match this total as they are two separate suppliers.
*Based on 11 submissions

Extrapolating for the industry

3.108. The cost estimates we received provide valuable evidence of suppliers' views on RMR implementation. However, these are not fully reflective of potential costs across the industry. Firstly, only 11 suppliers submitted cost returns from the 14 we sent it to. Secondly, only two suppliers submitted costs estimates for each proposal, particularly ongoing costs.

3.109. Therefore we have sought to extrapolate the information we did receive to fill these gaps and form a view of the industry as a whole. We used a three stage process which we followed for both the former incumbent suppliers as a group and then small suppliers as a group:

1. Totalled the cost information that we received for each RMR proposal from each supplier. So if we received four cost estimates for Tariff Simplification, we totalled these estimates together.

2. Divided by the suppliers' total number of customers. So for the four suppliers in (1) above, we used their customer numbers to arrive at a cost per customer.

3. Multiplied these average costs per customer by the total number of consumer accounts in GB for that supplier group.

3.110. Finally, we summed the totals in step 3 and divided by the total number of consumers in GB across both supplier groups. Splitting the analysis by supplier group is necessary because the former incumbent suppliers may face different implementation issues, in both scale and type, than small suppliers.

3.111. We recognise that this approach is stylised and based on incomplete information. It represents our best estimate on the costs of implementing the RMR with the information available to us. Consequently, the extrapolated estimates should not be understood as the definitive costs of RMR implementation.

Overview of extrapolated costs

3.112. The table below provides the extrapolated costs. We estimate ongoing costs of £79.3m per year[96], and one-off costs of £68.6m. These extrapolations give a total ongoing cost per customer of £2.52 per year and a one-off cost of £2.18.

Table 4: Total costs – Industry extrapolation

Cost category	TOTAL	Cost per consumer
One-off costs	£68.6m	£2.18
Ongoing costs	£79.3m	£2.52
TOTAL	**£148.0m**	**£4.70**

Costs per RMR proposal

3.113. The extrapolation approach allows us to form a more complete view of the ongoing costs that suppliers could incur for each RMR proposal. In summary, suppliers attached the highest ongoing costs to Information Remedies proposals. These included delivering the Annual Statements (£0.55), the Bill (£0.45) and the Price Increase Notification (£0.44). Suppliers expect lowest costs to be incurred through implementing the TCR (£0.04) and Tariff Information Label and Supplier Cheapest Deal (both £0.06 per consumer).

3.114. Table 5 shows the range of per consumer costs that we calculated for each proposal and the differences that exist between them. In some cases (Bill Content, Annual Statement, and Fixed Term Offers rules) the differences are significant. In part we recognise that suppliers will have difficulty in calculating ongoing costs pre-RMR implementation. However it also suggests that some suppliers' reasoning is worthy of further examination.

[96] This extrapolation includes the value of £22.7m ongoing costs submitted by one supplier, which also had the highest per customer cost of £2.40. Including this supplier has possibly inflated the extrapolated ongoing costs. In our view this may represent a maximum envelope for the ongoing costs estimate.

Table 5: Ongoing costs associated with each RMR proposed measure

RMR Proposal		Min per customer	Max per customer	Average per customer	TOTAL YEAR 1
Supplier cheapest deal		£0.01	£0.87	£0.06	**£1.8m**
TCR		£0.01	£0.87	£0.04	**£1.4m**
Personal projection		£0.05	£0.55	£0.09	**£2.9m**
Tariff simplification		£0.05	£0.77	£0.43	**£13.7m**
Bill	Content	£0.05	£1.11	£0.40	**£12.5m**
	Format	£0.05	£0.05	£0.05	**£1.4m**
Annual Statement	Content	£0.03	£1.07	£0.52	**£16.4m**
	Format	£0.03	£0.03	£0.03	**£0.8m**
Price Increase Notification	Content	£0.03	£0.73	£0.41	**£13.0m**
	Format	£0.03	£0.03	£0.03	**£0.8m**
End of Contract Letter		£0.03	£0.28	£0.05	**£1.5m**
Tariff Information Label		£0.03	£0.33	£0.06	**£1.7m**
Standards of Conduct		£0.06	£0.53	£0.25	**£8.0m**
Fixed term offers rules		£0.05	£1.76	£0.11	**£3.3m**
TOTAL		**£0.15**	**£5.23**	**£2.52**	**£79.3m**

Drivers of costs

3.115. This section provides some qualitative analysis of the cost information. We look at the main drivers of ongoing costs and critically assess suppliers' reasoning, before turning briefly to analysis of one-off costs.

Ongoing costs

3.116. We assumed that one-off RMR implementation costs (for example, by developing new information systems) would be costly, but that ongoing costs would be relatively low. However, the ongoing costs provided by suppliers were approximately 90 per cent of the one-off costs proposed. And following industry extrapolation, this increased to 115 per cent. Suppliers were asked to provide further detail on the drivers behind this relationship.

Communication

3.117. Suppliers expect to see an increase in the number of calls received as a result of the RMR. However, the level of increase, and the level of staffing that will be required to cope with more calls, is not clear. One supplier believed they would see a 3 per cent increase in calls, requiring an additional 27 full time equivalent (FTE) staff members, spending a total of £0.19 per customer on consumer queries a year. However another supplier felt that the increase in the level of calls would be 10 per cent and they would require an additional 110 FTE. They expected to spend an additional £0.63 on consumer queries in total on an annual basis.

3.118. One supplier estimated it would see a 50 per cent increase in customer churn as well as an additional 10 per cent increase in queries, which would require an annual additional call centre cost of £1.11 per customer. These estimates seem ambitious and we have not been provided with any evidence to support them. We would also question whether this is effectively a cost, and whether it should be allocated to our proposals.

3.119. Only one supplier sets out how its estimates of increased customer calls as a result of the RMR are likely to change, peaking in year one then reducing over time. Other suppliers did not make clear whether they expect this increase in costs to be permanent. While we consider that there may be a sharp increase in customer queries immediately after our proposals being implemented – there will be new rules and new concepts in the market that consumers would need to learn more about – we would expect that in time these queries would reduce.

3.120. It therefore is not clear what would be the net effect in the long run, especially considering that our proposals aim to make the market clearer and simpler. In particular, it is not clear that increased queries, even if a transition effect, would lead to a net cost, as we have been provided with no data about the difference between customer retention and customer acquisition costs.

3.121. Finally, one supplier estimated a cost for mailing. It proposed a per customer annual cost of annual statements of £1.07, while other suppliers did not include any communication costs at all. It is possible that other suppliers may have oversight this specific source of costs. But whilst neither printing nor postage is costless, considering current prices for these services it is likely that the cost indicated above overestimates actual mailing costs.

Personal Projection

3.122. One supplier proposed that it will need new hardware to provide the Personal Projection. The associated maintenance and software licences will mean an ongoing cost of £0.12 per customer solely for the Personal Projection. It does not seem appropriate to push these regular upgrade and expansion costs onto the RMR, when in fact these would probably be required in any case.

Auditing and Monitoring

3.123. One supplier proposed annual auditing and monitoring costs per customer of £0.38, which includes £282,000 a year for auditing the information remedies. As the only large supplier to propose monitoring costs over £0.06 per customer, this represents a significant outlier.

Other costs – Hedging costs

3.124. One supplier has considered a range of scenarios for the future development of the market, and expects that it is most likely that there will be more fixed term contracts in the future. This would increase the costs to the supplier through increased hedging and more consumer contact on an annual basis. To capture this change, they propose costs under tariff simplification of £0.77 per customer. Another supplier expects to face costs of a similar magnitude as a result of the removal of termination fees at the end of the fixed term period.

3.125. However, increasing the engagement of consumers (for example through making more use of fixed term offers) will bring benefits to the market overall. So though it will reduce some of the cross subsidy or the benefits of segmentation that suppliers currently have, it does not appear appropriate to include these as a cost for the RMR. For example, a higher proportion of consumers on fixed term tariffs will reduce uncertainty for suppliers, thereby reducing the risk and ultimately the cost. It will also reduce the costs of managing evergreen contracts, including the costs associated with hedging energy for less predictable evergreen contracts. There is some uncertainty about whether the overall effect will be a net cost to suppliers.

One-off costs

Systems costs

3.126. Suppliers emphasised that systems costs were the main cost drivers for one-off costs. Systems costs make up 43 per cent of the proposed one-off costs for the larger suppliers. However, this figure is dominated by one supplier who proposed costs for upgrading their system to incorporate the new tariff structure that would work out as £0.53 per customer. This accounts for 61 per cent of the total system costs for tariff simplification, and compared to the rest of the market this appears an unreasonably high estimate. This supplier also requires a new system for Price Increase Notifications, at a systems cost of £0.33 per customer, compared with an average total cost proposed by other former incumbent suppliers of £0.17 per customer. While the supplier acknowledges this cost is likely to be unique to them, it appears high in comparison to its competitors.

Hardware costs

3.127. One supplier proposes hardware costs for new mainframes, as the RMR requirements on their billing processes will go beyond their current capacity. Despite splitting these costs across the RMR and the smart metering programme, the supplier still attributes a one-off cost equivalent to £0.91 per consumer to hardware costs.

3.128. Another supplier also requires new mainframes to be able to develop personal projections. However, taking into account the re-sale price of the old mainframes, the supplier estimates this will cost £0.14 per customer, significantly lower than the cost cited above.

3.129. We appreciate that RMR will impose new demands on suppliers’ mainframe capacity. However, it seems inappropriate to attribute the entire costs of new mainframes to RMR. It is likely such upgrades would have been required, and would have been used in the near future in any case, in particular in the run up to the smart meter roll-out.

Communications and other costs

3.130. One supplier estimated communication costs for tariff simplification of £1.27 per customer. This would cover the costs of sending a letter to consumers explaining the changes brought about by the RMR, as well as the costs of calls it expects to receive in response to this correspondence. While in principle these seem likely areas where costs will be accrued, the value the supplier has suggested is the largest cost per customer proposed by all of the suppliers across all of the cost categories. Even if a separate letter were sent out for each electricity and gas customer (i.e. a dual fuel customer receives two letters) this would still be the highest ongoing cost on a per customer basis. It may be that this supplier was unduly cautious on the costs of this correspondence and dealing with responses from consumers.

3.131. One supplier has proposed 'other' costs in total across the categories of £1.29 per consumer. This supplier provided us with a detailed breakdown of these costs, which was helpful in better understanding what suppliers expect to face in implementing the RMR. However, some of the costs proposed (for example, that the development of the RMR policy will require two full time equivalent staff members, at a cost of £120,000 each) and the replacement of existing pre-printed material costing £0.5m seem high.

Could suppliers make efficiency savings?

3.132. We have seen that some suppliers submitted 'outlier' ongoing costs i.e. those that are significantly higher per customer than others. Each supplier will implement RMR from a different starting point, which may affect the resulting ongoing costs they incur. They may also have interpreted the proposals differently, leading to miscalculations around what they will need to do to comply. And we recognise that suppliers may have been less able to fully estimate costs, particularly ongoing costs, given the stage of RMR development that applied when they were asked for the costs information.

3.133. However, given the previous discussion around drivers of costs, coupled with the range of per consumer cost estimates we have calculated, we consider there is scope to reduce the total industry costs we extrapolated in the previous section.

3.134. For instance, if all suppliers delivered each RMR proposal as cheaply as the median supplier estimates, significant savings could be made overall.

Approach

3.135. To calculate median industry costs, we firstly calculated the median per customer cost for each RMR proposal for former incumbent suppliers and small suppliers separately. We then multiplied these by their respective total number of domestic energy consumers in GB before summing these two totals. This gave us total median industry costs for each RMR proposal. The final step was to sum the costs associated with each RMR proposal to calculate total median industry costs.

Overview of median costs

3.136. Table 6 summarises the findings. In total, we estimate that RMR could be delivered at an ongoing cost of £51.1m per year or £1.62 per consumer. This is around two thirds (64.4 per cent) of the total ongoing extrapolated cost we calculated in section 3.

Table 6: Total median costs – Industry extrapolation

Cost category	TOTAL	Cost per consumer
One-off costs	£35.1m	£1.12
Ongoing costs	£51.1m	£1.62
TOTAL	**£86.2m**	**£2.74**

3.137. We accept that this is a stylised example and it is unlikely that all suppliers could deliver at the median per consumer level. There is also a great deal of uncertainty about the costs that suppliers would incur. For example, costs may have been underestimated because suppliers are unclear about how they would implement the RMR. They may also be underestimated because some suppliers did not have the internal capacity to develop cost assessments.

3.138. However, it does show that some level of saving on delivery could be possible. And there may be reasons, in addition to those we set out in the previous section, why suppliers could have overestimated costs. For example, they may have been over-cautious in their assessment of implementation. The uncertainty and the associated risk of 'getting it wrong' may lead suppliers to over-estimate costs rather than being left with a budgetary shortfall.

3.139. It is also important to remember that we asked suppliers for an annual ongoing cost, but given the complexities in estimating future costs did not ask for several years of data. We would imagine that these annual ongoing costs would fall over time as suppliers become more efficient in delivering our proposals and as increased consumer engagement forces them to become more competitive and look for efficiency savings.

Benefits from implementing our proposal

3.140. In this section we assess the likely quantitative benefits of RMR, and the impact these could potentially have on a consumer's annual bill.

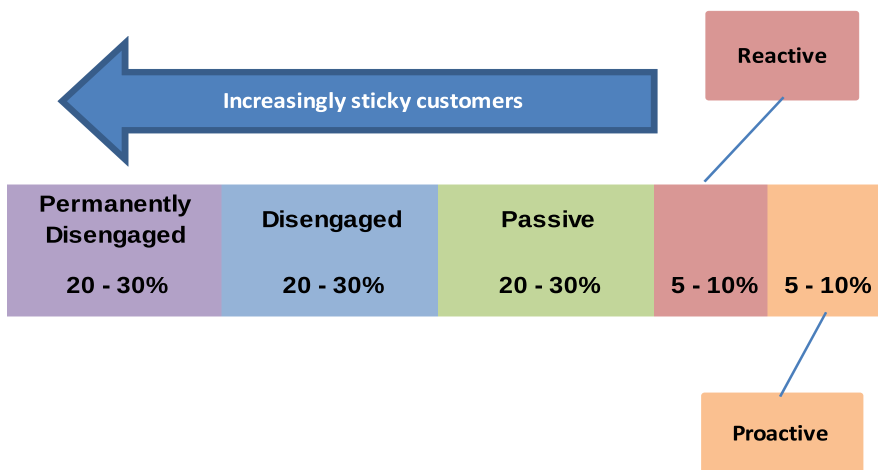
Changes in the level of engagement

3.141. For the purposes of this quantitative assessment, we segment consumers by level of engagement. In our 'RMR: Findings and Initial Proposals' consultation[97], we identified five different levels of consumer engagement, ranging from permanently

[97] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=MARKETS/RETMKTS/RMR

disengaged to proactively engaged. Descriptions of the characteristics of these categories, and the estimated percentage of consumers that currently sit in each, is set out below.

Figure 2: Levels of consumer engagement



Source: Ofgem consumer analysis

Proactive consumers: are likely to have switched supplier or tariff within the last year. They research alternative offers themselves and will switch supplier without the need for prompting.

Reactive consumers: are also likely to have switched supplier or tariff within the last year. They do not necessarily shop around or plan to switch, but may switch as a result of an encounter with a sales agent.

Passive consumers: are those who report switching at some time in the past, but have not in the last year. Our research tells us that many of these consumers have switched once, most often to a dual fuel offering either with British Gas or their incumbent electricity supplier. Having made an initial saving with their first switch they are not particularly likely to switch again.

Disengaged consumers: are those consumers who report never having switched but don't rule out switching in the future. Many disengaged consumers may only decide to switch in reaction to poor service from their supplier or following an encounter with a sales agent. They generally have little knowledge (and in some cases little interest) of the energy market.

Permanently disengaged consumers: are those consumers who claim they have never switched and are unlikely to switch in the future. They are the stickiest consumers and many are likely to be vulnerable consumers.

3.142. We expect the proportion of consumers sitting within each category in

3.143.

3.144. Figure 2 to change as a result of the introduction of our RMR package. However, predicting how consumer behaviour will shift as a result of our intervention is an extremely difficult exercise. For this reason we have created scenarios, discussed later in this section, based on a range of potential outcomes of RMR, which involve different proportions of consumers moving towards the more engaged end of the spectrum. We would anticipate that as levels of engagement increase, so too would the levels of switching.

Prices

3.145. We use domestic energy prices for typical consumption levels (3,300 kWh for electricity, 16,500 kWh for gas) to assess the range of electricity, gas and dual fuel tariffs available in the market.[98]

3.146. For simplicity of analysis, we have chosen not to look at multiple consumption levels. Furthermore, we have chosen to exclude E7 and other time of use tariffs. While we acknowledge that this limits the scope of our analysis, we consider that the results of our analysis will remain broadly representative of the state of play in the market.

3.147. Finally, we analyse only the prices of the former incumbent suppliers. While small suppliers account for a growing proportion of the domestic market, by focusing on the former incumbents we capture approximately 98 per cent of consumers in the energy market.[99]

Scenarios

3.148. In this section we set out our scenarios for assessing the likely benefits to consumers as a result of the introduction of the RMR package. We have previously identified the difficulty of accurately predicting how consumer behaviour will change in response to our RMR remedies. We have therefore chosen these particular scenarios as we consider them to be representative of the range of potential impacts, in quantitative terms, of the RMR package on consumers.

3.149. As stated previously, we assume that more engaged consumers are likely to be on those tariffs amongst the cheapest in the market. We segment the range of prices available in order to assign an annual price to each level of engagement. In order to preserve the simplicity of the analysis, we combine the range of prices for electricity, gas and dual fuel in order to assign a single figure to each level of engagement.

1. *Low impact scenario*

[98] Prices taken from analysis of TheEnergyShop.com data in August 2012.
[99] Source: Ofgem analysis of supplier market share.

3.150. In this scenario we assume that consumer engagement remains at its current level, with a relatively small number of customers (approximately 16 per cent) either proactively seeking better deals,[100] or reacting to the deals they are presented with. The bulk of consumers are either passive or disengaged.

3.151. What this means is that although our proposals may have contributed to make the energy market simpler, clearer and fairer, it has not resulted in an increase in consumer engagement or switching. Consumers remain on broadly the same tariffs as they had previously.

3.152. As there has been no change in consumer behaviour, we would not expect to see supplier behaviour to change markedly either. Thus we would expect the range of tariff prices to remain broadly the same as now.

3.153. Although we do not envision an increase in consumer engagement in this scenario, neither do we assume a decrease. We do not consider decreased engagement as a result of RMR to be a realistic possibility, given the results we have seen from our extensive consumer research.

2. High impact scenario

3.154. In this scenario we assume consumers respond strongly to our proposals and levels of engagement increase significantly. We would therefore expect to see an overall shift in the proportion of consumers from the disengaged to the engaged end of the spectrum, with the proportion of consumers considered to be either proactive or reactive increasing to 24 per cent.[101] This increase in engagement would be reflected in increased levels of switching. Therefore we would expect to see more consumers moving to those tariffs at the cheaper end of the market.

3.155. With a large number of customers moving to cheaper tariffs, one possible response from suppliers could be to try to maintain profit margins, either by limiting the availability of their cheapest tariffs or removing them entirely. We would therefore expect to see a narrowing of the price range of tariffs, with the cheapest offers disappearing from the market. However, we would also expect the increased competitive pressure brought about by switching levels to encourage suppliers to remove the most expensive tariff offerings. We refer to this as 'narrowing effect'.[102]

[100] This figure is based on a combination of quantitative and qualitative research conducted with consumers at the time of our first RMR consultation in March 2011.
[101] This figure represents a 50% increase in the proportion of engaged consumers compared to the status quo. Given the difficulty of predicting behavioural change amongst consumers it is intended to be indicative only.
[102] This effect will depend on the intensity of competition in the energy market. Under the narrowing effect, we assume that the intensity of competition is such that it would be unlikely that prices could be reduced across all consumer segments. An alternative approach would be to consider lower intensity of competition, where the downward price pressures across all segments would be more likely to happen. In our analysis in the chapter we use the more conservative approach to the medium and high impact scenarios.

3. Medium impact scenario

3.156. In this scenario, we assume that although there is an increase in the levels of consumer engagement, this increase is not as great as that seen in the high impact scenario. The proportion of consumers considered to be either proactive or reactive increases to 19 per cent.[103]

3.157. Again, while not as pronounced as in the high impact scenario, we would expect the increased levels of engagement to lead to an increase in the proportion of customers switching to tariffs at the cheaper end of the market.

3.158. We would again expect the increased engagement and switching to cause suppliers to either limit the availability of, or remove entirely, their cheapest tariffs. However, we would not expect the narrowing of the range of prices available to be as extreme in this scenario, due to the more limited change in the level of engagement.

3.159. The extent of the change in consumer behaviour is not as great as that seen in our high impact scenario, but nonetheless in this scenario we would expect to see an increase in engagement and switching to tariffs at the cheaper end of the market.

Results

3.160. The figures in Table 7 below represent the potential quantitative outcomes of each scenario for the consumers at each level of engagement.

Table 7: Gross benefits to consumers from RMR implementation

	% Consumers			Bill differentials (£/annum)			Gross benefit (£/annum)		
	Low	Medium	High	Low	Medium	High	Low	Medium	High
Proactive	8%	9%	12%	£0	£0	£0	£0	-£15	-£50
Reactive	8%	10%	12%	£55	£50	£30	£0	-£10	-£25
Passive	28%	29%	30%	£100	£90	£55	£0	-£5	-£5
Disengaged	28%	25%	20%	£150	£130	£90	£0	£5	£10
Permanently disengaged	28%	27%	26%	£240	£220	£165	£0	£5	£25
Overall benefit							£0	£4.06	£10.60

Source: Ofgem analysis of EnergyShop.com data from August 2012

3.161. The first three columns of the table indicate the distribution of consumers according to their level of engagement (proactive, reactive, passive, disengaged, and permanently disengaged) for the low, medium and high impact scenarios.

3.162. The percentage of consumers assigned to each category of engagement in our low impact scenario is based on a combination of our quantitative and qualitative

[103] This figure is intended to be representative of a post-implementation period in which our RMR package of remedies has had a meaningful impact on consumers, which has resulted in a limited, but nonetheless significant change in the level of engagement. It is intended to be an indicative figure only.

research conducted at the time of our first RMR consultation, in March 2011, and is intended to be representative of the level of consumer engagement in the market at present. The change in these percentages for our medium and high impact scenarios are intended to be indicative of a point in time post-implementation in which the consumer landscape has changed due to our RMR package of remedies.

3.163. The figures under 'bill differentials' represent the relative price of tariffs for each level of engagement. Proactive consumers, on the cheapest tariffs, are set to zero, while other consumers pay more in annual terms. The 'gross benefit' figures represent the amount a typical consumer for each level of engagement would benefit or lose out under each scenario.

3.164. As an example, in the low impact scenario, a reactive customer would pay £55/annum more for their energy supply than a proactive customer. This difference would be £50/annum and £30/annum in the medium and high scenarios, respectively.

3.165. Our low impact scenario bill differentials are based on the prices seen in the market currently. We split these prices into quintiles, using the average of each as a figure representative of the prices paid by consumers in each engagement category.[104]

3.166. We would anticipate the increased levels of engagement seen in our medium and high impact scenarios may lead suppliers to remove their cheapest offers from the market. However, we would also expect a reduction in prices at the most expensive end of the market due to increased competitive pressure. This tariff narrowing effect is represented in the 'gross benefit' columns. These figures represent, for each scenario, the change in annual bills that each consumer segment would face further to the implementation of the RMR.

3.167. For example, under our medium impact scenario, the cheapest tariffs in the market would be £15 more, on average, than in the counterfactual, whereas the most expensive tariffs would reduce by £5.[105]

3.168. The 'overall benefit' figures show the weighted average benefit across all consumers.

Low impact

3.169. Our low impact scenario represents an overall benefit of zero from RMR. The levels of engagement have remained at their current levels, switching has not

[104] We use the average of each quintile in order to allow some tolerance in the prices paid by consumers at each level of engagement, rather than ascribing a direct relationship between the proportion of consumers and the proportion of tariffs they are on. We do this as we know, for instance, that approximately 75 per cent of all consumers are on standard evergreen tariffs. See DECC's energy Trends and Quarterly Prices. Dataset available at: www.decc.gov.uk/assets/decc/statistics/source/prices/qep271.xls.
[105] We cannot accurately predict how supplier behaviour will change due to RMR implementation, so the figures we use for gross benefits are intended to be indicative of the types of outcomes we may see post-implementation.

changed and consumers remain on broadly the same price tariffs as at present. As there has been no change in consumer behaviour, there is little incentive for suppliers to change either, so the range of tariff prices available remains static.

High impact

3.170. In our high impact scenario, consumer engagement has increased markedly, with an increase of 50 per cent in the proportion of customers considered to be proactive and reactive, and a significant decrease in the proportion of consumers either disengaged or permanently disengaged.

3.171. We would expect that this increase in engagement would result in a significant increase in the quantity, and quality, of switching. A proportion of consumers would therefore switch to the cheapest tariffs in the market.

3.172. We consider it likely that suppliers would respond to this by removing both the cheapest[106] and the most expensive tariffs from the market, resulting in a narrowing in the overall range of prices from approximately £240 to £165.

3.173. Although this would mean a decrease in the level of savings available to engaged customers, we would nonetheless expect these customers to be on the cheapest tariffs in the market.

3.174. While the decrease in the proportion of disengaged and permanently disengaged consumers is not enormous, because the bulk of consumers sit within these categories at present, each incremental change has quite a significant impact on the overall benefit to consumers. The benefit to these consumers outweighs the detriment to the most engaged consumers, resulting in an overall benefit of approximately £10.60 per customer. This estimate is the net result of the following effects:

- Disengaged and permanently disengaged consumers are on better deals post-RMR than they would have been if the RMR package had not been implemented.
- Proactive, reactive and passive consumers are on worse deals post-RMR than they would have been if the RMR package had not been implemented.
- There are a higher number of proactive, reactive and passive consumers post-RMR. These consumers are getting better deals as previously they were disengaged or permanently disengaged.
- There is a reduced number of disengaged and permanently disengaged consumers post-RMR implementation.

Medium impact

[106] As we focus on the differentials in bill values for the purposes of this analysis, the cheapest tariffs in the market remain at '0', and the range of tariffs narrow towards this end of the price spectrum.

3.175. In our medium impact scenario, consumer engagement has increased, though only incrementally. The proportion of consumers considered to be either proactive or reactive has increased by 3 per cent, with a broadly similar decrease in the percentage of disengaged consumers.

3.176. We would expect the quantity, and quality, of switching to increase in this scenario, resulting in an increase in the proportion of consumers on the cheapest tariffs in the market.

3.177. We would anticipate that suppliers would respond to this by removing the cheapest tariffs from the market. However, we would not expect this effect to be as extreme as in the high impact scenario, as the proportion of consumers moving from high to low price tariffs would not be as great. Nonetheless, the range of prices available would decrease from £240 to £220. As a result of this, the most engaged consumers are likely to lose out slightly.

3.178. However, this detriment is outweighed by gains for those customers currently disengaged, resulting in an overall benefit to consumers of approximately £4.06.

Conclusions

3.179. Our stylised scenarios above provide an indication of the level of gross benefit to consumers we might expect to see as a result of RMR implementation depending on the level of consumer response to our package of remedies. What they demonstrate is that a relatively small shift in the levels of consumer engagement has the potential to deliver significant benefits to consumers. In our medium impact scenario this would equate to approximately £4 per customer, while in our high impact scenario consumers would benefit by £10.60 on average per year.

3.180. In developing our proposals we have conducted extensive research, focusing not only on the types of information that consumers want to see, but also looking at what consumers need in order to be prompted into action. As a package, we consider that our RMR remedies will make the market less complex for consumers to navigate, while simultaneously providing them with appropriate prompts to engage and assess their options, and the supporting information they need to decide which tariff is best for them. We therefore consider it unlikely that the RMR package will have no effect on consumer engagement, and for this reason rule out our low impact scenario.

3.181. However, while we are confident that consumers will respond to our remedies, they are, on their own, unlikely to act as a silver bullet solution to the lack of consumer engagement. For the levels of engagement identified within our high impact scenario to be achieved, a fundamental shift in the way consumers view their energy supply needs to occur.

3.182. Nonetheless, we consider the RMR package to be an important stepping stone towards a market that is more understandable and appealing to consumers. We consider that our proposals will help to boost consumer engagement, if only incrementally, and allow a larger proportion of consumers to identify, and switch to, cheaper deals for them.

3.183. We therefore consider that, of the scenarios identified above, the medium impact scenario is the most likely outcome to result from the implementation of our RMR package. And what the quantitative analysis above demonstrates clearly is that for the RMR package to provide significant quantitative benefit to consumers, only a relatively limited shift in the level of consumer engagement needs to occur.

Net impact

3.184. In this section we look at how the likely potential benefits to consumers of RMR compare with the implementation costs suppliers will incur and may pass on, in whole or in part, to consumers.

3.185. In our analysis of costs we identified both the average (£2.52) and the median (£1.62) ongoing costs per customer suppliers were likely to incur due to RMR implementation. We consider these two figures to represent a high and a medium case, respectively.

3.186. In our analysis of the quantitative benefits to consumers of RMR we identified a range of potential outcomes based on low, medium and high impact scenarios. The quantitative benefits in these cases ranged from zero to £10.60 per customer. Table 8 below summarises these costs and benefits.

Table 8: Consumer costs and benefits scenarios (per annum)[107]

		Net benefit per customer (£)			Total benefit (£m)		
		No cost	**Medium**	**High**	**No cost**	**Medium**	**High**
Benefits	**Low**	£0.00	£-1.62	£-2.52	£0	£-51	£-79
	Medium	£4.06	£2.44	£1.54	£128	£77	£49
	High	£10.60	£8.98	£8.08	£334	£283	£255

3.187. What the table above demonstrates is the range of impacts to consumers that might be seen under each combination of our cost and benefit scenarios. The net impact ranges from a £2.52 increase in the cost paid by consumers, in our high cost-low benefit scenario, to a £10.60 decrease in our high benefit-low cost scenario.

3.188. As can be seen, a negative quantitative outcome of RMR for consumers would result under our benefits low impact scenario. In this case, the levels of consumer engagement and switching would have not changed. The result would be that suppliers would not change significantly their behaviour and/or prices, and so consumers would remain on broadly the same tariffs as they are at present.

[107] We calculate the net benefits using total number of customer accounts (31.5m). This is intended to be indicative only. Although we have not split out by electricity, gas and dual fuel, we adopted a 'total customers' approach for our implementation cost analysis, so these figures are consistent.

3.189. As a result, the quantitative outcome for consumers would be that they would see an increase in their bills of an amount equivalent to RMR implementation costs.

3.190. However, as set out previously, we do not consider this low impact scenario to be a likely outcome of RMR. We also consider that the overall benefits identified in the high impact scenario have a limited likelihood of being realised. Instead, we consider it more likely that an outcome close to the medium impact scenario is realised. This would deliver a significant overall quantitative benefit to consumers, in either the 'high' or 'medium' implementation cost scenario.

3.191. We therefore consider that, on the whole, our RMR package of remedies will deliver quantitative benefits for the majority of consumers.

4. Impacts on competition

Chapter Summary

This section sets out the potential impacts on competition of the domestic RMR proposals. We identify the likely overall impacts across suppliers as well as differential impacts across suppliers.

4.1. In this chapter we assess the impacts of RMR on competition. We assess how likely our proposals are to affect supplier rivalry in the market, barriers to entry and expansion, small suppliers as well as the ability of suppliers to innovate.

4.2. This section also assesses competition against our consumer benefit scenarios and given the level of competition, which consumer benefits scenarios are most likely to materialise.

Recap of scenario analysis

4.3. In Chapter 2, we introduced the scenarios that provide the framework for our analysis. These are:

- **High impact** – positive engagement effect from our proposals will be much greater than any other negative effects. Consumers will be much better off as a result.
- **Middle impact** - positive engagement effect will dominate any other negative effects. Consumers overall will be moderately better off as a result.
- **Low impact** – there will be little positive engagement effect. Consumers will not be quantitatively better off as a result, but may experience some qualitative benefits.

4.4. We consider there are two potential outcomes that could result from the implementation of our RMR package of remedies:

1. The intensity of competition increases, resulting in lower average bills than would otherwise have been the case, as seen in our medium and high impact scenarios.
2. The intensity of competition is relatively unaffected, resulting primarily in tariff rebalancing, i.e. winners and losers but no overall reduction in bills.

4.5. In each of the following subsections, our analysis of competition will feed into implications for the consumer benefit and implementation cost scenarios.

Impacts in terms of supplier rivalry in the market

Overall impact across suppliers

4.6. Our proposed RMR package may affect market competition by changing the nature of rivalry between suppliers and making competition in the market more effective. We have divided our analysis of the impact of our proposals into two relevant dimensions of supplier competition:

- The impact on suppliers' incentives to compete.
- The impact on preventing suppliers' ability to compete in the market in ways that could cause consumer harm.

4.7. In the remainder of this section we provide an analysis of how our proposals affect these dimensions.

Impact on suppliers' incentives to compete

4.8. Our updated RMR package is designed to facilitate and promote consumer engagement in the market. We anticipate this will have a positive impact on suppliers' incentives to compete and will help to increase effective competition.

4.9. The proposals should have a strong demand-side effect. Consumers should have the opportunity to make well-informed decisions and be able to compare product offerings across suppliers in a meaningful way. Ultimately, they will have more confidence to engage with suppliers.[108]

4.10. The proposals aim to reduce the proportion of sticky consumers and increase the number of active and engaged consumers. This will make overall market demand more responsive to prices and the quality of products being offered. As we have seen in Chapter 0, more consumers switching or threatening to switch should increase rivalry between suppliers and work as an incentive for them to provide better quality of service or seek to lower their cost base.[109, 110]

4.11. Suppliers have submitted estimates of the one-off and ongoing costs of implementing our proposals. We recognise that there may be short-run costs that suppliers will not be able to avoid. However, we have shown in our high impact scenario in Chapter **Error! Reference source not found.**3 that these costs may

[108] Chapter 3 sets out in greater detail how the different components of the updated RMR package may impact upon consumer engagement.
[109] With respect to the 'status quo', we expect that the efficient competitive price to be lower than current observed prices.
[110] We also expect market entry to be easier with an increased proportion of active consumers. We discuss this effect of our proposals in the next section of this chapter.

reduce over time, and that our proposals may lead to cost savings for suppliers. For example, clearer information on bills and annual statements could lead to fewer customer queries, reducing administration costs. There may also be lower costs associated with managing a reduced tariff portfolio (marketing, customer management, menu costs such as pricing). Ultimately, in a market characterised by increased consumer engagement and competitive pressures, suppliers would need to pass these cost savings on in the form of lower bills to attract and retain customers.

4.12. We also expect other, more indirect impacts from increased competition. Where increasing effective competition results in higher customer churn rates we might observe vertically integrated energy companies resorting to the wholesale market to meet their energy supply needs.[111] This has the potential to increase wholesale market liquidity and improve supply side competition.

4.13. We recognise however that there is scope for 'coordinated effects'. Firstly, with fewer tariffs in the market coupled with the TCR and other simplification measures, suppliers may find it easier to monitor each other's prices and/or bundled products and services. Over time, it might be that this greater transparency allows suppliers to respond more easily to rivals' strategies, leading to converging prices and a reduction in the differentials that exist between them. However, it is also likely that some degree of narrowing would occur anyway – when suppliers face tariff restrictions, it is likely they will look to preserve overall margins and remove some of their cheapest deals.

4.14. On balance, we consider that a more engaged consumer base will help to reduce these effects and will outweigh incentives for firms to co-ordinate their actions. For example, a more engaged consumer base, one which is better able to assess tariff options, will look to see where the best deal lies across suppliers. It will have greater awareness of small and independent suppliers and may be more willing to explore the deals that these suppliers offer if they can see clearly that they are more competitive. We may see the emergence of different business strategies that result in different cost structures and innovative products. Ultimately, by simplifying the market, our proposal could reduce barriers to entry and lead to changes in what are relatively stable market shares.

4.15. Secondly, it is possible that suppliers remove their cheapest deals from the market if our proposals result in raising the prominence of those deals. Suppliers may decide that there is too great a risk of consumers moving to the cheapest deal in high numbers and reducing their ability to maximise revenues and profits.

4.16. We recognise the possibility that our proposal could lead to a short-term reduction in the availability of deeply discounted deals. However, over the longer term, a more engaged consumer base should help to increase competitive pressure on suppliers and force suppliers to look for efficiency savings. We expect that if these

[111] Note that in a scenario of increased competition, vertical integrated companies will tend to find it more difficult to construct balanced 'up' and 'down' stream energy portfolios.

cost savings are passed onto consumers, it will result in generally cheaper tariffs than would be the case without the implementation of our RMR package.[112]

Impact on preventing suppliers' ability to compete in ways that could cause consumer harm

4.17. We expect that our proposals will lead to additional, non-financial benefits. They will reduce the possibility of consumer detriment by affecting suppliers' ability to engage in profitable practices that result in consumer harm. This impact is achieved in a number of different ways:

- SOC will obligate suppliers to treat consumers fairly and require them to take consumer needs into account. As mentioned in the consultation document, Ofgem can take enforcement action if it considers that a supplier has not complied with the SOC.[113] The introduction of the SOC will limit a supplier's ability to take actions or omit information that significantly favours the interests of the supplier and which could lead to consumer detriment.

- By reducing the problem of imperfect information, the TCR proposal limits suppliers' ability to take advantage of uninformed consumers (e.g. in marketing information provided to consumers).[114] Suppliers will be required to use a standardised methodology for the calculation of the TCR and personal projection, ensuring that they are transparent metrics for comparing prices across suppliers.

- Our limit on open tariffs and ban on expensive dead tariffs will reduce, though not eliminate, the ability of suppliers to segment the market. There will be less scope to design tariffs specifically targeted at attracting or recovering costs from particular consumer categories.

- Fixed term rules could limit suppliers' ability to segment the market between active and inactive consumers. They will make the fixed term market less complex and easier to understand, and therefore more accessible to less confident consumers. Further, our new proposed rules will also limit the extent to which suppliers can further segment the fixed term market. Suppliers will no longer be able to offer initially attractive deals in the expectation that they could automatically rollover consumers to fixed term tariffs on less favourable terms.

[112] This assumes that the threat/competitive pressure caused by potential new entrants is limited.
[113] See Chapter 4 of the Ofgem March 2013 RMR consultation document.
[114] In a perfect world, i.e. 'perfect competition', both consumers and suppliers have full information on anything that might influence their respective decision-making process, for example all suppliers' costs, products and prices. In an imperfect world, the party with better or more complete information has a competitive advantage over the other party, potentially leading to market failure. At present, suppliers are better informed than consumers, leaving the latter at a competitive disadvantage. By improving accessibility of information and comparability of tariffs, the proposal gives consumers the tools they need to more effectively engage in the market. If successful, consumers will be in a better bargaining position, and each will be better able to choose the supplier offering the most appropriate tariff.

- The supplier cheapest tariff proposal could limit suppliers' ability to segment the market between more engaged consumers, and those less engaged. Suppliers will have to provide all types of consumers with clear, accessible information on cheaper energy options. This will also limit suppliers' ability to obfuscate tariff information. They will have to make clear what options a consumer has, making it easier for them to compare across the market.

- Our proposal to widen the definition of termination fees to cover loyalty discounts reduces the extent to which suppliers can 'lock-in' consumers to contracts.

Differential impacts across suppliers' incentives and ability to compete

4.18. We note that some of the measures in our final package may result in a differential impact across suppliers.

4.19. Our final proposals will simplify and standardise live and dead tariffs, increasing their transparency. We expect that this will encourage 'sticky' consumers to engage in the market and explore their tariff options. As most sticky consumers are customers of the previous incumbent suppliers, it may be that this engagement exerts greater competitive pressure on former incumbents than on small suppliers.

4.20. However, we recognise that if former incumbent suppliers become more competitive, it could affect small suppliers' ability to offer market-leading deals. If there is less price differentiation, small suppliers may find it more difficult to attract consumers on price alone. And small suppliers may be less able to absorb the one-off or fixed costs of RMR implementation. This may have a knock-on effect on the prices they are able to offer.

4.21. Nonetheless, our final proposals still permit all suppliers to compete on non-price tariff features. Suppliers will be able to offer evergreen, fixed term and fixed rate tariffs within the tariff cap. They will be able to offer green tariffs and may (if they apply for a derogation which is granted by Ofgem) have the flexibility to trial different types of tariff, subject to constraints, outside of the tariff cap.

4.22. Our final proposals standardise and simplify discounts and bundled offers but do not prohibit suppliers' from offering them altogether. We are banning cash discounts and, other than dual fuel/online, any other discount that is applied to (rather than already incorporated in) a unit rate or standing charge. There will be constraints on suppliers in order to deliver tariff simplification, but our final proposals preserve suppliers' ability to distinguish themselves from their competitors.

4.23. Under our new fixed term rules, suppliers may find it harder to pass on non-controllable costs, e.g. network charges. In particular, this may be more challenging for smaller suppliers, as larger suppliers may be better able to manage this risk. However, there may be certain circumstances beyond the control of the supplier where price increases are appropriate. Our proposals allow for tariffs with ex-ante automatic variations, which could be used to mitigate the risk of increases in network charges (or other costs). Under exceptional circumstances, the Authority may consider these variations for derogation from the prohibition on price increases and other adverse unilateral variations.

4.24. We acknowledge suppliers have limited visibility of future network charges. We published in October 2012 our decision in relation to mitigating network charging volatility.[115] These measures are intended to improve the predictability of allowed network revenues, which will improve suppliers' ability to price network charges into their fixed term offers.

Implications for consumer benefits and implementation costs

4.25. We consider that the engagement/switching effect[116] as defined in Chapter 2 will be most pronounced and will increase the number and proportion of consumers that will want to explore their tariff options. Over time, we would expect that the overall proportion of engaged consumers increases. Suppliers may respond by offering more competitive deals in the long run in if face of more informed demand.

4.26. We expect that the tariff narrowing effect[117] as defined in Chapter 2 will come into play in the short run as suppliers re-order and reappraise their tariff portfolios. We acknowledge the risk that the most engaged consumers begin to pay slightly more overall as suppliers remove their most competitive deals. However, the counterpoint is that increased competitive pressure will lead to lower bill values at the top end of suppliers' portfolios, with the least engaged ultimately paying less even if they do not take any action. All things being equal, we consider that this would have a net benefit for consumers.

4.27. We recognise that in the short-run, all suppliers may have to bear one-off implementation costs to begin delivering RMR. It is possible that they are able to pass these onto consumers before the full impact of RMR has time to bed in and increased consumer engagement exerts greater competitive pressure on suppliers.

4.28. Overall, we consider that of our three scenarios, the middle impact scenario is most likely. Whilst in the short run some degree of one-off implementation costs will be passed on, these will be outweighed in the long run by increased competition leading to lower bill values than would have been the case in the absence of RMR.

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[115] Ofgem (October 2012), 'Decision on measures to mitigate network charging volatility arising from the price control settlement'.

[116] **Engagement/switching effect** - we expect that simplification of tariffs, together with clearer information and more trust in the market functioning, will encourage, to different degrees and by different channels, more consumer engagement. As a result, a higher number of consumers will be placed on more competitive deals. This could happen through the choice of a cheaper tariff provided by the same supplier, through the customer switching to another supplier offering a cheaper tariff or simply through a price reduction initiated by a supplier to retain its customers. Overall, this effect will tend to lower consumers' bills relative to the counterfactual scenario."

[117] **Tariff narrowing effect** – the obligation for suppliers to simplify and limit the number of tariffs they offer is likely to lead to the trimming of the cheapest and the most expensive tariffs. This may entail a positive impact, as some disengaged customers could improve their situation without taking any action. However, there may be also a negative impact, due to the fact that other customers, possibly those who are currently actively engaged, may have to move to worse deals and could suffer an increase in their bills relative to the counterfactual scenario.

Impact on barriers to entry and expansion and small suppliers

4.29. We expect our proposals will lead to increased consumer engagement and trust in the energy market. By increasing awareness of alternatives, and enabling consumers to access key information to assess their options, our proposals are expected to enable consumers to engage effectively.

4.30. Our proposals may, in certain instances, have the potential to raise barriers to entry and expansion, or affect small suppliers. However, as the analysis below shows, these impacts are materially counterbalanced by relevant mitigating factors.

4.31. Given the opportunities for potential savings mentioned above, the increase in effective engagement should lead some consumers to switch, and therefore switching levels may increase overall. This should have a positive impact on smaller suppliers' ability to expand, and on the prospects of potential new entrants.

SOC

4.32. Suppliers submitted cost estimates following our information request in October 2012. They reported low to modest costs for the SOC. This was consistent across both small and large suppliers. For example, four of the five small suppliers estimate one off and ongoing costs to be less than £11k respectively.

4.33. Some suppliers may require more changes/actions than others to comply with SOC. This will depend on the nature of the supplier, and their goals and starting place with regard to processes and consumer interactions. Suppliers that currently have better practices and systems may use this as an opportunity to further improve. We would expect that costs would vary between suppliers for these reasons.

4.34. Small suppliers do not anticipate significant costs to implement the SOC. In its response to the December 2011 consultation, one small supplier suggested that the main costs of the SOC are likely to come from compliance and regulatory reporting, which, as a fixed cost, fall disproportionately on smaller suppliers. Other small suppliers did not feel they would face significant costs as a result of the SOC.

4.35. Based on our quantitative cost and qualitative information, we do not expect that our proposal adds a significant level of additional regulation to potential new entrants or disproportionate additional costs to business expansions. In any case, consumers expect that any reasonable supplier should, as a minimum; exhibit behaviours which comply with the SOC.[118] Therefore, any supplier should be doing this as a matter of course.

4.36. In any event, we would act proportionately in an enforcement case and take all circumstances of the case into account when assessing the seriousness of a case.

[118] Insight Exchange (October 2012).

TCR

4.37. We note that the TCR proposal could, in principle, lead consumers to focus on price to the exclusion of other features of energy tariffs. This could have a disproportionate adverse effect on smaller suppliers, to the extent that they are looking to compete on non-price grounds (such as by offering green tariffs).

4.38. In particular, it may mean that the tariffs offered by smaller suppliers would not feature on best-buy tables and so would be less visible to consumers. This could create a barrier to entry or expansion for smaller suppliers.

4.39. However, the provision of best-buy tables will be determined in the market. There may therefore be an opportunity for tables to be published that focus on non-standard products (such as green tariffs). Ofgem would not restrict commercial decisions on how best-buy tables should be published. Compilers of best buy tables would be free to frame the information as they choose, and highlight non-price features such as supplier satisfaction ratings and the percentage of 'green' supply, in the tables they provide.[119]

4.40. Additionally, the Tariff Information Label will contain a full description of tariff features, so consumers would have access to price and non-price information when comparing tariffs.

Tariff simplification

4.41. Our quantitative analysis shows that on average, small suppliers offer one or two core tariffs. This suggests that when new suppliers enter the market, they do not tend to offer a high number of tariffs as an entry strategy. Our proposal is therefore in line with current small suppliers' commercial behaviour.

4.42. Our final simplification rules on discounts will allow suppliers to offer some discounts for all tariffs, i.e. dual fuel and online. This should allow new entrants and small suppliers more commercial freedom to compete with established suppliers.

4.43. Some small suppliers have raised concerns that the deeply discounted tariffs other suppliers have offered make it harder for them to attract new customers. We expect our tariff simplification proposals will reduce the scope for market segmentation and possibly reduce the number of deeply discounted tariffs on the market. We think that our proposals will reduce the ability of previous incumbent suppliers to offer these deals and give smaller suppliers more opportunities to expand. We also expect that reducing segmentation may impact positively on the entry prospects of potential new suppliers.

[119] Ofgem has recently secured agreement from larger suppliers to regularly publish certain complaint statistics, which could be used by third parties as a basis for a non-price comparison tool.

Protecting consumers on fixed term offers

4.44. We recognise that our fixed term rules have the potential to increase the cost of providing fixed term offers. This could disproportionately affect new entrants, small suppliers or become a barrier to expansion. We acknowledge that suppliers might be exposed to wholesale price shocks during the price protection period. Even though potential entrants or small suppliers might be less capable of managing this risk because they have smaller customer bases, we also expect that they will be able to adapt their hedging strategies to minimise this impact.

4.45. Other respondents to the October 2012 consultation noted that prohibiting auto-rollovers to fixed term offers might make demand more uncertain and result in suppliers resorting to wholesale spot markets more often. This might affect potential entrants or smaller suppliers to a greater degree as they generally face higher trading costs in comparison to larger suppliers. However, as noted in some stakeholders responses, if auto-rollovers were to be removed suppliers may work harder to retain their customer base. This would limit the impact on suppliers' costs, though suppliers may incur additional cost in attempting to retain customers.

4.46. Restrictions on tariff types may mean that suppliers attach additional risk premium or enter more costly hedging strategies to manage this reduced flexibility. This might affect smaller suppliers as they have smaller customer bases.

4.47. We recognise that our proposed rules on unilateral variations may reduce the scope to pass on non-controllable costs to consumers on fixed term contracts. However, the derogations process we are putting in place should mitigate this risk.

4.48. Overall, we do not expect our fixed term rules to be material enough to block entry, limit expansion or induce exit of potential entrants or small suppliers. However, we do acknowledge they could negatively affect their short term competitiveness in the fixed term market. That said, in the longer term, we consider that our proposed rules can mitigate this negative impact. They will remove a significant barrier to entry and expansion by preventing consumers being automatically rolled over to fixed term contracts with termination fees.

Clearer and simpler information

4.49. In general, we do not consider that the content or format restrictions of our information remedies will affect barriers to entry or expansion. For example, the Tariff Information Label will ensure that non-price tariff information is presented to consumers in a clear and accessible format. The Tariff Information Label will increase the visibility of non-price tariff information and help small suppliers to demonstrate their market niche.

4.50. Our information remedies will impose compliance costs on suppliers and this may present a barrier to entry or expansion. For instance, some consultation responses and comments at our stakeholder roundtables from both large and small suppliers suggested that there may be significant costs involved in the implementation of the information remedies. However, other responses suggested these would be much less significant as the proposed requirements would not be very different from the information they currently provide.

4.51. Small suppliers and new entrants may be affected disproportionately by the fixed costs of making necessary systems changes for new communication templates. This could result in higher costs for compliance per consumer. Whilst we asked suppliers to submit estimated RMR implementation costs, the evidence is too incomplete to draw firm conclusions.

Supplier cheapest tariff

4.52. Two small suppliers suggest providing information on the lowest cost tariffs does not sufficiently account for consumers who prefer innovative tariffs such as green tariffs, as opposed to tariffs with the lowest price. However, our proposal is about making consumers aware about the cheapest tariff with their current supplier and it does not discourage innovation. In addition, our new proposals would allow suppliers to provide the message on cheapest tariff in their own phrasing/language. This additional flexibility will allow suppliers to frame the message to suit their own customer base. Consumers need to have access to clear information that enables them to engage with the market with confidence and make accurate decisions about their energy options.

Collective switching

4.53. Our tariff simplification proposals aim to support the continued emergence and growth of collective switching models in GB. We consider there is scope for small suppliers to benefit from collective switching and potentially help them to expand.

4.54. Although collective switching is in its infancy in GB, small suppliers have won several of the schemes that have taken place so far. These include the Big Switch, organised by Which? and won by Cooperative Energy, and two schemes organised by iChoosr at local authority level and won by Ovo. And we have seen from Belgium and the Netherlands, where collective switching is more established, that small suppliers have won the majority of schemes. If this broader trend were to continue, small suppliers could quickly capture blocks of market share that would otherwise take longer to build.

Implications for consumer benefits and implementation costs

4.55. RMR will reduce the number of tariffs, ban cash discounts and, other than dual fuel/online, any other discounts that are applied to (rather than already incorporated in) a unit rate/standing charge. It will also standardise rules on bundles, and introduce a range of information remedies that will help to level the playing field. Over time, we anticipate that this simpler and clearer market will work in the interests of small suppliers. The engagement/switching effect will help them to raise their profile relative to the former incumbent suppliers, with consumers better able to compare the tariffs they offer.

4.56. There is a counter argument that the tariff narrowing effect could reduce the price differentials between suppliers. This may mean that small suppliers are less able to attract consumers based on price alone. However, our other proposals provide flexibility for competition on non-price tariff features. Small suppliers will be able to offer green tariffs and a range of bundled offers that enable them to differentiate from their competitors.

4.57. We have seen in Chapter **Error! Reference source not found.**3 that suppliers expect to incur one-off and ongoing costs to implement RMR. An organisation considering entering the energy market may be deterred if it knows it will have to incur these additional costs. However, energy is a regulated sector. Suppliers have to incur costs to meet the requirements of the existing licence conditions. We do not consider that the overall level of incremental cost we extrapolated in Chapter 3 is sufficient to dissuade any potential new entrants.

4.58. Overall, of the three scenarios, we consider the medium impact scenario is most likely. As small suppliers become more visible in the market, so will the price of the tariffs they offer. This may reduce the ability of other suppliers to pass through implementation costs to consumers if doing so would make their tariffs uncompetitive. The visibility of small suppliers will increase competitive pressure and, all things being equal, reduce upward pressure on bill values. In other words, we expect that the engagement effect will outweigh any potential negative impacts of the tariff narrowing effect.

Impacts on innovation

Overall impact across suppliers

4.59. We expect that our proposals will allow suppliers sufficient flexibility to innovate, ensure that these innovations provide genuine value to consumers and ensure that the Time of Use (ToU) market is not negatively impacted by our proposals.

SOC

4.60. We propose to use a principles-based regulatory approach to implement our SOC, and to allow suppliers a degree of flexibility and freedom to deliver against the requirements. Suppliers will have 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.

Tariff simplification

4.61. Overall, our tariff simplification rules will allow a degree of innovative product differentiation within a simplified market.

4.62. Our cap on the number of open tariffs, and our rules on discounts and tied bundles will limit the number of tariff options that suppliers can offer to consumers. However, they will still permit innovation of tariff offerings, including a range of ToU and smart tariffs. And our proposals add flexibility around online account management and white label providers. Finally, suppliers will be able to offer bundled products freely if they offer them to all consumers across all core tariffs.

4.63. Our final proposal to limit tariffs to a standing charge and unit rate would not preclude suppliers from offering different unit rates for different times of the day or on different dates as long as only one unit rate applies at any one time. We also consider that our proposals represent an incentive to the roll-out of smart meters and ToU tariffs, given that suppliers could offer all their tariff options to a customer on a smart meter (though no more than four per meter mode).

4.64. As indicated in the accompanying consultation document, a supplier would be able to offer up to 48 core tariffs per meter type/mode, considering the options around payment method and online account management discount. We would expect that this provides sufficient flexibility for suppliers to innovate and differentiate their offerings.

4.65. Considering the responses to our October 2012 consultation, our proposal also enables suppliers to continue offering the options they considered important. We also propose to introduce a process for suppliers to trial new, innovative tariffs outside of the tariff cap.[120] We expect this would lead suppliers to be able to provide innovative products and be more selective in the offerings that actually add value and differentiate them from their competitors.

4.66. Our final proposals to simplify tariff structures will mean that multi-tier tariffs will no longer be available. However, we recognise some consumers, particularly those with very low energy consumption, may value these tariffs. Our proposals allow suppliers to set the standing charge at zero so as not to unduly harm such consumers.

Protecting consumers on fixed term offers

4.67. Our proposed fixed term rules will restrict the types of tariff available in the market. This may limit innovation to a certain extent. However, we consider that there is plenty of scope for suppliers to offer RMR-compliant alternative fixed term offers or for these to be offered as evergreen tariffs.

Clearer and simpler information

4.68. Respondents to the December 2011 and October 2012 consultations raised some concerns about the standardisation of the content and formatting of elements of key communications between the supplier and the consumer. This could potentially affect suppliers' ability to differentiate themselves (through innovative communications) and therefore compete.

[120] This will be subject to constraints which are set out in detail in our consultation document.

4.69. As a result of these responses, we have now attempted to minimise prescription requirements. This will allow suppliers to differentiate their communications to a greater extent while ensuring that consumers receive clear and consistent information across all suppliers.

4.70. We also noted that increased prescription may make the licence conditions less future-proof. For instance, the standardised formats for price increase information on the PIN may not be easily adaptable to tariff innovation. To mitigate this risk we have provided some flexibility in our proposed format. This will accommodate the more complicated tariff structures which may arise through the development of ToU.

Differential impacts across suppliers

4.71. Our SOC proposal will apply to all suppliers. The principles based approach allows all suppliers the chance to be innovative in their dealings with consumers, although some suppliers may choose to be more innovative than others. This will depend on business strategy and individual decisions rather than the impact of our proposals.

4.72. The range of suppliers' implementation cost estimates provides further evidence of differential impacts. We feel this will be an opportunity for the industry to adopt a different mindset around their interactions with consumers, and increase the degree to which they put these interactions at the heart of their business. We recognise that some suppliers are already considering this type of shift in their business culture, so some suppliers may face a greater degree of change to comply with the SOC than others.

4.73. Our prohibition on price increases and other adverse unilateral variations in the fixed term market may affect suppliers' ability to manage hedging risk. It may also affect their ability to pass through certain costs. These may affect small suppliers to a greater extent than former incumbent suppliers. However, on balance, we consider the consumer protection benefits arising from this policy outweigh the potential impact on small suppliers.

Implications for innovation

4.74. Our proposals will still allow suppliers to market innovative offers to consumers. In a simpler and clearer energy market, the prominence of these offers should be higher. In a world where the tariff narrowing effect dominates, suppliers' ability to innovate will be crucial in attracting consumers. There may be less focus on tariff price differentials and greater prominence on innovation in non-price features.

4.75. For the least engaged, it is likely that innovation will be less important. We might expect that innovation has less weight in their switching decision and they may be more concerned about price alone.[121] In this scenario the

[121] Ipsos MORI, Customer Engagement with the Energy Market - Tracking Survey 2012, April 2012.

engagement/switching effect will not be driven by supplier innovation and will have less impact on consumer benefits overall.

Implications from the quantitative assessment scenario analysis

4.76. In Chapter 3 we considered the likely quantitative impacts to consumers of the implementation of our RMR remedies. We did this by assessing the likely costs suppliers would incur as a result of RMR implementation, and also by analysing the potential quantitative benefits that consumers might receive due to an increase in the quantity and quality of switching decisions.

4.77. In this section we intend to consider the potential quantitative impacts on competition as a result of RMR implementation. We first discuss the interaction between the level of consumer engagement and the competitive pressure placed on suppliers. We then discuss the implications this may have for the overall costs and benefits to consumers resulting from RMR.

4.78. Although in Chapter 3 we acknowledged that one possible reaction from suppliers to an increase in switching to the cheapest tariffs in the market would be to limit the availability of these tariffs, or remove them from the market entirely. We also expected that the most expensive tariffs would be removed, resulting in a narrowing of the range of tariff prices available.

4.79. However, although we may expect a narrowing of prices, the median point around which prices range will rest to some extent on the level of competitive pressure placed on suppliers.

4.80. At present, levels of switching are low, so there is little incentive for suppliers to lower margins or seek to lower their cost base. Our remedies, if successful, will result in increased consumer engagement and switching. This will, in turn, lead to an increase in the competitive pressure on suppliers, and reward those who are efficient and thus able to offer consumers the best deals.

4.81. We would expect that if engagement increases sufficiently, downward pressure will be placed on suppliers' prices, which could force them to either seek reductions in controllable costs or reduce supply margins. Competitive pressure may also encourage suppliers to absorb some, or all, of the cost of RMR implementation. Below we discuss the potential for this to occur under each of our scenarios.

4.82. Table 81 below shows the range of potential costs and benefits to consumers of RMR that we identified in Chapter 3.

Table 8: Consumer costs and benefits scenarios (per annum)

		Net benefit per customer (£)			Total benefit (£m)		
		No cost	Medium	High	No cost	Medium	High
Benefits	Low	£0.00	£-1.62	£-2.52	£0	£-51	£-79
	Medium	£4.06	£2.44	£1.54	£128	£77	£49
	High	£10.60	£8.98	£8.08	£334	£283	£255

4.83. First, in our low impact scenario, we consider it likely that the implementation costs of RMR will be passed through to consumers in their entirety. In the worst case, this would lead to each consumer paying, on average, an extra £2.52 on an annual dual fuel bill. In this scenario, there is little incentive for suppliers to absorb any of the costs themselves, as the current levels of engagement mean consumers are unlikely to respond by switching supplier.

4.84. In our high impact scenario, on the other hand, we consider it likely that suppliers would absorb costs of RMR implementation. In this case, the significant increase in consumer engagement would place sufficient competitive pressure on suppliers to not only absorb implementation costs, but potentially to seek efficiencies elsewhere. High levels of engagement and switching would place downward pressure on supplier margins and incentivise the lowering of suppliers' controllable costs.

4.85. While we expect to see a narrowing of the range of tariff prices in this scenario, overall we would anticipate that, assuming other factors remain constant, the price of tariffs in the market would decrease. In this case we would expect the effect of the costs to be zero, or even less, leading to a net benefit per customer of approximately £10.60.

4.86. In our medium impact scenario, we consider that while suppliers may pass through some of the costs of RMR implementation to consumers, the pass-through would be less than the total amount of the costs. In this case, assuming the medium case of costs pass-through, the benefit per consumer would be approximately £2.44. In this case we would consider this to be a minimum benefit figure, as increased engagement may encourage consumers to lower the pass-through of these costs to consumers.

Conclusion

4.87. Overall, we expect our RMR package to increase the levels of consumer engagement and switching, and thus increase the level of competitive pressure placed on suppliers.

4.88. We recognise that one possible impact of increased engagement is a narrowing of the range of tariff prices, which would have a negative impact on those consumers already on the cheapest available tariffs. However, we believe that increased engagement among currently passive or disengaged consumers will be of benefit to the market as a whole, as this would significantly increase the competitive pressure placed on suppliers.

4.89. We would anticipate that if this competitive pressure is sufficient, suppliers would seek to lower their controllable costs and minimise the pass-through of RMR implementation costs to consumers. This would maximise the quantitative benefits to consumers we identified in Chapter 3.

5. Impacts on sustainable development

Chapter Summary

This chapter assesses the potential impact of our proposed package of measures on three key sustainable development themes. These themes are: eradicating fuel poverty and protecting vulnerable consumers, managing the transition to a low carbon economy, and smart metering.

Protecting vulnerable consumers and tackling fuel poverty

5.1. In performing our functions, Ofgem must have regard to the needs of particular groups of consumers: those of pensionable age, those that have a disability, those that are chronically sick, those on low incomes and those living in rural areas. We must also have regard to equalities considerations. In Chapter 0 we explored the impacts of our proposal on domestic consumers more broadly. Here, we focus on consumers in vulnerable situations.

5.2. Ofgem has published proposals for a new Consumer Vulnerability Strategy.[122] The Strategy proposals recognise that to identify and address vulnerability, we should not just focus on the groups listed above, but should consider vulnerability in a broader way. Vulnerability may not only stem from an individual's personal circumstances, and it may also be caused or acerbated by the market itself. We have identified a set of factors that may make someone more vulnerable to experiencing detriment than others. Such factors include, but are not limited to, the characteristics and capacity of an individual, the extent to which they are aware of their vulnerability and the design of goods and services and the way in which they are sold.

5.3. Throughout the RMR, in our research and analysis we have not just considered the needs of those who are pensioners, disabled, chronically sick, low incomes or rural, but we have considered also broader factors such as having limited numeracy and literacy skills or not having internet access.

Insight into vulnerable consumers

5.4. Our research suggests that many vulnerable consumers are less likely to be willing or able to engage with the energy market.[123] A clear relationship exists between social grade and switching rates, with professional and managerial grade ABs much more likely to have switched than state-supported grade Es.[124] Like supplier switching, tariff switching is related to payment method and social grade –

[122] Ofgem (September 2012), 'Proposals for a new Consumer Vulnerability Strategy', Ref. (124/12).
[123] FDS International (February 2011).
[124] Ipsos MORI (April 2012).

customers now on direct debit are more likely to have switched to this method, and ABs are more likely to have switched than social grade Es.[125]

5.5. The barriers to engagement that consumers face are likely to be more acute for vulnerable consumers. For example, internet use is linked to various socio-economic and demographic characteristics. Adults who are less likely to have used the internet include the elderly and disabled: individuals with a disability are just over three times more likely never to have used the internet than individuals with no disability.[126] Consumers with internet access are more than twice as likely to have switched in 2011 compared to those without, as consumers without internet access are less able to use online switching sites which we know can filter tariff results for an individual. In facilitating 'best buy tables' based on the Tariff Comparison Rate, we hope to make information on tariff options across the market more accessible to consumers who are unable or unwilling to use comparison sites.

5.6. Throughout all of our RMR research we have sought views from a range of consumers likely to be in vulnerable situations. From across our research we recognise that consumers are all different – they have different needs and interests, and engage in the market in different ways. Therefore, different parts of the package are likely to appeal to different types of consumers.

5.7. Our package of proposals aims to encourage and equip consumers to engage effectively in the market. Clearer and simpler supplier information aims to make the market more accessible for more consumers. Price Increase Notifications, for example, will be tailored to the individual and state how the increase will impact that consumer. Such information can help to make consumers more aware of their energy costs and could help them to budget.

5.8. Research shows that some consumers, including vulnerable groups, assume that their supplier would automatically put them on the best tariff.[127] Some consumers are surprised that they may not be on the best possible tariff with their current supplier, which can cause frustration.[128]

5.9. We are proposing that suppliers provide their customers with cheapest tariff information both by a consumer's current preferences and their cheapest tariff overall, on some routine communications. This is designed to make consumers aware that there are other options, and clearly detail, in pounds and pence, what a particular consumer could save from switching to that tariff. However, our research suggests that savings would need to be 'significant' for consumers to be prepared to take action to switch tariffs, even within their current supplier (although savings expectations tend to be lower among less affluent socio-economic groups).[129]

[125] Ibid.
[126] Office for National Statistics (Q2 2012), 'Internet Access Quarterly Update Q2 2012'.
[127] FDS International (February 2011).
[128] SPA Futurethinking (October 2012b).
[129] Findings from 2012 tracking engagement survey indicate that, on average, switchers expected on the last occasion to save around £173 per year by switching. Expectations are related to social grade – the ABs expect to save more – and inversely to age – 15-34s expect to save more than older switchers, especially the 65+.

5.10. Pre-payment customers are more likely to be in vulnerable situations, using pre-payment to manage or avoid debt. We therefore propose some bespoke rules for the cheapest tariff messaging these customers will receive. Under the narrow definition for a cheaper tariff recommendation, pre-payment customers will only receive recommendations for other pre-payment meter (PPM) tariffs.[130] Under the wide definition, pre-payment customers will also be offered cheaper tariffs which may involve changing meter but with clear messaging that highlights that a meter change may be necessary to access that tariff, an explanation of the costs involved and where there may be restrictions to switching due to debt. PPM consumers will also get a statement to remind them that they may be able to switch supplier even if they are in debt up to £500 according to the debt assignment protocol. We believe that this messaging will ensure PPM customers are not excluded from being informed of cheaper tariffs available but are also provided with all the information they need to assess their energy options effectively.

5.11. Our fixed term tariff rules are designed to protect all consumers on these types of offers. Although consumers in vulnerable situations are less likely to be on fixed term tariffs, those that are may be less able or prepared to take action as they come to the end of a fixed term tariff. Our rules will ensure that even in the absence of action, consumers will not be automatically rolled over and locked into a potentially uncompetitive fixed-term tariff with a termination fee.

5.12. The SOC are designed to improve all interactions between suppliers and consumers. They will require suppliers to treat all consumers fairly. We envisage that the SOC would require a supplier to identify, understand and accommodate the needs of their vulnerable consumers.

5.13. Despite the RMR package, some vulnerable consumers may continue to find the market hard to navigate without further support such as face to face advice. For example, they may be loyal to what they perceive to be national brands, or consider it be a hassle.[131] Our research into the TCR found that for many disengaged consumers – and vulnerable consumers are more likely to be disengaged – interest in the TCR rarely extended to their envisaging how they would actually use it to compare their current tariff with alternatives.[132] This will limit the benefits that tools like the TCR can bring to vulnerable consumers.

5.14. However, some consumers will not necessarily need to act to benefit from the RMR proposals. Sticky consumers may often remain on uncompetitive dead tariffs. Our proposals require suppliers to move all consumers on uncompetitive dead tariffs to their cheapest tariff.

Further measures

5.15. The impact of the RMR proposals on consumers, including those in vulnerable situations, will be monitored as part of the enhanced monitoring work.

[130] We recognise alternative tariffs for PPM customers are currently limited. However, following the introduction of smart metering technology tariff options for this group may increase.
[131] FDS International (February 2011).
[132] Ipsos MORI (October 2012).

5.16. Door to door sales representatives have been more important as sources of information on deals and for making a switch for those 65+, those without internet access and those in the DE social group.[133] The use of sales persons in public places has also been increasing, which will provide an alternative, non-internet source of sales. We are working to ensure that consumers have access to, and confidence in, such intermediaries, and are assessing our options in this space. Furthermore, we are taking steps to facilitate collective switching schemes. We recognise that collective switching schemes have the potential to reach out to consumers in vulnerable situations, including those without internet access.

5.17. Further work to protect and empower vulnerable consumers has also been proposed under Ofgem's new Consumer Vulnerability Strategy.

Impact on fuel poverty

5.18. Consumers who spend at least 10 per cent of their income on keeping their property heated to a reasonable level are considered to be in fuel poverty. In reality, many fuel poor households are not heated sufficiently, which has implications for health and social well being. Fuel poverty is a result of low income, high energy bills and poor housing conditions or efficiency. The best long term solution for tackling fuel poverty is to invest in energy saving. Energy prices are expected to continue rising and the RMR provides the information to encourage and equip consumers to get the best deal for them.

5.19. We do not consider that this package of proposals will create any negative impacts on households experiencing fuel poverty. The benefits of the package will be equally available to consumers in fuel poverty as to other consumers.

5.20. Fuel poverty is most common among those who live in private rented accommodation, and our research shows that consumers living in rented accommodation are also less likely to have switched supplier.[134] The cheapest tariff messaging will be useful for these consumers who are less likely to switch supplier. Such consumers therefore have the most to gain from the measures we are proposing which should help them have the confidence and tools they need to assess whether they are on the best deal.

Managing the transition to a low-carbon economy

5.21. This section describes the impacts of our proposed package of measures on the environment and on the transition to a low carbon economy. We focus our analysis on the impacts that our proposal may have on green tariffs, and also on the impacts on consumers' awareness of their energy usage and wider energy issues.

[133] Ipsos MORI (April 2012).
[134] Ibid.

Consumer awareness of energy usage

5.22. Our research indicated that most participants did not know how much energy they consumed.[135] Consumers use rules-of-thumb, such as considering the composition of their household or considering the number and type of appliances they own, to decide if they were a low, medium or high user.

5.23. Our measures to improve consumer communication will make information on consumption much clearer and more accessible, in terms of kWh and estimated annual costs.[136] This information is primarily designed to help consumers choose the best tariff for their circumstances. However it can also make consumers more aware of their consumption ahead of the roll out of smart meters.[137]

5.24. We removed the requirement to present categories for energy usage information (high-medium-low user). In part, this is based on parallels with research DECC commissioned on including benchmark comparisons on bills.[138] The findings showed little or no impact on consumption patterns. The SOC may further encourage suppliers to consider how best they can educate consumers about energy use, as well as how consumers can access Green Deal funding to reduce their consumption.

5.25. We have proposed to restrict the content provided on suppliers' communications to information directly related to the purpose of the document and information that can assist the consumer engage with the market effectively. For instance, this includes information on a consumer's personal energy consumption over the last 12 months. The purpose of the restriction is to ensure that information and messages which are key to a consumer's understanding and potential engagement with the market are not obstructed by large amounts of additional information. We consider this is necessary to keep the purpose of the documents clear and engaging for the consumer.

Green tariffs, Green Deal and Energy Company Obligation

5.26. As 'green' tariffs can often be priced at a premium to other tariffs, they may be less likely to feature in cheapest tariff messaging. However, by facilitating the compilation of best buy tables we aim to provide scope for relevant organisations to include non-price factors such as green supply in these tables.

5.27. Our proposal will raise consumers' awareness of energy information including an increase in the awareness of consumption information, and so it may lead

[135] Ipsos MORI (September 2012).
[136] Our research shows that many consumers struggle to understand what a kWh is. Providing clearer information on energy consumption and tangible examples of kWh can help to improve energy literacy and may further encourage energy savings. In our consultation document we are welcoming views on how this may best be achieved.
[137] Improved understanding of consumption will help users make better use of the In-House Displays (that will be provided during the roll-out of smart meters, and enable them using energy more efficiently.
[138] DECC (July 2011) Empowering households: research on presenting energy consumption benchmarks on energy bills https://www.gov.uk/government/publications/empowering-households-research-on-presenting-energy-consumption-benchmarks-on-energy-bills.

consumers to be more environmentally conscious. Potentially this could have a positive effect in the take-up of green tariffs. Limiting the number of tariffs, however, may deter suppliers from offering green tariffs. While we are not including a 'green' surcharge in the specified list of allowed surcharges, we consider that our proposals still provide flexibility and enable suppliers to offer green tariffs. We therefore do not anticipate that our proposals will represent a significant deterrent to the supply of green tariffs.

5.28. We have considered the impact that our updated RMR proposals may have on the Green Deal and the Energy Company Obligation energy efficiency programmes as they are currently envisaged.[139] Our tariff simplification rules will still apply to energy products when they are bundled with Green Deal and / or the Energy Company Obligation related products. However, we expect that our proposal allows for sufficient commercial freedom to market these products without materially impacting either on their implementation and / or future take up.

Smart metering

5.29. The Government policy for suppliers to roll out smart metering to domestic and smaller non-domestic premises in GB by the end of 2019 has the potential to transform how energy markets operate. It is expected that consumers will have ready access to much more information about their energy usage, helping them use it more efficiently. Domestic consumers will also be offered an In-Home Display (IHD) which will provide them easy access to near real-time information on their consumption.

5.30. We expect our proposal will increase effective consumer engagement in the energy market. This improved engagement now will provide a strong foundation for consumers to be able to engage with future innovative products and services facilitated by smart meters. Therefore, we consider the RMR proposals to be complementary to the roll–out of smart meters.

5.31. In this section we set out the links to, and potential impacts of several elements of our proposed package of measures on smart metering.

Cheapest tariff information

5.32. The roll-out of smart metering will provide consumers with more detailed information on their energy consumption than is currently available. One possible use of this will be for consumers to determine whether they could benefit from moving to a Time of Use tariff.

5.33. Suppliers may also be able to use detailed consumption data from smart meters to identify whether a ToU tariff could be the cheapest option for a consumer. However, the government has put in place a new framework in supplier's licences that sets out what consumption information suppliers can access from a consumer's

[139] The Energy Company Obligation is the Government's new domestic energy efficiency programme. It works alongside the Green Deal to provide additional support for packages of energy efficiency measures.

smart meter, and the level of choice the consumer should have about this.[140,141] Therefore, if a consumer chooses not to share detailed consumption information with their supplier, the supplier might not be able to evaluate whether a particular ToU tariff would be cheaper for that consumer.

TCR

5.34. The TCR provides an opportunity to educate consumers about energy units in advance of the mass roll-out of smart metering and the introduction of smart ToU tariffs.[142] ToU tariffs will be priced in terms of p/kWh and prices may change during the course of the day (either in a pre-defined or a dynamic way). Providing a TCR in units of p/kWh will therefore help to build consumers' understanding of energy tariffs.

5.35. Accommodating ToU tariffs within the TCR will however pose a challenge. This is because it will require assumptions about a consumer's load profile (i.e. consumption at different times of day), which will be different for each consumer.[143] A TCR calculated in this manner may be misleading. In particular, it may under- or overestimate the savings that are available. This could lead to consumers choosing a tariff that is not appropriate for them, and thereby undermine take up of ToU tariffs.

5.36. At present, the most common ToU tariffs on offer to domestic consumers are Economy 7 and Economy 10, which offer fixed different rates for certain times of the day. However, in future smart metering will enable more sophisticated ToU tariffs to be developed, which could have multiple rates for different times of the day (or weak/month/ year). In addition, some tariffs may be 'dynamic' such that either the unit rate and / or the period when these rates apply will vary.

5.37. Integrating current and, in particular, future ToU tariffs into the TCR methodology will be challenging. As a result, we have not included any ToU tariffs under the current TCR rules, but will instead set up an industry working group to further develop the TCR methodology for this type of tariffs. We expect that this working group will respond with an effective and workable method for calculating TCRs for ToU tariffs within twelve months of RMR implementation.

Tariff simplification

5.38. We want to ensure our proposed tariff cap is compatible with the smart meter roll-out, so suppliers will be able to offer four ToU tariffs per meter type or meter mode, including for smart meters, in addition to four non-ToU tariffs. This provides a degree of future-proofing of our proposals, building in flexibility so that suppliers can continue to innovate on ToU tariffs as smart meter technology develops in the next

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[140] This framework only applies to 'compliant' smart meters, i.e. those that meet the government's mandated technical specification.
[141] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/43046/7225-gov-resp-sm-data-access-privacy.pdf.
[142] The implications of the TCR proposal for ToU tariffs are discussed in Chapter 8.
[143] And, for a given consumer, it may change over time if the consumer's behaviour changes (e.g. the consumer changes jobs and starts working from home).

few years. Our proposals will allow suppliers to vary the unit rate with time of day or time of year.

5.39. We have also developed a process for suppliers to introduce 'trial' tariffs outside of the tariff cap, subject to Ofgem agreement through a derogation process. This will allow suppliers to test consumer demand and preference for different smart tariffs without taking up any of their four tariff slots.

5.40. We also consider that our proposal may represent an additional incentive to the roll-out of smart meters. Supplier may provide, if they wish to do it, a customer with a smart meter all of the options they have for each meter mode (provided that the smart meter may be enabled to work in any of those modes). In any case, we will pay close attention to this issue and monitor accordingly. Our proposed review (which will take place no later than 2017) will examine this in more detail.

Clearer and simpler information

5.41. With the roll out of smart meters, consumers will have easier access to better quality information. As the roll-out of smart meters is at an early stage, we will keep under review whether additional obligations are necessary for suppliers to help ensure consumers are realising the benefits of this additional information.

5.42. We are also mindful that in the future we may need to accommodate advancements relating to easier access to data into some of the information requirements we are proposing. For example, we may need to reassess whether consumers still require all the information required by our RMR proposals, given that smart metering will provide easier access to granular consumption data. Given the early stage of the smart meter roll-out, and the importance of improving consumer engagement now to ensure consumers can effectively engage with more sophisticated products and services offered in the future, we consider that our RMR proposals should apply to all meter types.

SOC

5.43. The use of a principles based approach to regulation under the SOC gives scope to incorporate any future market developments or innovation. This approach will allow flexibility for innovation to occur in the market. Under requirements of the SOC suppliers will need to take into account any change in consumer needs and the environment. They must ensure they are treating consumers fairly and are appropriately meeting their needs. Therefore, the SOC are technology neutral.

Protecting consumers on fixed term offers

5.44. We recognise that current licence requirements together with the rules proposed regarding price increases and other adverse unilateral variations may limit more dynamic ToU arrangements in fixed term contracts. If suppliers intend to offer such dynamic ToU fixed term tariffs, we will consider how these tariffs interact with existing licence requirements, our new proposed rules, and wider consumer protection. We may consider future exemptions to our proposals, provided that these tariffs remain consistent with the consumer protection requirements of the gas and electricity directives, for example regarding notification of price increases and other adverse unilateral variations.

6. Impacts on health and safety

Chapter Summary

In this section we look at the potential impacts of our package of measures on health and safety.

6.1. We have not identified any relevant impacts that the implementation of our proposed package of measures could have on health and safety.

7. Risks and unintended consequences

Chapter Summary

This chapter assesses the potential risk and unintended consequences of our proposed package of measures.

7.1. In earlier chapters of this Impact Assessment we have discussed the likely impacts of our recommended options. This section considers any risks and possible unintended consequences of these options.

Risks

7.2. Below we consider the risk factors that may reduce the RMR identified benefits. We focus on effects such as consumer disengagement, frustration and detriment on the one hand, and on regulatory risk for suppliers on the other.

Risk of continuing consumer disengagement

7.3. There is a risk that, despite the introduction of the RMR package of remedies, some consumers remain disengaged. While we do not anticipate that post-RMR all consumers in the market will be fully engaged, we also do not expect the level of engagement in the market to remain at its currently low level.

7.4. In our impact assessment, we assume that the numbers of consumers in the permanently disengaged, disengaged, and passive categories reduces to some extent in our medium impact case, with consumers moving gradually up the engagement spectrum. However, to a certain extent this hangs on our assumption that a concerted push like the RMR can engage to some extent those consumers who categorise themselves as 'permanently' disengaged. The risk remains that the RMR proposals only make those consumers who are already engaged (to a greater or lesser extent) more engaged, and leaves the permanently disengaged and also more vulnerable consumers untouched, widening the gap between the two groups of consumers.

7.5. To mitigate this risk, we have proposed several policies that are targeted at less informed consumers, including:

- Suppliers' cheapest tariff message on Bills, Annual Statements, Price Increase Notices and End of Fixed Term notices.
- Providing clear prompts to engagements.
- Simplifying and standardising terminology.

7.6. An additional measure we are proposing to mitigate the risk of disengagement is to put in place enhanced and ongoing monitoring focusing both on:

- The direct impact of our proposals on specific consumer groups.
- The overall impact on competition in the market.

7.7. A further aspect of disengagement that could result from our proposal is the risk that consumers would only consider the supplier's cheapest tariff and would not look at alternative options. However, we see the supplier's cheapest tariff proposal as part of a complementary set of initiatives, which aim to give consumers a stronger prompt to engage and to provide the information that they need to further assess alternative offers, both from their current and alternative suppliers.

7.8. It is possible that the industry working group we intend to establish to develop the TCR for ToU and staggered price[144] tariffs concludes that it would be inappropriate to provide a TCR for these types of offer. If we decide the TCR would mislead consumers and so should not be calculated for such tariffs, there is a risk that usefulness of the TCR will be confined to standard meters only, and that it is likely to become less useful with the wider rollout of smart meters. However, we aim to explore these issues through this industry working group in order to develop an optimal solution.

Risk of consumer frustration

7.9. Providing consumers with information about a cheaper tariff that might not be available to them (for example, a cheaper tariff that is not open to new consumers by the time a consumer contacts the supplier) could be extremely frustrating. This frustration could lead the consumer to further disengage from the energy market as they are not able to benefit from the savings that have been brought to their attention.

7.10. For this reason, we propose to require suppliers provide both a 'narrow' and a 'wide' definition cheapest tariff, to ensure consumers are provided with a savings figure more relevant to them in the first tariff recommendation they receive. This implies that a consumer on a PPM for instance will be able to compare different deals available to their meter type, as well as cheaper tariff recommendations which involve changing meter, and customers without internet access will not be disengaged by only receiving details for online offers. Furthermore, consumers will receive personal projection information for their current tariff on regular communications, enabling them to assess market options outside their current supplier.

[144] 'Staggered price' tariffs are fixed term tariffs where rates change at fixed points in time during the year (agreed at the outset of the contract). For the avoidance of doubt, where the tariff rates change 12 months into the duration of a contract, we are proposing to require a TCR to be calculated. However, for those tariffs where rates change after 6 months, for example, we do not initially expect a TCR to be calculated, due to the potential for seasonal variability to make the TCR potentially misleading or susceptible to gaming by suppliers

7.11. We have allowed suppliers to caveat tariff recommendations where restrictions on availability may apply, to ensure consumers are aware that access to a tariff may be limited. This is also why we provide consumers with the personal projection for that tariff. The personal projection will enable consumers to compare this tariff with other tariffs in the market.

7.12. As discussed in Chapter 8, a prohibition on price increases and other adverse unilateral variations will restrict available tariff types, thereby leading to a loss of certain tariffs that may be favoured by some consumers (e.g. tariffs which track other tariffs). However, our Tariff Comparability Qualitative Research shows consumers generally assumed that fixed duration tariffs are also fixed price, and the quantitative research suggests a fixed-price fixed term tariff is an attractive choice for many consumers. Neither of these findings suggests that consumers have a strong expectation to see non-fixed price fixed term tariffs in the market.

Risk of consumer detriment

7.13. There is a risk that our proposal leads to a reduction in competitively priced variable and fixed offers due to coordinated effects. However, we have discussed this in Chapter 4 and consider that overall competitive pressure exerted by a more engaged consumer base outweighs this risk.

7.14. Our proposals on auto-rollovers will make it harder for suppliers to offer very cheap fixed term offers to consumers in the hope that they rollover onto less competitive offers at the end of the contract. In this scenario, active consumers who take steps to switch when the fixed term deal comes to an end might lose out whilst those who might have been caught by the auto-rollover would benefit. However, some current practices (as outlined above) might constitute a barrier to entry or expansion for small suppliers because they are less able to match these initially cheap fixed term offers. Therefore, in this regard, banning auto-rollovers might make it easier for small suppliers to enter and expand, which would increase the degree of competition in the market.

7.15. Restricting the types of fixed term offers that are available may have implications for suppliers' hedging strategies. With restricted ability to vary prices, suppliers may attach additional risk premium / enter more costly hedging strategies to manage this reduced flexibility. This may have the effect of increasing the prices of the remaining offers in this market. It should be noted however that suppliers will still be able to vary prices through the mechanisms identified in the exceptions and the provisions for mutual variations discussed in our consultation document.

7.16. In addition, it was noted in consultation responses that restricting fixed term offers may push consumers into the evergreen market. This might occur because suppliers would remove some tariffs that were attractive to consumers and could lead to consumers disengaging from the market. However, our current proposals should align the fixed term market with consumer expectations that fixed term offers would have reduced price variation. We expect that aligning the fixed term market with consumer expectations would increase engagement in this part of the market.

7.17. Our proposals on bundled products require suppliers offer bundles as an optional product / service that must be available with all core tariffs. Otherwise it must be offered as a separate core tariff. Some suppliers may decide to reduce the different bundles they currently offer if they feel that it cannot be offered to all consumers and if they choose not to offer it as a core tariff. This may impact on some engaged consumers who value the choice of bundled products and services. From our assessment of bundled products in the energy market we feel that suppliers can still offer these products with some adjustments to ensure compliance with our rules. We also note that we are not restricting suppliers from offering these products to consumers that are not their energy supply customers. We consider that any negative consequences that may result from a reduction in choice of bundled products or services for consumers are outweighed by the benefits of creating a simpler market, which will make it easier for all consumers to navigate through.

Regulatory risk for suppliers

7.18. Responses to the December 2011 consultation raised concerns about the potential for regulatory risk, in particular in relation to the SOC. Since our policy proposal has a wide scope, as it covers all interactions between consumers and suppliers, concerns were raised that suppliers could be exposed to risks if our expectations in relation to the SOC were not clearly understood.

7.19. To address these concerns and help clarify our intent with regard to expectations around the SOC we:

- Introduced a fairness provision.
- Provided some draft guidance.
- Developed a bespoke approach to enforcement for the SOC.

7.20. The addition of an overarching fairness objective will help focus supplier activity in relation to the SOC. This framing makes our policy intent and vision for the SOC clear, which should mitigate regulatory risk.

7.21. We propose to provide draft guidance about the terminology used in the SOC to ensure that suppliers and consumers are aware of how to interpret these terms. This clarity will also reduce regulatory risk as suppliers and consumers are clear about our aim and requirements with reference to the SOC.

7.22. Our proposed approach to enforcing the SOC should also help to mitigate unintended consequences of regulatory risk.

7.23. As we see a role for the Ombudsman Services: Energy (the Ombudsman) with regard to individual cases of consumer complaints in relation to supplier conduct, some suppliers have raised concerns that there may be a risk, based on experiences in some markets, that the Ombudsman's determinations will develop precedent over time. However, rulings made by the Ombudsman are independent to those made by

Ofgem. Therefore, we do not consider the Ombudsman would set precedent (particularly in a legal sense) in their rulings. The Ombudsman judges cases individually and treats them on a case by case basis and they will assess the SOC in a different context to Ofgem (as the independent regulatory authority).

7.24. In summary, we consider that the enforcement approach and further detail provided regarding how we see the SOC working in practice mitigates the concerns surrounding the potential for regulatory risk.

7.25. In response to the December 2011 consultation, issues were raised with regard to enforcement of the SOC, exposure to regulatory risk that would result from a principles-based approach, and the potential for different interpretations (or misinterpretation) of key terms used in the Licence drafting. Whilst we do not think that regulatory risk is as significant as initially suggested, as terms such as 'professional' and 'appropriate' are in everyday use and should be widely understood, we nonetheless took account of concerns raised by stakeholders and developed guidance. We considered views and also proposed a bespoke approach to enforcement in our October 2012 proposal that will use a 'reasonable person' test.

7.26. Our draft guidance draws on existing legal definitions of key terms within the SOC including 'appropriate', 'professional manner', etc; and provides stakeholders with greater clarity regarding these terms. The proposed guidance will offer further clarity, but – in line with the principles based approach of the SOC- suppliers will still be solely responsible for ensuring compliance. In this context suppliers would need to consider how best to embed the SOC within their organisation, including how this is made operational within their business. Within the accompanying consultation document we have also provided further information on our policy approach to applying the term 'Representatives' in the context of the SOC and how we are likely to approach enforcement, in relation to Representatives.

7.27. Following the October 2012 consultation, some suppliers have raised concerns around what Ofgem will deem to be 'reasonable' in the context of the SOC. Some suppliers still consider there is potential for regulatory risk, which may arise if they have a different understanding of what outcomes the SLC for the SOC is designed to achieve. Some suppliers have again requested a formal two stage approach to enforcement, which involves dialogue between Ofgem and suppliers, or the use of an independent adjudicator, for instance a judge, to advise on cases. Also, some suppliers have requested clarification of what Ofgem would deem to be 'reasonable' and guidance around Ofgem's expectations from the SOC.

7.28. Having considered the consultation responses we confirm that we would usually speak to a supplier before taking enforcement action. However, we are not proposing a staged approach to enforcement where suppliers would be given the opportunity to 'put things right' and we would only take enforcement action if they did not take the appropriate action at that point. As outlined in Chapter 8 we consider this approach would reduce incentives for suppliers to take responsibility for the implementation of the SOC and reduce our ability to take enforcement action in serious cases or to address past breaches and the associated financial gain. As mentioned in the March 2013 consultation document as part our approach to enforcement[145] (which is currently in consultation), one suggestion has been to move to an approach where final decisions in relation to contested enforcement cases are made by a panel of decision makers appointed by the Authority. This should address concerns raised by stakeholders with regard to how enforcement decisions are made and their comments that it is important to ensure a consistent approach to assessing compliance with the SOC.

Possible unintended consequences resulting from competition dynamics

7.29. We considered previously the risks that could reduce the identified benefits of the RMR. Closely related to these risks are the possible unintended consequence that could emerge as a result of the RMR, even if all stakeholders implemented the proposal in good faith. These can be split into possible unintended consequences for switching, and possible unintended consequences for new entrants, and are considered below.

Lower switching

7.30. As we have acknowledged in our scenarios, we expect the RMR proposal to narrow the range of tariffs available. This will likely reduce the availability of costly deals at one end of the distribution, and the availability of cheap deals at the other. However, there is the risk that the number of tariffs reduces so much and prices converge so drastically that the tariff options become (as consumers already conceive) 'all the same' and switching becomes less beneficial, even to consumers who are more engaged. If this were the case, the RMR proposal would make switching reduce over time rather than increase, so the main benefits we quantify would disappear.

7.31. There is a risk that this could occur, but it would be quite an unstable scenario. Given competitive forces, if prices were to converge at the lowest level, consumers would already be getting the best deal that can be offered, and suppliers could compete on non-price issues. On the other hand, if the deals converged at a higher level than this, it would only require one supplier to offer a lower price to attract a larger share of the more engaged market to spark the switching to resume.

7.32. Related to this issue, we do expect our proposals will redistribute benefits between the most engaged consumers (who it is assumed are currently are benefitting from very cheap deals) to less engaged consumers (whose more costly tariffs may currently be cross-subsidising the cheapest deals to the more engaged). However, more engaged consumers have already benefitted from competitive tariff deals, and our proposals will level out the playing field somewhat to allow more consumers to benefit in this way.

Impacts on competition

[145] Open letter on the Review of Ofgem's enforcement activities – consultation on strategic vision, objectives and decision makers (March 2013).

7.33. There is a conception that energy suppliers currently make too much profit (see Chapter 3 for more discussion of consumer perceptions of this issue). However, if our proposal genuinely pushed down supplier margins significantly, this could limit competition in the long run by forcing suppliers away from the market. From an economic theory standpoint, it is beneficial if inefficient suppliers leave the market as it keeps prices down. However, if in practice some of the former incumbent suppliers were able to hold onto a core of permanently disengaged consumers and charge them higher prices, they would be in a position to cross subsidise and 'undercut' efficient, otherwise competitive, smaller suppliers and price them out of the market for engaged consumers.

7.34. Undeniably this would be a bad result for the energy market. However, in the face of the relatively small changes in consumer behaviour we are predicting this does not seem a serious issue as we do not expect the pressures on margins to be this strong. In addition, the products suppliers offer on the market are not completely homogenous, and many of the smaller suppliers focusing on niche deals such as green energy, on which it is unlikely the previous incumbent suppliers would be able or interested in competing on.

7.35. Our proposals reflect the view that tariff proliferation has confused consumers and reduced engagement with the market. As noted in Chapter 3, choice is only a good thing for consumers if it is providing options they value, whereas the current tariff variety brings confusion. There is a risk that as consumer confidence and ability to navigate the market increases, the tariff cap and related rules will limit the ability of suppliers to provide consumers with choice and competition. This would be undesirable, but based on our consumer research the priority is to reduce tariff proliferation. At a later date, it may be appropriate to rebalance the levels of simplicity and choice in the tariff cap.

Possible unintended consequences from suppliers' response to RMR

7.36. We have considered two key strategies that the suppliers could adopt in response to a number of our proposals, in particular those involving the introduction of TCR and personal projections, simplification of tariffs and informing consumers of their supplier's cheapest alternative tariff. 'Frustrate strategies' could be designed to limit the effect of our interventions while 'non-compliance' may involve suppliers choosing not to comply with one or more licence conditions. These are discussed in turn.

Frustrate strategies

'Fiddle the numbers'

7.37. Suppliers could seek to reduce the effectiveness of our proposal by attempting to make it impossible to compare TCRs for different tariffs. There are a number of routes through which this could be done, including misinterpreting the rules (intentionally or otherwise), being inconsistent in the application of assumptions when calculating TCRs for different tariffs, or using inappropriate consumption figures for consumers when calculating personal projections.

7.38. To mitigate this behaviour we have specified a complete calculation methodology for non-ToU tariffs (ToU and 'staggered price' TCRs will be introduced at a later stage). This methodology includes clear rules for each type of discount or product bundle such that the scope for supplier interpretation is minimised. In the event that a supplier misuses the TCR, we may take appropriate enforcement action.

'Try to confuse'

7.39. This strategy would be designed to make it difficult for consumers to use the TCR effectively. If suppliers deliberately try to make the TCR confusing, consumers may lack confidence to use it and engage in the market. This would help suppliers maintain a sticky customer base and earn relatively high margins on supplying energy to these customers.

7.40. To this end, suppliers could use a range of tactics, including providing a poor explanation of how to use TCRs when they are introduced, and/or presenting unclear information concerning the cheapest alternative tariff. Our requirements about the information surrounding the TCR, as well as our proposals for the cheapest tariff messaging, will make it harder for suppliers to pursue such a strategy.

7.41. We consider that a single medium, regional level TCR will be less susceptible to gaming by suppliers than a national average for low, medium and high consumers. However, we will monitor suppliers' responses to our proposals to assess whether further action or intervention is necessary.

Tariff proliferation strategy

7.42. Our proposed cap on the number of open tariffs and elimination of uncompetitive dead tariffs will help prevent suppliers from increasing the number of tariffs that consumers must compare to identify the best tariff. However, suppliers could choose, for example, to have a very high turnover of fixed term tariffs, opening and closing a tariff every week. This strategy could lead to consumer frustration if they explore a deal and subsequently find it is closed.

7.43. We recognise that our tariff cap is location specific. It may be that suppliers offer more than four tariffs, but that these are spread across more than one region. For example, a supplier could offer four separately branded tariffs in London and another four differently branded tariffs in Scotland.

7.44. We propose to monitor the market to see whether this materialises. However, we do not consider that it is a significant risk. Suppliers are unlikely to develop multiple tariffs with different branding, as this would require a significant commitment of resources to develop, promote and maintain a large number of different tariffs for specific locations across GB.

7.45. Nonetheless, we will monitor the extent to which this practice occurs and the extent to which it may cause consumer harm (for example if consumers in one location are offered more competitive tariffs than those in another). We will consider further action if we see evidence of practices that are harmful to the interests of consumers.

'Bait and switch' strategy

7.46. Suppliers could respond to our proposal by using a 'bait and switch' strategy to attract consumers. For example, they might advertise a cheap tariff that is only available to a small number of consumers and would direct those that apply too late to a less competitive tariff.

7.47. Suppliers could also offer attractive prices for fixed term offers, while recouping the profits on inactive consumers transferred to more expensive evergreen tariffs at the end of the contract. We propose to mitigate this behaviour by ensuring that consumers default to the cheapest variable tariff at the end of a fixed term contract. Our restriction on tariff numbers would also mitigate the risk of both alternative 'bait and switch' strategies. We also note that some bait and switch practices are likely to constitute an unfair commercial practice under the under the Consumer Protection from Unfair Trading Regulations 2008 and therefore the criminal and civil sanctions which apply should deter this type of behaviour.

7.48. Suppliers might also use aggressive marketing strategies near the end of a fixed-term contract to try to retain their customer base. However, our proposed SOC remedies, licence conditions, consumer protection law and our monitoring duties mitigate this risk.

Emphasis non-price features of tariffs

7.49. The introduction of a TCR and cheapest tariff messaging may affect the nature of competition in the retail market. In particular, suppliers may make more use of non-price features of tariffs as the focus of competition. This strategy might make it difficult for consumers to compare tariffs.

7.50. We understand that non-price features of tariffs are valued by some consumers and do not wish to prohibit such offers. However, we consider that consumers should be fully informed of the terms and in advance of signing up to a tariff. To this end, consumers should be made aware of whether opt-out bundles are available and the cost of the non-energy product if they decide not to opt-out. Our rules on discounts will also require that suppliers clearly set out the value of a free product at the outset.

7.51. To mitigate this potential comparability problem, we have proposed to apply different rules to the TCRs of bundled products, depending on whether or not the bundle is tied to the tariff. The TCR will exclude the value of any optional bundles and / or contingent discounts. The value of 'tied' bundles will be reflected in the TCR value as long as the bundle in question is not also a discount that would not be directly reflected in a consumers' bill (e.g. shopping vouchers).

7.52. We acknowledge this may create the potential for suppliers to offer multiple (potentially expensive) opt-out bundles. However, we will monitor how the market develops in this respect to assess whether further action is warranted.

7.53. It is possible that our proposals might lead prices to converge and competition to focus almost entirely on non-price features. This would be a particular concern if prices were to converge at a high level due to the removal of cheap tariffs.

7.54. While to some extent additional features such as reward points can be used to attract customers and form part of a competitive behaviour, they can also be used to exploit information asymmetries and consumers' limited capacity. The use of additional features as the focus of competition would not be a concern if consumers had complete information about all tariffs including the characteristics of each feature, the monetary value of that feature and were able to process that information.

7.55. However, consumers have limited capacity in this regard. The TCR has been created to aid consumers as they process pricing information, but would not be useful when comparing additional features. An increasing use of non-price features for competition would lead to the TCR becoming less effective as a tariff comparison tool.

7.56. We aim to mitigate the potential risks of this primarily through our rules on bundles, non-price offers, and discounts. The requirement for suppliers to offer the same optional bundles/reward point offers across all tariffs or else use up core tariff slot and our rules for bundles that are also discounts will limit the scope for suppliers to 'game' the proposals in this manner. Our new rules would mean that suppliers will not be able to offer unlimited tied bundles alongside their core tariffs. If a supplier wishes to offer a tied bundle, it must do so as part of one tariff, which will count towards the limit. Additionally, suppliers will be required to provide clear information on tied bundled products as part of cheapest tariff messaging to ensure that this prompt is not used as a means of gaming by suppliers.

7.57. Our rules on discounts, where suppliers are not permitted to offer one-off cash discounts or any other cash discount that is not applied to the standing charge and/or unit rate, will aid in providing clear and simply tariffs in the market and help mitigate consumer harm.

7.58. We could also consider putting in place more restrictive measures on discounts and bundles if we find that suppliers have responded strategically to our proposals with the aim of maintaining consumer confusion in the future.

Removal of white label tariffs

7.59. It may be that suppliers remove their white label products so that they can use their four tariffs for their own products. If this were the case, there would potentially be fewer marketing channels for energy products and a possible reduction in overall consumer awareness of the deals available.

7.60. However, three factors mitigate this risk. Firstly, as long as a tariff's terms and conditions are identical, white labels do not count towards the tariff cap. So a supplier could still offer a white label tariff that is identical to an existing tariff and market it accordingly. Secondly, our other proposals aim to simplify the market and make it clearer for consumers to understand. We expect that the impact of our overall RMR package would offset any reduction in consumer awareness caused by a reduction in white labels. And thirdly, the rule on white labels will only become effective after 12 months from the RMR implementation starting date. This will allow white label providers and parent suppliers to make transitory arrangements and prepare consumers for any adverse impact on the number and type of available tariffs.

Product differentiation

7.61. The potential outcomes in terms of product differentiation can be classified under two extremes. Firstly, with a limit on the number core tariffs, suppliers could design their tariffs so that they are the only supplier offering a tariff of that term, bundle, etc. Other suppliers may not design their tariffs to compete for that market segment because they would have to close down one of their other tariffs to meet the requirements of the cap.

7.62. In this scenario, comparisons between tariffs might be harder as the services being offered would be different. Our requirement for a supplier to offer at least one evergreen tariff helps to reduce one dimension (i.e. differentiation by contract term) arising in part of the market. Additionally, the requirement for optional bundles to be offered across all of a supplier's tariffs eliminates another potential difficulty of within-supplier comparisons.

7.63. In the other scenario, suppliers might attempt to mimic their competitors' offerings. The result would be a range of very similar tariffs. They would be easier to compare although the amount of consumer choice would be lower than the scenario above. However, we expect our reforms to encourage new supplier entry and assist those looking to gain market share through product differentiation or by offering prices that are more competitive. Therefore, while we might see some convergence of prices, we would expect that with more engaged and confident consumers there is greater scope for suppliers to break away from this convergence and to gain market share through doing so.

7.64. Finally, we have considered the possibility that a single corporate group may apply for multiple supply licences to allow them to offer more than four tariffs. Our licence drafting will address this concern by ensuring that any licence holders that are part of the same corporate group will be treated as one, no matter how many licenses they hold.

Non-compliance

7.65. The discussion above has outlined a number of potential strategic responses to our proposals and considered how these might be mitigated. However, there remains a risk that suppliers may choose not to comply with the licence conditions and so our mitigating actions might have limited effect. This would mean that the RMR could result more in enforcement costs than in the benefits set out in Chapter 3. However, considering that in advance of the RMR implementation, suppliers have been taking steps to change their practices and move closer to the RMR model, we are confident that this will not be the case.

7.66. Nevertheless, we will monitor suppliers' responses to our proposal and assess whether suppliers are compliant. Where a breach is suspected, we may take enforcement action, in line with our published Guidelines.[146]

[146] Ofgem (June 2012), Enforcement Guidelines on Complaints and Investigations http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20guidelines%202012.pdf.

8. Assessment of alternative options

Chapter Summary

This section sets out the alternative options considered in developing our package of proposals. These are presented for each of the RMR proposed package of measures.

8.1. In this section we present the options considered when deciding on our updated package of proposals. The evolution of our thinking since the December 2011 and October 2012 proposals is presented first, followed by the consultation responses which helped inform our decisions. The policy proposal options are explained, followed by a discussion of the alternative design options available within each chosen proposal.

Supplier Cheapest Tariff

Developments since December 2011 and October 2012 proposals

8.2. In our December 2011 consultation, we did not consider in detail the requirement for suppliers to provide consumers with information on the cheapest tariff. Following the consultation, we have worked with industry stakeholders, consumer groups and Government to consider how best to support the provision of such information to consumers while meeting the outlined objectives.

8.3. In October 2012, we set our detailed proposal to require suppliers to provide their customers with personalised information about supplier's cheapest tariff. The majority of respondents supported our view that the cheapest tariff message should include both supplier cheapest tariff for their payment method, consumption, meter type, and the cheapest overall tariff from their supplier irrespective of their current circumstances, personalised by consumption.

8.4. However, two small suppliers opposed this proposal on the grounds that it does not sufficiently account for the situation of their consumers who prefer innovative tariffs over cheap tariffs. We affirmed that our proposal is to make consumers aware of the cheapest tariff with their current supplier and not to discourage innovation. Consumers need to have access to clear information that enables them to engage in the market with confidence and make informed decisions about their energy options.

8.5. Over the period since December 2011, we have also worked with design experts and conducted further consumer research to refine the templates for Bills, Annual Statements, Price Increase Notifications and End of Fixed Term notices, in order to incorporate the messaging on supplier's 'cheapest' tariff.

8.6. In summary, our final proposal is; that suppliers will be required to provide each of their customers with personalised information on the cheapest tariff available to them and the potential saving if they switched. In the March 2013 consultation document we set out details on what exactly the cheapest tariff message must include.

8.7. As proposed in October 2012, the cheapest tariff messages must be provided on Bills/statements of account, Annual statements, Price Increase Notifications (and notifications for variations to other terms) and End of Fixed Term Notices. We also set the rules for suppliers to follow when calculating the savings available from switching tariffs.

8.8. We believe that the aim of a voluntary agreement between the Government and energy suppliers; that included providing information on the best tariff for them ('Clegg agreement') supports our RMR proposals.[147] However, our view is that a more consistent approach with an enforceable framework is required.

Options considered

8.9. The options we considered relating to the implementation of our proposal and definition of the cheapest tariff are set out below.

Implementation

Options considered: voluntary vs. enforceable approach

8.10. The alternative to the formal and enforceable framework (i.e. licence obligation backed by enforcement), is to rely on the current voluntary agreement between the Government and energy suppliers that includes providing information about the best deal for consumers ('Clegg agreement').[148]

8.11. As set out in our October 2012 consultation document, we are contemplating regulatory action because suppliers have not addressed similar problems in the past through voluntary initiatives, including our proposals from the Probe, which sought to improve consumer experiences in their interactions with suppliers.[149]

8.12. The proposed approach would ensure that the information on the cheapest tariff is more consistent, transparent and accessible to all consumers. It will help disengaged consumers identify the cheaper tariff for them and it will help increase engagement in the market for all consumers.

8.13. By making the provision of the information on the cheapest tariff enforceable, we will ensure that suppliers have the incentive to successfully deliver this message.

[147] For details please refer to: http://www.decc.gov.uk/en/content/cms/news/dpm_bestdeal/dpm_bestdeal.aspx.
[148] For details please refer to: http://www.decc.gov.uk/en/content/cms/news/dpm_bestdeal/dpm_bestdeal.aspx.
[149] See Chapter 4 in Ofgem March 2013 RMR Consultation Document.

Suppliers have stated that without speaking to their customers it's impossible to assess what the 'best deal' for them would be. They felt that any information they provided regarding the cheapest tariff for a customer should only be the starting point for a conversation. Previous experience clearly suggests that a voluntary approach would not deliver the desired outcomes.

8.14. Our approach allows us to prescribe *where* this messaging appears as we believe there are real benefits from consumers being able to see the savings[150] they can make when it appears on Bills/statements of account, Annual Statements, Price Increase Notifications (and notifications for variations to other terms), and End of Fixed Term Notices.

8.15. Under a voluntary approach, without specifying what the supplier's cheapest tariff should be, there is potential that a large proportion of consumers would remain unaware that they are not on their current supplier's cheapest tariff, and may not know the savings they could make. Our research has shown that understanding the amount of savings, in pounds per month or per year, is a key driver to engagement.[151]

Options considered for: Definition

8.16. We considered five possible options that could be implemented to define and provide consumers with information on the cheapest tariff from their current supplier. As part of our assessment the pros and cons associated with each option are explored in Table 9 below:

Table 9: Summary of options for defining supplier cheapest tariff

Policy option	Pros	Cons
Option 1. Cheapest tariff across all tariffs offered by that supplier ('wide definition')	- useful for some consumers - offers greatest savings - this level of savings may be high enough to be compelling for many and act as effective prompt for engagement and switching	- for some consumers there may be costs involved in changing to some tariffs (for example PPM customers may need to change their meter) - it may often imply significant changes to consumer preferences, and if this is not clear it may damage consumer confidence - cost implications for suppliers
Option 2. Cheapest evergreen standard tariff offered by that supplier within consumer's current payment method	- simple tariff - available to all consumers - has no termination date and no minimum contract length - incentives to switch are not distorted by the existence of a termination fee - may be more appealing for less	- doesn't highlight supplier's cheapest tariff - may be more expensive than the customer's current deal, which could undermine the purpose of the message on savings - unlikely to be a significant prompt for many consumers

[150] SPA Future Thinking's research ('Options for cheapest tariff messaging on customer communications - Report of qualitative research' October 2012) shows that one of the key pieces of information customers wanted to know was how much they personally could save by changing tariff.
[151] SPA Future Thinking, 'Options for cheapest tariff messaging on customer communications - Report of qualitative research', October 2012b).

Policy option	Pros	Cons
	engaged consumers, or those who do not feel comfortable changing tariff type or payment method - less burdensome in terms of costs to suppliers than Option 1	- offers consumers only a limited choice as suppliers offer limited number of standard tariffs - supplier has the ability to vary the terms, given the evergreen nature of these tariffs
Option 3. Cheapest tariff offered by that supplier within consumer's current payment method, consumption and meter type ('narrow definition')	- doesn't imply changing payment method - likely to be suitable for consumers' current circumstances - makes the choice simpler - appeals to less engaged consumers, or those less confident in navigating the market - less burdensome in terms of costs to suppliers than Option 1	- doesn't highlight supplier's cheapest tariff - offers consumers only a limited choice - savings may not be very high - producing the offer personalised by payment method is likely to be more costly for suppliers than Option 2
Option 4. Cheapest tariff offered by that supplier within consumer's current consumption, tariff type and meter type ('narrow definition')	- appeals to 'sticky' and less engaged customers' more than Option 3 - likely to be suitable for consumers' current circumstances - makes the choice simpler - less burdensome in terms of costs to suppliers than Option 3 as it does not require producing the offer personalised by payment method	- will often require changing payment method - doesn't highlight supplier's cheapest tariff - offers consumers only a limited choice - particularly difficult to calculate without consumption - savings may not be very high
Option 5. Generic message and signposting for information on cheapest tariff	- encourages consumers to speak to someone whom they may trust more	- doesn't highlight the cheapest tariff - doesn't provide personalised information - concerns that consumers may be reluctant to approach someone to discuss their energy options - very limited impact on consumer engagement as personalisation and use of personal data to illustrate or provide savings are more effective ways of engaging consumers
Option 6. No change – suppliers provide details of premium/discount between customer's current and supplier's standard direct debit tariff on annual statements	- easy to implement - no/minimal additional costs for suppliers	- doesn't highlight the cheapest tariff - provided only once a year - doesn't provide personalised information - very limited impact - it won't facilitate greater levels of consumer engagement

8.17. Our research highlighted that personalisation and use of personal data to illustrate or provide savings is more effective in engaging consumers than using generic information.[152]

8.18. Based on the research noted above and analysis undertaken, we adopted a combination of narrow definition (Option 4) and wide definition (Option 1) as our preferred option for defining the cheapest tariff. The intention of the narrow definition is to provide consumers with a savings figure which would represent very low barriers to overcome to engage with the market. By contrast, the wide definition is intended to show the largest savings available if consumers are willing to change their current preferences.

8.19. This proposal will make it easier for consumers to engage with the market. Consumer research and testing clearly show that many consumers are interested to see if there are cheaper tariffs available from their existing supplier using personalised information on their consumption.[153] Many are interested in what they could save through a switch that doesn't require a change to their current preferences such as their current type of tariff and / or meter type. However, they also want to see information on the level of savings that could be made irrespective of current preferences (which are likely to be higher), but may involve changing payment method or moving to online account management.

8.20. In October 2012 we proposed that the narrow definition respects payment method but not tariff type. However, our new rules to simplify tariffs allow suppliers to choose the tariffs for which they offer different payment methods. As a result, not all tariffs will be available for all payment methods. It is likely this will significantly reduce the number of available tariffs for some consumers in the narrow definition. This would reduce the effectiveness of this messaging for the most 'sticky' group of consumers, those on evergreen contracts paying by standard credit.[154]

8.21. Furthermore, under our October 2012 proposals, consumers on evergreen contracts would be offered fixed term tariffs if they are cheaper in the narrow definition. There are many factors for a consumer to consider when deciding to change to a fixed term tariff. For example, whether they are willing to be tied to a tariff for a long period or pay an exit fee to leave early. This could be a significant barrier for some consumers to overcome, particularly, if they have not previously engaged in the market.

8.22. Following consideration of these issues, we think it is appropriate to change our proposal and respect tariff type but not payment method in the narrow definition. We recognise changing payment method could be seen by some consumers as a barrier to changing tariffs, however on balance we consider changing to an alternative tariff type (and in particular a fixed tariff) would be a greater change. Our new proposal will therefore ensure consumers are provided with a tariff which is similar to their own, and has lower barriers to overcome.

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[152] SPA Futurethinking, 'Options for cheapest tariff messaging on customer communications; Report of qualitative research' (October 2012b).
[153] Ibid.
[154] Ipsos MORI, Tracker Survey (April 2012).

Tariff Comparison Rate

Developments since December 2011 and October 2012 proposals

8.23. In December 2011, we proposed to introduce a price comparison guide. This 'Standard Equivalent Rate' (SER), was designed to improve comparability between the prices of standard and non-standard tariffs. The Tariff Comparison Rate (TCR) developed out of this proposal. Stakeholders were broadly supportive of the concept, and there was a general consensus that it can be difficult for consumers to compare the price of energy tariffs and that a standard comparison metric would be helpful.[155]

8.24. Respondents to the October 2012 consultation were broadly supportive of our proposals to develop a tool to make it easier to compare tariffs, but there were some concerns about the form it should take. Respondents indicated that a national TCR would not be practical, that requiring the TCR to be set for low, medium and high users could be confusing and that setting the TCR in p/kWh could make it an ineffective prompt for engagement.

8.25. Some suppliers felt that the TCR would be misleading for consumers and unworkable to use in advertisements and other promotional material.

8.26. There were fewer responses on the personal projection proposal, and though many respondents were supportive of the idea, there were some concerns as to how it would be calculated when no previous consumption data was available for a particular consumer.

Options considered

8.27. This section provides an overview of all of the options we considered when developing the TCR and the personal projection between December 2011 and publication of our final proposals in March 2013. Table 10 summarises these options.

Table 10 Summary of options for defining the TCR methodology

Policy design area	Options
Units	Option 1. Indicative costs (£/year or £/month)
	Option 2. Unit rates (p/kWh or £/MWh)
Dual fuel tariffs presentation	Option 1. Compile a single TCR for each dual fuel tariff based on assumptions about gas and electricity consumption
	Option 2. Calculate separate TCRs for the gas and electricity elements of dual fuel tariffs
Dual fuel tariffs calculation	Option 1. Treat dual fuel discounts as a type of contingent discount such that they would be excluded from the TCR and specified separately
	Option 2. Include dual fuel discounts in the TCR
	Option 3. Include dual fuel discounts and define the split between fuels
Treatment of features such	Option 1. Exclude the value of additional features from the TCR

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Policy design area	Options
as reward points	Option 2. Include the value of additional features in the TCR
Treatment of bundles products	Option 1. Include only the energy component in the TCR for bundled products (for opt-in bundles)
	Option 2. Define specific product offerings/bundles so TCRs can be calculated and compared across suppliers for these specified bundles
	Option 3. Include the entire bundled offering in the TCR (for opt-out and tied bundles)
	Option 4. Exclude bundles products entirely from TCR
Number of consumption assumptions for TCRs	Option 1. Median consumer only
	Option 2. Low, median, high consumers
Regional issues	Option 1. Use regional TCRs
	Option 2. Use national TCRs
Time of Use	Option 1. Separate TCRs for each time period involved
	Option 2. Suppliers to use their own customer base to determine weighting
	Option 3. Ofgem to set the weightings to be used by suppliers
	Option 4. Average domestic customer shape
	Option 5. 'Flat' shape -Consistent usage for each period of the day
	Option 6. Require TCR for E7 only
	Option 7. No TCRs for ToU tariffs
Governance	Option 1. Licence
	Option 2. Direction
	Option 3. Code
	Option 4. Industry working group
TCR in regular communications	Option 1. Prescribe position and detail for TCR and personal projection
	Option 2. Prescribe minimum information that must be provided
TCR in marketing materials	Option 1. Most prominent price information
	Option 2. TCR must be clearly communicated and clearly visible

Units for the TCR and personal projections

8.28. In Spring 2012, Ofgem commissioned Ipsos MORI to test the ability of consumers to use a price comparison guide expressed in different units (£/MWh, p/kWh, £/month and £/year),[156] consumer preferences and whether any of the metrics are likely to mislead consumers. The qualitative phase of the research suggested that there is little difference in consumers' ability to use the metrics when expressed in different formats. Given the lack of firm evidence for either approach, the choice between unit rates and indicative costs has been determined by other factors.

Option 1: indicative costs (£/year or £/month)

[156] Ipsos MORI (September 2012).

8.29. In the Ipsos MORI (2012) research, many participants showed a preference for presenting the price comparison guide in terms of £/month. While there is little difference between the indicative costs and unit rate metrics in terms of consumers' ability to compare tariffs, we consider that there is a difference in terms of the effectiveness of the measures as a prompt. Presenting the TCR in monetary terms would lead to a wider range than would for the p/kWh approach, showing that significant savings might be made and hence may be more likely to prompt consumers to engage in the market.

Option 2: unit rates (p/kWh or £/MWh)

8.30. While this approach is less effective as a prompt to engagement, it may limit the risk of consumer detriment arising from unfulfilled expectations, as the importance of energy consumption as a component of bills would be more apparent.

8.31. In October 2012 we proposed that TCRs should be presented in p/kWh and we continue with this approach. While this may not be the best prompt to engagement for consumers, it avoids the risk of consumers receiving bills higher than expected. Using different units for the personal projection and TCR should also help to avoid confusing consumers.

Number of consumption assumptions for TCRs

8.32. TCRs could be based on the consumption of the medium consumer alone or could be based on the consumption of low, medium and high consumers.

Option 1: medium consumer only

8.33. Relying on a single assumption for a medium user would make the TCR a simple and relatively easy to understand concept. However, this could lead consumers to unwittingly switching to a more expensive tariff.

Option 2: low, medium and high consumers

8.34. This would meet consumer preferences for information that is tailored to them, but it would be more complex for consumers to understand.

8.35. In October 2012 we proposed to provide separate TCRs for low, medium and high users. However, this received mixed responses from consultation respondents and our consumer engagement showed some consumers did not understand it. There are concerns that consumers might not know which consumption band they are within. While we intend to mitigate this risk through clear messaging on consumer communications, this may not be sufficient to mitigate confusion.

8.36. Furthermore, as our policy has shifted to regional TCRs (see below), a larger number of TCRs will be required. Moving to a single medium user TCR will mitigate the impact of this policy change to some extent, and re-balance the requirements of simplicity and accuracy for the TCR. As a result of these considerations, we are therefore proposing to move to a single medium user TCR, gaining in simplicity and saliency while losing somewhat accuracy.

TCR: Regional issues

8.37. Regional pricing creates a complication for the TCR, given that TCRs would be used in national best-buy tables and would appear in national advertisements. In the October 2012 consultation, we considered two options:

Option 1: regional TCRs

8.38. This would be more accurate and pose fewer risks of gaming but would likely be harder to publicise in the national media.

Option 2: national TCRs

8.39. This would take the form of a weighted national average, which would be easier to understand, compare and use in advertisements.

8.40. In October 2012, we concluded that we would develop a national TCR and select the regional weightings. However, several respondents to our consultation warned of the risks surrounded with using a national weighted average. They argued that our proposals for the TCR could potentially be in conflict with advertising standards and consumer protection legislation.

8.41. The key factor in these standards is the degree to which a consumer could be misled into making a decision that they would not have otherwise. Creating a comparison tool like the TCR that factors in the standing charge of various regions means that it will not be reflective of the tariff prices in any one given region. This would mean that if a consumer was to use the information contained in a national Best Buy Table as the sole basis for comparison, they could make a poor switching decision.

8.42. For this reason we have opted to pursue a regional rather than a national TCR. This may reduce the number of situations in which a consumer can be presented with the metric but it will reduce the risks that a consumer will be misled into making an incorrect choice.

Dual fuel tariffs - presentation

8.43. We have considered two options for presenting TCRs for dual fuel tariffs.

Option 1: compile a single TCR for each dual fuel tariff based on assumptions about consumption

8.44. This would clearly distinguish dual fuel tariffs as a separate product and would ensure that it is easy to compare dual fuel tariffs across the market but they would not be comparable with single fuel tariffs.

Option 2: calculate separate TCRs for the gas and electricity elements of dual fuel tariffs

8.45. Under this option, consumers could compare the price of each fuel with alternative single fuel tariffs. However, it would be more difficult for consumers to compare the total cost of a dual fuel tariff with alternative dual fuel tariffs under this option. Given that the TCR is designed to prompt consumers to compare tariffs, we consider that it is most appropriate to have separate TCRs for the gas and electricity elements of dual fuel tariffs.

Dual fuel tariffs - calculation

8.46. We have considered how dual fuel discounts should be treated in the TCR. We note that dual fuel discounts are only 'contingent' on the consumer's choice at the time of selecting a tariff and not on their subsequent behaviour. The discount is also based solely on the consumer's energy supply and is not contingent on the purchase of a non-energy product. Given that dual fuel discounts apply from the point of sale onwards, we consider that it should be included in the TCR. This approach would make it easier for consumers to compare the price of dual fuel and non dual fuel tariffs using the TCR than if dual fuel discounts were excluded from TCRs and required the consumer to judge the impact of the discount on the TCR.

8.47. Having considered the issues, we propose that the TCR should include dual fuel discounts and that, for simplicity, half of the discount is to be applied to gas and half to electricity.

TCR: Treatment of additional features such as reward points

8.48. We considered whether additional features should be included in the TCR.

Option 1: exclude the value of additional features from the TCR

8.49. Additional features are typically used as a marketing tool. It can be difficult to monetise the value of some of these features and so it could be sensible to exclude the value of these features from the TCR.

Option 2: include the value of additional features in the TCR

8.50. Given that additional features are valued by some consumers, there is an argument that the value should be reflected in the TCR. We are conscious of the fact that any policy for treating additional features can affect the incentives to offer different types of features. This option could lead to a distortion in the market by incentivising suppliers to offer only additional features that could be easily monetised, or lead to suppliers offering features that are difficult to monetise and applying high values to these features to reduce the TCR of the tariff.

8.51. Based on the discussion above, we proposed to exclude additional features from the TCR.

TCR for bundled products[157]

8.52. We have considered whether the cost of bundled products should be included in the TCR. We have also considered how the type of bundling affects the optimal approach.

Option 1: include only the energy component in the TCR for bundled products

8.53. Under this option, the TCR would be based on the cost of the energy element of a tariff alone. Additional fees charged for the extra products or services would not be included in the TCR and would need to be specified separately.

8.54. While the TCR would not reflect the total cost of the product bundle, it does allow consumers to compare energy tariffs on a like-for-like basis. However, this risks being misleading, particularly where taking the bundled product is mandatory if the consumer is to access a particular energy tariff. The same concern would apply if the default option is to take the product bundle and the consumer would need to actively choose to opt-out if he wished to secure the non-bundled energy tariff.

Option 2: define specific product offerings/ bundles so TCRs can be calculated and compared across suppliers for these specified bundles

8.55. Ofgem would specify the components (services/products included) that could be included in each bundle. However, true comparability between tariffs and suppliers would require that the terms and conditions of each tariff (including the bundled product) were identical. This is unlikely to arise in the absence of Ofgem's intervention but such intervention would constraint suppliers' freedom and ability to innovate. Consumers are likely to be confused under this option and so several unintended consequences could arise.

Option 3: include the entire bundled offering in the TCR

8.56. In this option, suppliers would calculate the TCR on the entire bundled product (including the energy and non-energy services). This option would provide a better estimate of the expected tariff cost where bundles are tied or opt-out in nature than Option 1, but TCRs for bundled tariffs would not be directly comparable to non-bundled tariffs. While this option would allow a more accurate comparison of the expected cost of non-bundled tariffs and those where taking a bundled product is mandatory, it is not necessarily appropriate where bundles are 'opt-in'. In this case,

[157] Currently, SLCs 22 and 24 contain requirements for bundled products.

the consumer must make an active choice to take the bundled product and hence the default is a non-bundled tariff. In such circumstances, Option 1 is more appropriate.

Option 4: exclude bundled products entirely from the TCR

8.57. This would avoid some of the complications that arise under the other options but would mean that consumers could not easily compare the price of bundled and non-bundled tariffs.

8.58. Taking into account the issues described above, we propose that a combination of Options 1 and 3 be used, contingent on the type of bundle. When calculating the TCR for tied bundled products Option 3 will be used. All optional bundles will be excluded from the TCR calculation.

TCR for ToU tariffs

8.59. In the October 2012 consultation, we did not propose a methodology for calculating ToU tariffs, but while acknowledging this would not be straightforward, we expected to develop this in advance of the implementation of the RMR proposals. The challenge is how to weigh the different electricity costs for different times of the day to come up with one number for the TCR. In developing our final recommendations we considered a number of options.

Option 1: separate TCRs for each time period involved

8.60. Under this option there would be a different TCR for off-peak and peak hours. While this is relatively easy to explain, in practice it will require consumers to look at multiple figures even when comparing tariffs for the same ToU meter type. As the hours of the day will vary by meter and/or tariff, TCRs will not be directly comparable.

Option 2: suppliers to use their own customer base to determine weighting

8.61. Under this option, suppliers would develop their own weightings for different periods, using actual customer consumption. This will likely be more accurate than if Ofgem were to set the weightings, but it will mean that TCRs will not be comparable across suppliers. This will lead to situations where the prices and periods of time that two ToU tariffs cover could be identical but the TCRs may be different.

Option 3: Ofgem to set the weightings to be used by suppliers

8.62. Standard weightings are already in existence for some standard ToU meters, but these would have to be developed for any new or more obscure ToU tariffs. However, this would require the collection of consumption information for each different meter type, which would be a resource intensive process.

Option 4: average domestic customer shape

8.63. Under this option, we would base the TCR on the average electricity use of domestic consumers. This would be consistent and straightforward, but it would not pick up the benefits consumers could achieve from ToU tariffs. A ToU TCR would always appear to be an uncompetitive value compared with a single rate equivalent. It would also be challenging for ToU customers to gauge the best tariff for them, as the difference between varying periods will be obscured.

8.64. A variation on this could be to 'amend' this shape to reflect the likely change in consumption that could be seen if a consumer were to move to that ToU tariff. However, this would assume that consumers would take the steps to shift their consumption to off-peak times, which they may be unable or unwilling to do and would therefore be misleading.

Option 5: 'flat' shape - consistent usage for each period of the day

8.65. This would be a simple solution as it would remove the need for assumptions around consumption across different time periods. However, again this would likely always make ToU tariffs look uncompetitive compared to standard tariffs and would not reflect realistic consumption.

Option 6: require TCR for E7 only

8.66. The benefit of focusing on E7 tariffs is that it would capture the vast majority of the ToU market. Assumptions are already made about consumption on these meters which could be familiar to consumers. However, this could limit the use of the TCR, not only by excluding some ToU tariffs but also restricting how useful a tool this could be in the future as smart meter ToU tariffs enter the market.

Option 7: no TCRs for ToU tariffs

8.67. While this would avoid the complexity surrounding the options considered above, it would prevent approximately 20 per cent of households from using and accessing the TCR in the medium term. It would also reduce the TCR's benefit as a comparison tool in the longer term as smart meter ToU tariffs enter the market.

8.68. Each of the options above would require significant additional development to ensure that a TCR for ToU tariffs functions effectively and is not misleading for consumers. We therefore recommend that the issue of ToU TCRs be passed to an industry working group to develop a solution to be implemented at a later date. Our approach to this is discussed further below.

TCR Governance

1.2. In the consultation document, we note that for the TCR to be effective, it requires binding, standardised rules for its calculation and it would be appropriate that Ofgem sets these as it could integrate them into the supplier licence conditions. However, if we wish the TCR methodology to develop in line with the market, and to integrate changes such as ToU TCRs, this may not be an appropriate option.

Option 1: TCR methodology in the licence

8.69. The process for making amendments to a licence is burdensome. All licence modifications must be consulted upon, requiring significant inputs of time from Ofgem, suppliers and other stakeholders. This process would be inappropriate for a concept such as the TCR, which is new and may require tweaking when implemented.

Option 2: TCR methodology through direction

8.70. Ofgem could set the governance for the TCR out in a direction. Using directions to set the methodology of the TCR would allow rules to be updated when necessary without a protracted process. However, changes made without the engagement of market stakeholders are very unpopular and could lead to decisions that are not optimal.

Option 3: TCR methodology in industry code

8.71. Under this option we would set up a TCR industry 'code'. A code is a live document that can be changed by the code signatories. However, a code is likely to be burdensome and costly.

Option 4: Industry working group

8.72. Under this option, we could require the industry to provide a collective report from time to time, with the purpose of reviewing the TCR methodology and developing the ToU TCR methodology. Those recommendations of the working group with which Ofgem agreed would be integrated into the licence conditions via a proposed power of direction for applying the TCR to such tariffs.

8.73. Overall, Option 4 appeared to be the best option to create consensus and a strong, flexible methodology for the TCR.

TCR in regular communications

8.74. For the TCR to be useful to consumers, they will need to be able to refer to the TCR for their own tariff. We consider that it should therefore appear on certain consumer communications. Following our October 2012 consultation, we considered two options of how this could be included.

Option 1: prescribe position and detail for TCR and personal projection

8.75. Our October 2012 proposal was that the TCR should be included on the bill within the prescribed box on page 2, and that the personal projection should be included on the bill within the prescribed box on page 1. While this would ensure the prominence of these metrics, it was unpopular with respondents who felt it would take up a significant amount of space.

Option 2: prescribe minimum information that must be provided

8.76. We acknowledge the space constraints that exist on the bill, but consider that if the TCR is not included, it would significantly weaken it as a comparison tool. Accordingly, we propose that the TCR and the personal projection should be featured on the bill.

TCR in marketing materials

8.77. Related to this issue is where the TCR should feature in adverts and other marketing materials. In our October 2012 proposals, we required that when pricing claims are made, the TCR must be the most prominent pricing information. However, one of the larger suppliers considered this requirement to be 'unworkable'. The options here are considered below.

Option 1: TCR as the most prominent pricing information

8.78. Requiring the TCR to be the most prominent piece of pricing information on all marketing material would strengthen the effectiveness of the measure, drawing consumers' attention to the rate.

Option 2: TCR must be clearly communicated and clearly visible

8.79. While this would not require that the TCR was the most obvious item of pricing information, this would prevent the TCR from being 'lost' in the small print, while not being unduly prescriptive.

8.80. On a related issue, a number of suppliers noted that requiring where relative price claims are made, the TCRs of comparable tariffs will need to be presented to substantiate the claim, would prevent absolute claims (e.g. 'we're the cheapest in the market') from being made, as all TCRs would need to be provided. As a result, we instead propose that when comparative claims are made, only the TCR for the tariff in question (e.g. the cheapest) is provided.

Personal projection

8.81. In October 2012 we proposed a different approach for personal projections, where the treatment of bundled products in personal projections would depend on the consumer's current tariff choice. If the consumer has already chosen a bundled product, personal projections would assume that he wishes to retain that bundled product.

8.82. However, for simplicity and for alignment with our approach to the TCR, we now propose that the personal projection will include the value of any tied bundles, or any tied bundles which are also discounts, (were the value of the discount affecting the standing charge and/or the unit rate), but will exclude the value of any optional bundle. This will help consumers compare their current tariff to another on a more like-for-like basis, while also allowing the personal projection to help with consumer budgeting, as it will show consumers approximately what they will have to pay over the course of the next year.

8.83. Our approach is that where information provided to a consumer is personalised (e.g. in written communications or as part of direct sales), the Personal Projection should be used. For all other circumstances, the TCR should be used.

Tariff simplification

Developments since December 2011 and October 2012 proposals

8.84. In December 2011, we proposed to limit suppliers to one tariff per payment method in the evergreen market and to ban discounts and bundled products and services (RMR Core). We considered that these measures, along with an Ofgem - set standing charge, would allow consumers to make 'at-a-glance' tariff comparisons and assess their options more easily and effectively.

8.85. Respondents to our December 2011 consultation agreed with the problems we identified in relation to tariff complexity. They also recognised the need to simplify the market in order to build consumer trust and engagement.

8.86. However, stakeholders also raised a number of concerns, for example that our proposals might not significantly reduce tariff numbers. They indicated that the scope for innovation and entry from small suppliers might be harmed, and that discounts and bundles that many consumers value would be eliminated from the evergreen market. Some did not agree that too much choice was detrimental to the interest of consumers. There was also concern that our proposals did not cover the fixed term segment of the market and concerns were also raised with regard to the cost and potential unintended consequences of our proposals.

8.87. In parallel to our December 2011 proposals, some incumbent suppliers began to review how they engage with their customers. They took on board suggested improvements to rebuild their customers' trust. As a result, suppliers have reduced their core tariffs, simplified tariff structures and discount practices. In our October 2012 proposals, we recognised that industry has made progress in the last 12 months. We acknowledged that many small suppliers offer few named tariffs and use simplicity to differentiate themselves from incumbent suppliers. Further details of industry initiatives were provided in the main October 2012 consultation document and we have published on our website letters from suppliers, which set out steps they have taken to improve tariff simplicity.

8.88. We stated in October 2012 that we no longer proposed to take forward RMR Core. Instead, we proposed that suppliers would be limited to offering four core tariffs per fuel and meter type. We also proposed rules to simplify discounts and bundled offers. We considered this struck an appropriate balance between supplier freedom to offer, consumers' choice, and our RMR goals of a simpler, clearer and fairer domestic energy market for consumers.

8.89. Respondents to the October 2012 consultation broadly welcomed our overall policy intent. They recognised that tariff proliferation was still a concern for consumers which factored in overall levels of disengagement. They also welcomed the proposal to standardise tariff structures.

8.90. However, there was concern about parts of our proposals. For example, some suppliers wanted the tariff cap to be higher than four. Others wanted derogations for specific types of tariffs, such as deemed contracts. Some Big 6 and white label suppliers argued that there were not enough slots in the cap to allow licence holders to offer their tariffs to white labels. Others also argued that the tariff cap would constrain their ability to test consumer demand with short term, 'trial' tariffs.

8.91. There was also some concern about our proposed treatment of discounts. Some suppliers wanted more freedom to offer cost-reflective discounts, such as those for online billing. All suppliers favoured maintaining a way to reward customer loyalty, to help them maintain the relationship with customers. Consumer organisations strongly argued against discount complexity.

Consideration of other options

8.92. This section provides an overview of all options considered to achieve tariff simplification between December 2011 and publication of our final proposals in March 2013. It includes the options from the October 2012 Impact Assessment, as well as key alternatives we considered following responses to the October 2012 consultation document. The key decisions to be made relate to standardising complex aspects of tariffs so that it is easier for consumers to assess their options, reducing the overall number of tariffs in the market and ensuring that any policy intervention provides a long-term solution. The alternative options are summarised in Table 11 below and their advantages/disadvantages discussed in turn.

Table 11 Summary of options for the tariff simplification proposal

Policy option	Pros	Cons
Our proposals		
Option 1. Package of simplification measures including capping tariff numbers	- reduces number of tariffs in the market - removes many complex tariffs from market - reduces complexity of bundled offers and services whilst providing supplier freedom - introduces key provisions for deemed tariffs, paperless billing, white labels and collective switching - introduces exemption process for trial tariffs and green tariffs	- some restriction on innovation
Options put forward in October 2012 IA		
Option 2. As option 1 without	- removes complex tariffs from the market	- does not safeguard against future tariff number increases

Policy option	Pros	Cons
cap on tariff numbers	- suppliers have greater commercial freedom to offer widest range of tariffs	- less effective at building consumer trust and confidence
Option 3. As option 1 without simplifying tariff structures	- reduces number of tariffs in the market - may achieve indirect simplification of complex tariff structures	- does not guarantee tariff structure simplification - complicates consumer tariff comparison exercise
Option 4. One tariff per payment method (December 2011 proposals)	- reduces number of evergreen tariffs to the greatest degree - facilitates unit rate comparisons (combined with Ofgem-set standing charge) - eliminates complexity caused by discounting and bundling practices in evergreen market	- eliminates consumer's choice to choose discounts and bundled services in evergreen market - does not cap overall number of tariffs - restricts supplier innovation
Option 5. Principles-based approaches	- provides parameters for suppliers to work in whilst allowing commercial freedom - arguably less complex to implement	- does not guarantee tariff simplification or a reduction in tariff numbers - does not provide suppliers with specific instructions and thus regulatory uncertainty is higher
Options considered following October 2012 consultation		
Option 6. Increase overall level of tariff cap (e.g. to six)	- gives suppliers more freedom to develop tariffs according to commercial priorities - allows a non-prescriptive, more flexible approach around green, innovative, and white label tariffs - review period could be used to assess effect on the market	- could increase tariff numbers by up to 50 per cent on Option 1 - would make less contribution to RMR Simpler goal
Option 7. keep level of tariff cap at 4 and allow additional slots for particular tariff types (e.g. white label, green)	- keeps tighter control on which tariffs can be offered - Not all suppliers would need the additional tariffs. - gives suppliers greater freedom - review period would be used to assess effect on market	- could increase tariff numbers by over 50 per cent on Option 1 - less easy for consumers to understand - some suppliers could question logic of having special slot for green tariffs
Option 8. exempt independent white label suppliers but not branded white labels from the cap	- would preserve additional route to market and consumer engagement - could help to preserve business models of independent white labels	- would not reduce overall tariff numbers - additional market participants could increase complexity - could lead to more white label suppliers being set up to circumvent tariff cap

Options considered

Option 1: (our proposals) a package of simplification measures including capping open core tariff numbers

8.93. Our proposals, as set out in the March 2013 consultation document, aims to strike a balance between increased tariff simplification and reduced scope for market segmentation against giving consumers a choice of tariffs and retaining the discounts and bundles they value.

8.94. We consider that this option will be most effective in reducing tariff complexity and increasing consumer confidence. Although it is more restrictive of suppliers' commercial freedom in the fixed term market than our December 2011 proposals, it balances this by loosening the restrictions we originally proposed in the evergreen market. In summary:

- Our proposal to eliminate multi-tier tariff structures will mean that a large number of the more complex tariffs would be removed from the market. It will improve tariff comparability whilst still allowing tariffs to be cost-reflective.

- Rules on white labels will allow those suppliers to make the case to Ofgem for an exemption from the tariff cap (or for white label providers to obtain a supply licence). This will provide some temporary flexibility for white labels that add value to the market.

- Our ban on the more expensive dead tariffs will remove a number of tariffs from the market that do not offer consumers value for money.

- Proposed exceptions for paperless billing and deemed terms will allow suppliers to offer these to consumers without using an additional tariff slot.

- Rules on discounts will make tariffs clearer and simpler. Since our permitted discounts must take the form of adjustments to the standing charge and / or unit rate these proposals are consistent with, and share many of the benefits of, our required simplification of tariff structures. We also considered the effects of one-off discounts in the form of cash and non-cash discounts. It is important that consumer choice is clear when comparing energy tariffs. As consumers have time inconsistency of valuing money now more than in the future, this can lead to choices that are biased and not optimal for them in the long run. Therefore, we have proposed that, other than Dual Fuel and Online, all other discounts are to be or applied to a unit rate/standing charge are banned. One off discounts must also be provided upfront and cannot be in the form of cash.
- Rules on bundled products / services and reward points will reduce undue complexity whilst allowing suppliers to offer the products that consumers most value. We felt that it was appropriate to allow suppliers the freedom to offer bundled products and services in the market if they were offered across all core tariffs to all consumers. We also considered different options for tied bundles and felt it was necessary to reduce complexity so that consumers

could better navigate through the market. Allowing one bundled product to be tied to more than one core tariff, or allowing several different bundles to be tied to one specific core tariff adds complexity in consumer choice and the potential for consumer harm which has lead us to restrict such practices.

8.95. Our appraisal of Option 1 is set out in more detail in other sections of this document and the consultation document. We considered seven other options to address tariff complexity. These are discussed below.

Option 2: Option 1 without a cap in tariff numbers

8.96. The design of this option would be the same as Option 1 with the exception that there would be no cap on open core tariff numbers.

8.97. This option would retain some of the benefits of Option 1 for example, tariffs would be clearer and more comparable due to the removal of multi-tier tariffs. The application of discounts and bundled products and services would be standardised across the market. The lack of a cap on the number of tariffs would mean that suppliers would have a greater degree of freedom to offer a wider range of tariffs.

8.98. All other things being equal, we estimate that under this option around a half of open tariffs would need to be eliminated (or adapted), to comply with our rules on tariff structures and ban on variable price, fixed term tariffs.[158] We also estimate that dead tariffs would fall by around a third. The way in which bundled products and discounts are currently offered would also need some adjustments to comply with our rules.

8.99. However, although tariffs would reduce in the initial implementation phase, this may be a temporary effect. Option 2 would not prevent suppliers from introducing new tariffs in the future to replace those they had lost. The eventual reduction is likely to be smaller than our estimate and / or be transitory. Any initial positive impact on consumer confidence may be lost. We consider that without a cap, suppliers could more easily ‘game’ our proposals and there would be a risk that key benefits from our proposals would not materialise.

8.100. Option 2 would be less effective than Option 1 at increasing consumer confidence. We are concerned that consumer engagement in the market may be affected if suppliers continue to have free rein to introduce multiple new tariffs, despite the progress that they have made to date.

[158] This is based in our analysis of the impact of our tariff structure proposals on availability of current tariffs, as at 28 August 2012, using information available from our information request to suppliers. This analysis was undertaken across both large and small suppliers (including white labels), for all payment types, for standard meters only. Numbers are based on the London region. It should be noted that this analysis was undertaken in consideration of percentage reduction in original tariff data, as opposed to reduction in ‘core tariffs’, which we define in our consultation document.

Option 3: Option 1 without simplifying tariff structures

8.101. This would be as Option 1 though without simplifying tariff structures. A limit on the number of tariffs that a supplier can offer would be introduced as well as the rule to eliminate dead tariffs.

8.102. This option would address a key area of concern for consumers and consumer groups. It would reduce tariff numbers and provide a safeguard against tariff proliferation in the future.

8.103. Our concern with this option is that it does not guarantee that all suppliers would eliminate multi-tier tariffs. Suppliers could also re-introduce multi-rate tariffs at a later date. Ultimately, this option would not ensure standardisation of tariff structures, which we consider an important step towards helping consumers compare tariff options.

Option 4: one tariff per payment method (December 2011 proposal)

8.104. In our December 2011 consultation, we proposed that each supplier would be limited to one tariff per payment method in the standard market (i.e. evergreen variable tariffs). We also proposed to prohibit discounts and bundled offers. To facilitate 'at-a-glance' comparisons on the unit rate, Ofgem would set the standing charge.

8.105. Option 4 has a number of advantages. Firstly, it would significantly reduce tariff numbers in the evergreen market. It would simplify the overall range of evergreen tariffs to the greatest extent. The majority of consumers are on evergreen tariffs, which lack any trigger point for engagement. This portion of the market is likely to require the greatest degree of intervention to encourage consumers to explore their options.

8.106. Secondly, it would facilitate 'at-a-glance' comparisons on the unit rate of energy, allowing consumers to use hard copy media to determine which tariff is cheapest. This would be a useful tool in reaching the least engaged consumers.

8.107. Thirdly, there would be no need to factor in the value of discounts and bundles, reducing the amount of supplementary information that a consumer has to consider as part of the price comparison exercise.

8.108. However, there are aspects of Option 4 that are less favourable. Firstly, more engaged consumers do value choice and the opportunity to take advantage of discounts and offers. Dual fuel and online tariffs have grown in popularity and there would be a risk of consumer frustration if the associated discounts were to disappear as a consequence of this option.

8.109. Secondly, the overall number of tariffs in the market would not be capped, only variable evergreen. Some respondents to our December 2011 consultation noted that tariff proliferation could occur in the fixed area of the market. The result could be a supplier shift away from variable evergreen tariffs towards fixed term tariffs, which would only benefit the most engaged consumers.

8.110. Thirdly, there is a risk that suppliers offer less competitive deals in the evergreen market and focus their attention in the fixed term market. This would disadvantage the least engaged consumers who tend to be on variable evergreen tariffs. Fourthly, there are practical challenges around setting a national standing charge. Finally, suppliers consider Option 4 to be restrictive and anti-competitive. In response to the December 2011 proposals small suppliers in particular argued that it would constrain their ability to offer niche products to differentiate themselves and gain market share. Suppliers also expressed concern around Ofgem setting the standing charge and restricting their ability to set it according to their commercial drivers.

8.111. Overall, we now consider that we can achieve a better balanced package that simplifies tariffs whilst avoiding many of the disadvantages of Option 4.

Option 5: principles-based approaches

8.112. We considered whether to provide principles-based direction to suppliers on limiting their tariff numbers and / or simplifying tariffs. This could be provided either through Standards of Conduct guidance or in a licence condition. Some examples could be:

- **Discounts:** suppliers should offer cost reflective discounts. Contingent and upfront one-off discounts could be prohibited or regulated. Rules could be introduced to ensure that certain discounts are displayed in a defined format.

- **Bundles:** suppliers should offer only energy-related bundles or other partnership deals. Rules could be introduced to ensure that bundled products must be marketed and sold separately.

- **'New' tariffs:** suppliers should only offer a new tariff if they can demonstrate a clear need to do so. Suppliers should submit retrospective statements to Ofgem justifying their reasons for introducing new tariffs.

8.113. This approach has several benefits. For example, using SOC guidance or rules in the licence removes the need for Ofgem to be as interventionist as in the other options. Some suppliers might prefer this approach as it would provide parameters in which to work whilst allowing them a degree of commercial freedom.

8.114. However, using SOC guidance or Licence rules to ensure suppliers reduce and / or simplify tariffs would be a less prescriptive approach than setting a tariff limit or eliminating multi-tier tariffs, therefore the risk that individual suppliers interpret these principles in different ways exist.

8.115. It might also not directly address consumers' and consumer groups' concerns around tariff numbers. It is possible that they would feel that a principles-based approach did not do enough to address tariff proliferation, perhaps reinforcing feelings of frustration and affecting their willingness to engage in the market.

8.116. Finally, a principles-based approach does not guarantee that the market will take the direction we want to see. While suppliers had the chance to simplify tariffs as part of the Probe, they did not do so. There is a risk that without a more prescriptive approach, the market will not be simplified to the degree that is required.

Option 6: increase overall level of the tariff cap to six

8.117. We considered whether to increase the cap to six core tariffs. This was in response to some suppliers' consultation responses in which they argued that a cap of four was too restrictive.

8.118. This approach has three main advantages. Firstly, it would give suppliers a greater degree of freedom to develop tariffs according to their commercial priorities. There is also a possibility that all suppliers would not use all six tariffs, so the higher theoretical maximum number of tariffs may not be reached.

8.119. Secondly, it loosens Ofgem's role in prescribing the types of tariffs that suppliers are permitted. Together with the 2017 review period, we could assess the effect that the higher cap and comparative lack of prescription is having on the market.

8.120. However, there are also three main disadvantages. Firstly, it permits an overall increase in tariff numbers. Even if not all suppliers use their full allocation initially, the possibility exists that they could do so in the future. This would not reduce complexity in the market nor make it easier for consumers to navigate through it.

8.121. Secondly, it would not help to build consumer trust. It would undermine our RMR goals of a simpler and clearer energy market.

8.122. Thirdly, we have used Option 1 to provide additional flexibility on key areas of stakeholder concern (e.g. paperless billing discount, deemed contracts, white labels (on a temporary basis), and the possibility of derogations for trial tariffs). We consider that this flexibility provides enough accommodation without increasing the number of core tariffs.

Option 7: keep level of tariff cap at four and allow additional slots for particular tariff types (e.g. white label, green tariffs)

8.123. We considered whether to keep the number of core tariffs at four but specify additional slots for particular types of tariff. These could include for example white labels, green tariffs, and trial tariffs.

8.124. The advantages of this option are that it directly addresses supplier concerns around key types of tariff. It allows them to offer these tariffs if they wish without using core tariff slots.

8.125. Secondly, it allows Ofgem more control over the tariffs that suppliers are offering into the market. We could more easily monitor and assess overall market complexity and the impact of particular tariff types on consumer engagement.

8.126. However, there are a number of disadvantages. Firstly, it permits an overall increase in tariff numbers. This option would not reduce complexity to the same degree as Option 1. Secondly, it may be a harder message to communicate to consumers. They may find it more difficult to assess a 4+1+1 model for example than just a cap of four core tariffs.

8.127. Thirdly, some suppliers could question why additional slots are needed for specific types of tariff. For example, there are those suppliers that offer only green tariffs and use green energy as a unique selling point. They may argue that other suppliers could also offer green tariffs within the cap of four if they chose to do so.

8.128. Finally, Option 1 has added flexibility around white labels (on a temporary basis), fixed term collective switching tariffs, and the possibility of derogations to allow for trial tariffs. This mitigates the need for additional slots for specific tariff types.

Option 8: exempt independent white label suppliers from the cap

8.129. We considered whether to exempt independent white label suppliers from the tariff cap. This would allow those suppliers that offer energy independently of their main licence holder to continue to do so, whilst catching other 'branded' offers from retailers in the cap.

8.130. The advantages are that it would preserve an additional route to market. It would allow these white labels to compete for and attract consumers, bringing in more market players to exert competitive pressure on licence holders.

8.131. Secondly, it would not affect the business models of current independent white label suppliers. They could continue to operate in the market subject to their own commercial priorities and their relationship with the main licence holder.

8.132. However, there are a number of disadvantages. Firstly, it would not reduce the overall number of tariffs in the market. Additional market participants could make it more confusing for consumers to navigate their options. Secondly, it could lead to additional white label suppliers being set up to circumvent the tariff cap.

8.133. We consider that the proposed 12 month 'case making' period built into Option 1 is an appropriate means for white label providers to demonstrate the value they add to the domestic energy market. Full details of this process are outlined in the main consultation document.

Clearer and simpler information

8.134. In December 2011 and October 2012, we set out proposals to prescribe (to varying degrees) the format and content of five supplier communications – the Bill, the Annual Statement, the Price Increase Notice, the End of Fixed Term Notice, and a new document, the Tariff Information Label. This included additional prompts to engage through requiring personalised messaging to consumers on their supplier's cheapest tariff and the creation of a tariff comparison metric, the TCR.[159] Our final proposals for clearer and simpler information remain broadly in line with these but with some reduction in the level of prescription for particular communications.

8.135. As outlined in the consultation document, we believe these measures will achieve our aim of ensuring consumers receive sufficient information and prompts to engage while allowing sufficient flexibility for supplier adaptation to evolving consumer needs and market developments. The details of these proposals and their implications for each channel are set out in the accompanying consultation document.

Developments since December 2011 and October 2012 proposals

8.136. Responses to the December 2011 and October 2012 consultation showed a high level of support from consumer groups for many of our proposed package of measures. The majority of large suppliers and some smaller suppliers also agreed with the objectives of our proposals, and understood the benefit to consumers of having personalised information across key communications. Some small suppliers even indicated that elements of our proposals did not go far enough.

8.137. However, while felt to be of benefit to consumers, all suppliers and some consumer groups did not support the extent of prescription we proposed in October 2012, particularly for format and language for our proposals for the Bill and Annual Statement.[160] Respondents' main concern was that our approach was not sufficiently flexible to adapt to the needs of consumers and future market developments, such as the Green Deal.[161]

8.138. Some suppliers suggested that the more prescriptive approach for some communications may impact innovation and their ability to differentiate their service offerings. This was particular relevant to small suppliers whose customer base may differ significantly from that of the mass market providers. It was considered by suppliers and Energy UK that the competitive market could deliver more engaging formats, given suppliers' expertise and understanding of their customers. Suppliers also expressed concerns about the initial and ongoing IT implementation costs of our rules on format and language of personalised information.

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[159] See Chapter 3 of Ofgem March 2013 RMR Consultation Document for further details on the supplier cheapest tariff and the TCR.
[160] October 2012 Consultation Responses to Ofgem October 2012 RMR Consultation Document. See Ofgem March 2013 RMR Consultation Document for a summary of responses.
[161] Further information on the Green Deal can be found here: https://www.gov.uk/green-deal-energy-saving-measures/how-the-green-deal-works.

8.139. Several large suppliers and small suppliers suggested having content requirements only in the supply licence, alongside principle-based regulations for how that content should be communicated to consumers.

8.140. In response to the October 2012 consultation the majority of respondents focused on our proposal for a Summary Box on Bills, and to a lesser extent, the Annual Statement. However, overall our proposals for Price Increase Notices and Tariff Information Label were considered to offer an appropriate balance of prescription. Support was also expressed for some standardisation of terminology where this leads to clarity of communications.

8.141. Given our aims as set out above, responses to consultations and dialogue with stakeholders, we have developed these proposals to remain broadly in line with the principles set out in our last consultation but with some reduction in the levels of prescription where appropriate.

8.142. In developing our October 2012 proposals, we incorporated findings from consumer research conducted to understand how consumers react to specific layouts, information and language[162] and worked with design experts to produce standardised templates.

8.143. In developing these final proposals, we have incorporated feedback received from both the Consumer Bills and Communications Roundtable Group[163] and the Retail Market Review working groups.[164] Some suppliers provided us with the research for their current and future routine communication designs.[165] This provided valuable findings and greater insight into the steps suppliers are already taking to improve their communications. We also considered suppliers' research on routine communications they sent out to their consumers in 2012.

8.144. Alongside consultation responses, and our consumer research, this further evidence from stakeholders has informed a more targeted approach in our proposals. We are proposing to maintain tight regulatory control over areas where evidence suggests poor performance and where information is important to consumer understanding. However, we would allow some flexibility in design, format and language where competition and supplier incentives are likely to deliver optimal solutions for engagement.

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[162] We commissioned design experts Boag McCann and consumer research company SPA Future Thinking to assist with further development of the standardised formats for Bills, Annual Statements, PINs and the Tariff Information Label.
[163] This is a working group that has been established to look at the broad range of information and communications that energy customers receive. It is comprised of representatives from Ofgem, Citizens Advice, Consumer Focus, DECC, Energy UK, Which?, and both Energy UK affiliates and non-affiliates. Links to meeting notes can be found at: http://www.ofgem.gov.uk/Markets/RetMkts/consumer-bills-and-comms-round-table/Pages/index.aspx.
[164] Working groups were held with stakeholders as part of the development of our proposals. Agendas and minutes of these meetings are available here: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/stakeholder-engagement/Pages/index.aspx
[165] As part of a response to an information request, suppliers provided us with copies of their current communications. Some also provided prototype templates incorporating our proposals, as well as research conducted to inform their designs.

8.145. Further information on the final recommendations for each communication is provided in Chapter 3 of the consultation document and illustrations of the impact of these adjusted recommendations are provided in the form of templates in Appendix 4 of the consultation document.

Options considered

8.146. This section provides an overview of the policy options we have considered, and the rationale and supporting evidence for our chosen proposals. The alternative policy options which have been considered are summarised in Table 12 below:

Table 12 Summary of options for the clearer and simpler information proposal

Option	Pros	Cons
Option 1. Clarify the original policy intent of the Standard Licence Conditions (SLC 23 and 31A)[166]	• Low cost • No additional burden on suppliers • Minimal requirements but freedom for suppliers to determine majority of content and design of communications	• Risk key information may continue to be generic, missing or incomplete • Communications may fail to prompt engagement • Risk information may not be presented in a clear and engaging manner • Excessive additional material and content of varying relevance may be included with important information • No standardisation and lack of consistency across the industry
Option 2. Additional content requirements only. No format or language prescription	• Ensure key information is provided and personalised where appropriate • Provide consumers with additional prompts to engage • Content requirements but freedom for suppliers to determine remainder of content and presentation of information	• Risk information may not be presented in clear and engaging manner • No standardisation and lack of consistency across the industry • Excessive additional material and content of varying relevance may be included with important information • Cost implications of additional personalised information
Option 3. Additional content requirements plus minimum formatting, positioning or language requirements for <u>some</u> items. Restrictions on additional content or materials	• Ensure key information is provided and personalised where appropriate • Provide consumers with additional prompts to engage • Ensure presentation of most important information is clear, engaging and comparable across the industry • Ensure important information is not obscured by excessive	• Some limited restriction on supplier innovation • Some risk remains that information may not be presented in clear and engaging manner • Further cost implications of formatting and standalone mailings

166 This option would entail tightening the drafting of the licence condition to reduce scope for alternative interpretation. For example, clarifying more precisely the existing information requirements and providing added weight to any guidance issued.

Option	Pros	Cons
	additional material and content • Allows suppliers to optimise the presentation of content • Allows adaptation to evolving consumer needs and market developments	
Option 4. Additional content requirements plus all content to be presented using prescribed format and language. No additional content or materials permitted	• Ensure key information is provided and personalised where appropriate • Provide consumers with additional prompts to engage • Guarantee presentation of all information is clear and comparable across the industry • Guarantee no additional material and content is provided with key communications	• No flexibility for supplier innovation and optimisation • No option for adaptation to evolving consumer needs and market developments • High costs for supplier implementation • Long governance process for any routine changes required

Assessment of Options

8.147. This section provides our assessment of the policy options that we have considered. The features of each of the options are described and we assess the pros and cons of each approach.

Option 1: clarify the original policy intent of the Standard Licence Conditions (SLC 23 and 31A)

8.148. We consider that SLC 23 on the Price Increase Notice and SLC 31 on Bills and Annual Statements are not currently working as intended.[167] Under this policy option, Ofgem would clarify the policy intent of these Licence Conditions but would not impose additional prescriptive requirements on suppliers. The new Standards of Conduct[168] would provide overarching principles for suppliers to have regard to when communicating with their customers.

8.149. We consider that this policy option could address some issues concerning the current interpretation of rules for some suppliers and would not incur substantial additional costs. However, we do not consider that relying on the current Licence Conditions and Standards of Conduct will be able to address all the issues identified. Indeed, we have already attempted to address these issues by taking a relatively non-prescriptive approach:

- In October 2010 we wrote to domestic energy suppliers to outline our expectations regarding SLC 31A and to prompt certain individual suppliers to

[167] For example, current obligations require suppliers to provide consumers with key information in prominent positions on communications, including supplier reminder that they may change supplier. Suppliers also have flexibility regarding how they display information within the relatively broad scope of the prominence requirements. In both cases, suppliers have fallen short of policy expectations.
[168] Please see Chapter 4 in Ofgem March 2013 Consultation Document.

review the information they provide.

- We modified SLC 23 in April 2011 to address concerns about the clarity and content of notices. Alongside this we have written to suppliers to remind suppliers of our expectations for compliance with both SLC 23 and SLC 31A.[169]

- To ensure our intent was clear we also issued guidance in August 2011 for SLC 23, and are currently in the process of developing further guidance on SLC 31A.[170]

8.150. We recognise that a minority of suppliers demonstrated some good practices in response to these measures.[171] Overall, however, these measures have not incentivised the change that we consider necessary for the Bills, Annual Statements, PINs and other supplier communications to work in the interests of consumers. Therefore, we are not confident that further guidance will be an effective way of meeting the objectives of the information remedies proposals.

8.151. Taking the above into account, we consider that further prescription is necessary to ensure suppliers' communications deliver the full range of prompts and information consumers need to engage effectively.

Option 2: additional content requirements only- no format or language prescription

8.152. Under this option, Ofgem would specify additional content that suppliers must include in Bills, Annual Statements and PINs, as well as End of Fixed Term Notices and the new Tariff Information Label, personalised where appropriate. We would not prescribe the format in which the information should be presented or the language that should be used.

8.153. This approach would ensure that the personalised information consumers need to understand their tariff is available and tools to explore their energy options effectively are provided. For instance, savings available from switching tariff with their supplier will prompt consumers to consider alternative options with personalised consumption and tariff details provided will help ensure consumers are armed with the information they need to explore their options further. Suppliers would then retain freedom to convey and adapt this information in the manner they consider appropriate to their customer base. They will also have the freedom to determine the remainder of the content within and in conjunction with their communications.

8.154. The risk inherent in this approach is that the content of a communication may not be fully understood by the consumer if suppliers continue to present important

[169] Decision to make modifications to standard conditions 23, 14 and 24 of the supply licences - (Reference number: 43/11), 28 March 2011. Available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=38&refer=Markets/RetMkts/Compl/pricechange.

[170] Guidance on notification of price increases – Standard Licence Condition 23. Available at http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=42&refer=Markets/RetMkts/Compl/pricechange.

[171] Ofgem internal review of supplier communications in relation to SLC 23 and SLC 31A in 2010 and 2011.

information in a relatively unclear format. For instance, information may be presented in a disjointed or scattered way, or key details buried in small text or footnotes. The format and layout, not just the provision of information, can be crucial in facilitating a consumers understanding. For instance, the standardised tabular format of the personalised pricing information on a PIN was found to be key to fully grasping the impact of a price increase during our consumer testing.[172]

8.155. We recognise there is an interaction with this approach and our proposals for the Standards of Conduct (SOC). Suppliers have suggested the SOC would provide a framework to ensure information is presently clearly to consumers. However, the same principle based, non-prescriptive approach was adopted following the Probe, and our most recent monitoring of suppliers' communication practices has found important information is still not being provided clearly to consumers.[173]

8.156. A further risk under this option is that suppliers could include a multitude of information that is not relevant to the purpose of a communication. Our consumer research found that communications without a clear purpose were found to be less effective and tended to obscure understanding of the key information provided.[174] A related risk is that it would remain possible for suppliers to send the Bill and Annual Statement in the same envelope, reducing a consumer's ability to differentiate the two documents and their distinct purposes.

8.157. Our research also suggests that consistency between different customer communications makes it easier for them to understand and use the details provided, as well as make cross-market comparisons.[175] This policy option guarantees no such consistency and therefore, we are concerned this approach would not adequately achieve our objectives.

8.158. Overall, we consider that this option would not fully address barriers of lack of consumer knowledge and understanding as there would still be a risk that consumers would not receive clear and accessible information.

Option 3: additional content requirements plus minimum formatting, positioning or language requirements for <u>some</u> items - restrictions on additional content or materials.

8.159. Under this option, in addition to requiring personalised content, Ofgem would specify the layout, formatting or language of some items, such as a box for grouped tariff information or prescribed wording for a heading. This is our proposed approach as we consider it addresses the issues we have identified in the market effectively, while remaining proportionate.

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[172] Please see chapter 5 of SPA Futurethinking (October 2012a), 'Energy bills, annual statements, price increase notification letters and tariff information labels: proposals for consumer testing'.
[173] Following the consultation in October 2012, we issued a request to view copies of all suppliers' routine communications to customers for the Bill, Annual Statement, PIN, and End of Fixed Term notices, review of which found important information was still not being provided in some cases.
[174] Lawes Consulting and Lawes Gadsby Semiotics (November 2011), 'Retail Market Review: Energy bills, annual statements and price rise notifications; advice on the use of layout and language. A Research Report For Ofgem'.
[175] Ibid.

8.160. Expert language research, consumer testing, consultation responses and stakeholder engagement have all informed the format and layout prescriptions we have proposed for each communication type. For instance, language research found that using consistent terms and grouping together key pieces of information would help to improve consumers' understanding of the information.[176] However, the great majority of consultation respondents felt the level of format and language prescription we proposed in October 2012 was too great, particularly for the Summary Box on Bills.[177]

8.161. Feedback from stakeholder working groups determined that although a standardised layout would encourage familiarity with the Annual Statement document, the content could potentially be conveyed more effectively through supplier innovation and optimisation of language and design.[178] This is substantiated by our observation that since the publication of our proposals in October 2012, some suppliers have made good progress in improving elements of their Bills and Annual Statements.[179] Following our proposals, for the Summary Box on Bills and on Annual Statements, some suppliers have begun to develop their own versions of our proposals. In some cases these prototypes demonstrated simpler language and a more engaging format than the published suggested templates.[180] Our research has shown that regular change makes consumers more likely to engage with a communication and we consider that the market rather than regulation could be better-placed to deliver this ongoing change.[181]

8.162. Therefore this option proposes that the format of the Tariff Information Label be prescribed and the information on the Annual Statement be subject to standardised layout with minimal format and language prescriptions. Elsewhere we have only targeted specific information which we feel is most likely to benefit from standardisation. The format and style of the majority of the content on a PIN and Bill (subject to Green Deal requirements), plus the entire format of End of Fixed Term Notice to be determined by suppliers. Additional content and material will be restricted on some of the communications but suppliers will be free to determine additional information that can be sent within or in conjunction with the Bill.[182]

8.163. This targeted approach could deliver greater benefit to consumers through allowing the market to dynamically update the presentation of information in accordance with evolving consumer needs and market developments, rather than having the design of communications remain static in regulation.

Option 4: additional content requirements plus <u>all</u> content to be presented using

[176] Lawes Consulting and Lawes Gadsby Semiotics (November 2011), 'Retail Market Review: Energy bills, annual statements and price rise notifications; advice on the use of layout and language. A Research Report For Ofgem'.
[177] Consultation responses to October 2012 consultation.
[178] Ofgem has held a range of working groups with stakeholders since the publication of the October 2012 RMR consultation to further develop our proposals. Agendas and minutes of these meetings are available here: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/stakeholder-engagement/Pages/index.aspx.
[179] Internal review of recent supplier communications submitted after our October 2012 consultation.
[180] For the templates proposed, see 'Supplementary appendix to: The Retail Market Review - Updated domestic proposals', October 2012.
[181] See 'Prompting engagement with and retention of written customer communications' Ipsos MORI 2012.
[182] For the avoidance of doubt, the Annual Statement will be required to be sent as a standalone document and cannot be sent out in conjunction with the Bill.

prescribed format and language- no additional content or materials permitted

8.164. Under this option, the entire content of key communications would be subject to standardisation, including those beyond the five key communications previously proposed, such as direct debit review letters.

8.165. This policy option would guarantee that all key communications received by consumers would be clear and consistent across energy suppliers. Consumers would become familiar with the content of each communication and the format in which it is presented. This would ensure that all consumers received the information they need and are able to understand it.

8.166. However, at this stage we do not consider that this level of prescription and standardisation is proportionate. Firstly, the incremental benefit of this policy option over Option 3 is likely to be limited, while incremental costs could be substantial. Secondly, this would greatly reduce the ability for suppliers to compete on a non-price basis, particularly impacting small suppliers where the ability to tailor their communications to a niche customer base is of particular importance and would reduce reputational incentives for suppliers to invest in the production of clear and engaging communication designs. Lastly, as outlined above, there is evidence to suggest that regulation may not be the best vehicle to deliver the most engaging and informative manner of conveying information in all cases. The ability for suppliers to explore a process of optimisation, and develop their designs according to market developments and consumer needs would be of greater benefit to consumers in the long term.

Preferred Proposal – Option 3

8.167. Taking into account the issues discussed above, and pros and cons of each option we consider it appropriate to propose and implement Option 3. This means that while the content of the majority of the key communications will be prescribed, we will apply a more targeted approach to the formatting and language requirements. This would entail setting standardised format in circumstances where clarity and comparability are crucial, such as the TIL and the pricing information on a PIN, and a minimum of other formatting requirements, such as prominence and page requirements, where some flexibility would be advantageous.

8.168. We consider that key communications at each stage of the year and at critical points (such as price changes), need to be improved if we are to ensure that consumers receive and understand the information they require to effectively explore their energy options and engage with the market.

8.169. We consider that the measures proposed for key communication channels under this option will inform consumers of available savings and prompt consumers to engage. When consumers choose to engage, the policy option will ensure that they have sufficient information and understanding to make better quality switching decisions. While limited restrictions on the format of content present the risk that some information could continue to be provided in a complicated way, it could also deliver greater benefit to consumers through allowing room for competition to continually work toward greater engagement in communication design than static regulation.

8.170. On this basis we propose to implement Option 3.

Standards of Conduct

8.171. Our core proposal for the SOC remains the same as that presented in our December 2011 RMR consultation document and October 2012 RMR consultation document.

8.172. In these documents we proposed to introduce the SOC to apply to all interactions between suppliers and consumers and to make the SOC legally binding by incorporating them into an overarching, enforceable licence condition.

8.173. Chapter 4 of the March 2013 consultation document outlines our proposal and further detail around how we see the SOC working in practice.

8.174. Our proposal is considered the best policy option to see improvements in the energy market at the level required. We believe the introduction of our SOC proposal will lead to improved supplier behaviour and increased levels of consumer trust in suppliers and the industry. With this increase in consumer trust we consider it will reduce barriers to effective engagement of consumers in the energy market and provide more effective competitive pressures on suppliers.

Developments since December 2011 and October 2012 proposals

8.175. As part of written responses to the October 2012 RMR consultation we received feedback on our SOC proposals from a range of stakeholders. The majority of respondents are in favour of the SOC and were generally supportive of our approach. Feedback received as part of the October 2012 consultation was more supportive of our proposal than that received from the December 2011 consultation.

8.176. However, there are still some concerns over regulatory risk and our proposed approach to enforcement among some suppliers - we address these concerns in Chapter 7 of this Impact Assessment and in our consultation document. That being said, there has been a convergence in views since the December 2011 consultation with less general opposition to the SOC. Responses focused concerns more on points of detail with regard to our expectations on supplier actions and what we would consider as ‘reasonable’ to comply with the SOC.

8.177. Our proposed approach to enforcement includes an assessment of the seriousness of a potential breach by looking at suppliers’ actions and considerations. This is likely to mean that we will look at practices in relation to interactions with consumers, and their relevant internal policies and practices by reviewing contemporaneous documents. Following the October 2012 consultation, some small suppliers have raised concern about the associated administrative burden this may cause. Suppliers have also raised concerns over the implementation timeline for the SOC.

8.178. The consultation document and Chapter 7 of this Impact Assessment provide details of an approach we are considering, which is subject to consultation under Ofgem's Enforcement Review[183], where final decisions in relation to contested enforcement cases are made by a panel of decision makers appointed by the Authority for the purpose of deciding on these enforcement cases. This approach may help mitigate some of the concerns suppliers have raised with regard to Ofgem adopting a subjective assessment of supplier behaviour with relation to the SOC.

8.179. In response to our December 2011 consultation a range of stakeholders expressed concerns about the regulatory risk that may arise from introducing the SOC as legally binding measures. It was suggested that concerns may be mitigated if the revised SOC were introduced as voluntary measures or if suppliers had a better understanding of how Ofgem intended to enforce new rules under the SOC.

8.180. As outlined below, maintaining the SOC as voluntary measures with a revised scope would not provide adequate protection for consumers. As a result, we have engaged with consumers, consumer representatives and suppliers to inform our thinking as we considered the detail of our SOC proposal. Through collaborative sessions with consumers and suppliers we facilitated a dialogue between these groups on how the SOC proposal may be taken forward and to further draw out consumer expectations of supplier conduct. Key messages from this research are presented in the sections below.[184]

8.181. Findings from our consumer research and collaborative engagement in October 2012 indicate that in general energy consumers do not have many interactions with suppliers and therefore do not always have strong views about them.[185] However, where consumers have strong feelings about customer experiences in the energy market they are mostly negative. Some consumers who have had a negative experience feel that if suppliers adopted the SOC, and changed their practices, it could lead to real improvements and increase levels of trust.[186]

8.182. There was a clear desire that someone – either 'the government' or Ofgem – ensures that suppliers are consistently meeting consumer needs and are treating them fairly and with empathy.[187]

8.183. Some suppliers have taken some steps to address the issue of trust in the market. However, evidence shows that practices across the market are not

[183] Open letter on the Review of Ofgem's enforcement activities – consultation on strategic vision, objectives and decision makers (March 2013).
[184] Insight Exchange (October 2012).
[185] Ibid.
[186] However, some remained sceptical about the ability of the Standards to affect this change.
[187] Insight Exchange (October 2012).

universally conducive to promoting consumer trust and that consumer experiences with the same supplier can also vary.[188]

8.184. The current voluntary SOC cover a more narrow set of interactions – i.e. interactions such as sales and marketing or consumer complaints where consumers may face a trigger to engage with the market. They also cover interactions which were found to only represent a small part of the cause of negative interactions between consumers and their suppliers.[189] Our review in October 2012 of consumer direct complaints data shows that the majority of issues raised related to marketing, billing, metering, transfers, debt / disconnection and transportation / distribution.[190] Of these, information and billing were the biggest source of complaints and these cover a large range of issues, which are not uniformly covered by exiting licence conditions.[191]

Options considered

8.185. The alternative policy options which have been considered are summarised in

8.186. Table 13 below:

Table 13 Options for the SOC proposal

Areas	Options
Approach to Regulation	**Option 1.** Principles based approach
	Option 2. Directive based approach
Framing of the SOC	**Option 1.** Binding license condition
	Option 2. Non binding condition
Scope of the SOC	**Option 1.** Covering all interactions
	Option 2. Limited interactions
Enforcement	**Option 1.** Bespoke approach
	Option 2. Two staged approach
Guidance	**Options.** Spectrum of options
Communication of the SOC	**Option 1.** Mandating requirements
	Option 2. Non mandating requirements
	Option 3. High level communications

188 Ibid.
189 Ibid.
190 Consumer Direct/OFT (2012) Contracts Data.
191 Information includes information related to contact details, pricing information and meter type information.

Areas	Options
	Option 4. Detailed communications

Approach to regulation

Options considered: Principles based approach vs. directive based approach

8.187. With regard to our approach to regulation there has been no change proposed since our October 2012 proposal. As stated in the consultation document our assessment suggests that this is the most appropriate approached compared to the alternative.

8.188. A principles based approach to regulation is a way to address key concerns within the market without taking a detailed directives based approach to addressing the range of issues identified. The move to a principles based approach allows suppliers the ability and flexibility to focus on improving their relationship with consumers. This approach keeps the supplier's focus on the consumer and what consumer needs are rather than it being focussed on Ofgem and our definition of particular prescriptions.

8.189. This will involve suppliers focusing their efforts on identifying and delivering what consumers need. It provides the opportunity for innovation and for suppliers to differentiate their services. This approach also allows suppliers the flexibility to change their services over time as consumer needs change. A more principles based approach to regulation is also consistent with Better Regulation Principles and we therefore are not proposing to introduce a directive based approach in order to address the particular problem the SOC seek to address.

Framing and scope of the SOC

Options considered: binding license condition vs. non binding condition

8.190. There has been no change proposed from our October 2012 consultation with regard to the introduction of a binding licence condition.

8.191. The option of non binding conditions provides no direct means of enforcement and limited incentive for suppliers to adhere to the principles of the Standards. Under this option it is unlikely that we would see the needed improvement in supplier interactions with consumers. Despite the introduction of the voluntary Standards, as part of the Energy Supply Probe, consumer engagement and trust remains an issue.[192] Experiences for consumers when engaging with their suppliers across the market have not consistently been positive, which also leads to low levels of trust.[193] For this reason we are proposing to introduce the SOC as a legally binding licence condition.

[192] Ipsos MORI (January 2011).
[193] Insight Exchange (October 2012).

8.192. Through qualitative research consumers have also noted they would be sceptical about how the SOC would be effective if introduced as voluntary measures.[194]

8.193. In developing our evidence base for the SOC, we examined other industries and countries where industry codes or SOC are used. This found that where comparative policies were successfully introduced, codes or standards were supported by enforceable rules, conditions or laws.

8.194. Examples include, the energy regulator in Ireland, Ofcom's code of conduct, a dictated code set out by Australian state energy regulators and the Financial Services Authority.[195] This evidence along with evidence illustrating the limited impact of the voluntary Standard has led us to propose the introduction of the SOC as enforceable standards.[196]

8.195. Many stakeholders including consumer representatives support the need for enforceable SOC. In addition, three of the previous incumbent suppliers supported the need for the SOC to be enforceable. One of them also noted they believed that non-binding SOC would not achieve the policy objectives, and the SOC need to be enforceable.[197]

8.196. In response to our October 2012 consultation the majority of respondents are in favour of the SOC and believe they will help achieve our objectives of increasing trust and engagement in the market. Many respondents believe the SOC should empower suppliers to focus on delivering services for the consumer.

8.197. Most small suppliers are supportive of the SOC; however, two small suppliers are less supportive and raised some concerns. Notably, one small supplier questioned the need to introduce the SOC in a licence condition as they already apply the principles of the SOC and another small supplier felt that there is already a wealth of legislation governing the retail relationship.

8.198. The main concern raised by these small suppliers is the administrative burden the SOC could place on their business due to the emphasis placed on contemporaneous documents.

8.199. As outlined in the consultation document we recognise that, depending on the size of the organisation, the nature of the business or internal business practices, it may be appropriate for actions around the SOC to be documented and communicated in different ways.

[194] Ibid.
[195] Ofgem (2011) Retail Market Review.
[196] Ibid.
[197] Retail Market Review December 2011 consultation responses.

Options considered: scope covering all interactions vs. limited interactions

8.200. We do not propose to change our proposal from October 2012. We have however provided further clarity in our March 2013 consultation document with regard to the coverage of the SOC in relation to charges. We are not proposing to include the level of any charge within the scope of the SOC with the exception of Deemed Contracts.

8.201. Research shows there are a wide range of interactions between consumers and suppliers that can impact on consumer trust.[198] For this reason, we propose to introduce the SOC to cover all interactions between consumers and suppliers (and their representatives).

8.202. This will help ensure that a positive change will occur across interactions between suppliers and consumers. It will also provide protection for consumers on a range of issues where consumers currently have limited or no formal protection under the Standard Licence Conditions.

8.203. In the December 2011 consultation responses, two of the previous incumbent suppliers did not feel that 'all interactions between consumers and suppliers' needed to be covered by the SOC, with one of them suggesting that there were already existing legal rules that offered the protections the SOC would cover. Many responses supported the need for all interactions to be covered by the SOC. One of the previous incumbent suppliers suggested the SOC should be more widespread and cover all interactions, and any supplier who was found to be non compliant should face enforcement action. Some suppliers supported widening the scope of the SOC also. One supplier acknowledged the SOC should be widened but felt guidance was needed alongside the SOC.

8.204. For the avoidance of doubt, as outlined in the consultation document, with the exception of Deemed Contracts, the SOC do not impose restrictions on the level of charges for supply prices that energy suppliers charge as a means of ensuring fair treatment, nor does it impose a limit on the level of any ancillary charges. However, the SOC would apply to a determination of whether it was fair to charge for a given product or service, including the circumstances in which a charge is levied.

Enforcement

Options considered: approach to enforcement

8.205. It is important that we assure suppliers that we will take a fair and reasonable approach to enforcing the SOC. The consultation document outlines our proposed, bespoke approach to enforcement to achieve this, while at the same time assuring consumers that a clear regulatory 'back-stop' is in place.

[198] Ipsos MORI (January 2012).

8.206. We note our proposal differs from the proposal put forward by some stakeholders within their responses to the consultation, many of whom suggested a formalised two-stage process along the lines of that put in place for SLC 25A. This process was one where we committed to engaging in dialogue before opening investigations and desisted from further action where suppliers put things right where we identify issues. As a result suppliers would be guaranteed an opportunity to avoid enforcement action, so long as they took steps to resolve the breach.

8.207. Applying this approach to enforcement of the SOC would reduce incentives for suppliers to take ownership of the implementation of the SOC and reduces our ability to address breaches and the associated financial gain. Therefore, we do not propose taking this approach. The proposed approach gives suppliers the chance to make changes to address the breaches; however, that will not necessarily prevent the opening of an investigation.

8.208. We have limited functions in dealing with individual disputes between consumers and licence suppliers. We therefore see a role for the Ombudsman Services: Energy (Ombudsman) in applying the SOC when dealing with individual cases referred to it.[199] We will take a proportionate approach to enforcement.

8.209. As outlined in the consultation document, our enforcement approach will focus on an assessment of whether the supplier has acted reasonably in the circumstances and has taken seriously its obligation to comply with the SOC and to treat consumers fairly. The consultation document provides further detail of our proposed approach to enforcement.

Guidance or clarification of our expectations

Options considered: spectrum of options

8.210. We are not introducing any changes to our October 2012 proposal with regards to guidance. However, we have provided further clarity of how we see the SOC working in practice in our consultation document along with providing draft guidance on key terms used in the proposed licence condition.[200]

8.211. It is important for suppliers to maintain responsibility for embedding the SOC in their organisation. We are keen that any potential clarification does not transfer responsibility for this from the suppliers to Ofgem. Given this, we have carefully considered the format and the level of detail included in draft guidance.

8.212. As mentioned in the consultation document we would require suppliers to have regard to any guidance issued by Ofgem on any aspects of the overall SOC licence condition (the guidance provision). Before issuing (or revising) guidance which is subject to the guidance provision, Ofgem would need to consult with suppliers. This means that in conjunction with the consultation, we are also

[199] In line with the Ombudsman's terms of reference we would expect disputes to be resolved on the basis of what is 'fair and reasonable' in each individual case.
[200] Please see Chapter 4 and Appendix 7 of Ofgem RMR March 2013 Consultation Document.

consulting on the draft guidance on some of the key terms used in the SOC licence condition. Following a review of consultation responses, we will consider whether to designate this as guidance subject to the guidance provision.

8.213. Two suppliers voiced concerns over the definition of representatives in the December 2011 consultation responses. These concerns were in relation to the potentially wide definition of representatives to include third parties that suppliers may not have a direct contract with.

8.214. An unintended consequence that may arise could be that suppliers are deterred from dealing with third parties where there is not a direct contract in place. Stakeholders noted that activities outside of contracts could still potentially expose suppliers to enforcement action; as a result they would cease all activities with such parties. This, amongst other results, may lead to decreased engagement levels by consumers with the market via representatives. Another consequence may be that suppliers enter into contracts with all their third parties that may be costly to draw up and to impose to all relevant parties. These costs may ultimately be passed onto consumers.

8.215. With regard to representatives, we want suppliers to ensure third parties acting on their behalf treat consumers fairly and act in a way that promotes trust. As outlined in the consultation document, without prejudice to other licence conditions that use the term[201], as a matter of policy, we would intend to focus our oversight of the SOC on more direct and express relationships between a supplier and another person. This includes chains of sub-delegation arising from such a relationship. The consultation document provides clarification of where we would intend to focus our oversight of the SOC with regard to representatives to mitigate some of the concerns noted above by some suppliers.

Communication of the SOC

Options considered: mandating requirements vs. non mandating requirements

Options considered: high level communications vs. detailed communications

8.216. There has been no change proposed from our October 2012 consultation with regard to communication of the SOC.

8.217. We received some positive feedback in responses to our October 2012 consultation, from suppliers and consumer groups who are keen to be involved in our process to consider how we can help increase consumers' awareness of the SOC and how to best provide a high level understanding of the SOC.

8.218. We received no other significant feedback at this point; however, one supplier raised concerns with providing information in written form to consumers on an annual basis due to the costs associated with it. It should be noted that the licence

[201] For example, the marketing licence condition: SLC 25.

condition specifies that the licensee must prepare and update annually information set out in writing. This may be done so in electronic or hard copy form. This may mitigate some of the concerns raised of potential costs associated with this element of the proposal.

8.219. We hope that communication of the SOC to consumers will raise consumer awareness of the new SOC that apply in the industry. The consultation document outlines requirements on suppliers in communicating the SOC. If this requirement was not mandated we consider that it would limit the effectiveness of the SOC as consumers would not be aware of what they can expect from their supplier. Alternative options considered were more prescriptive and detailed in nature. We have proposed an option which allows suppliers some flexibility in deciding how and what they communicate with their consumers. Keeping in line with a principles based approach to regulation we consider that it is unnecessary to take a detailed prescriptive approach to requirements with regard to the communications of the SOC.

8.220. We believe that communication can be a powerful tool to help rebuild trust in the market. Information on the SOC and what individual suppliers are doing to comply with them should empower consumers by highlighting what they can hold suppliers accountable to. Through this communication consumers can also be reassured that suppliers are committed to meeting their needs.[202]

8.221. Beyond this requirement on suppliers, we consider it would be useful to have further correspondence that increases consumer awareness of the SOC in general. This information can be an important consumer empowerment tool as it increases awareness of the SOC. It provides both direct comfort to consumers in the form of knowledge that protections are in place and helps consumers to understand what they can expect from suppliers and industry. Consumer research suggests it would be helpful if generic messaging was consistent across all potential providers.[203] We intend for such materials or language to be developed in cooperation with relevant stakeholders, and provision of such material or information would be made on a voluntary basis.

Protecting consumers on fixed term offers

8.222. Our current proposals for the fixed term market focus on two areas: automatic contract rollovers (‘auto-rollovers’) and price increases and other adverse unilateral variations.

Automatic contract rollovers – developments since December 2011 and October 2012 proposals

8.223. In our October 2012 domestic proposals we consulted on a ban on auto-rollovers. Our final proposal for auto-rollovers is largely unchanged since October.

[202] Insight Exchange (October 2012).
[203] Ibid.

Options considered

8.224. Table 14 sets out the main options considered.

Table 14 Options for fixed term market

Areas	Options
Auto-rollovers to fixed term offers	**Option 1.** A prohibition on auto-rollovers to fixed term offers
	Option 2. Not prohibiting auto-rollovers to fixed term offers
Price increases and other adverse unilateral variations	**Option 1.** Prohibition of price increases and other adverse unilateral variations to fixed term tariffs (subject to exceptions)
	Option 2. Ensuring alignment of fixed term tariffs with relevant consumer protection legislation and SLC 23

Auto-rollovers to fixed term offers

8.225. As part of the overall policy development process, including that which we undertook following our December 2011 proposals, we considered two main options for auto-rollovers to fixed term offers:

- Option 1: a prohibition on auto-rollovers to fixed term offers.
- Option 2: not prohibiting auto-rollovers to fixed term offers.

8.226. Option 1 involves prohibiting automatic contract rollovers to subsequent fixed term tariff offers.

8.227. Option 2 involves not prohibiting automatic rollovers to subsequent fixed term offers. This could involve either:

- Drawing on existing licence conditions and consumer protection law.[204]
- Restricting the length of time a tariff could be automatically rolled over for and / or include an 'opt-in' clause to auto-rollovers.

8.228. Some of the other measures we are proposing relating to the end of fixed term offers (notification periods, switching windows and price protection) could be introduced under either of these options. We assess these separately in subsequent sections.

[204] For example, we could issue clarification or guidance to suppliers on their application of: (1) Standard Licence Condition (SLC) 23: Notification of Domestic Supply Terms; (2) SLC 25: Marketing to Domestic customers; (3) The Unfair Terms in Consumer Contracts Regulations 1999; and (4) Consumer Protection from Unfair Trading Regulations 2008.

Assessment of options

8.229. Option 1 would ensure that consumers are not 'locked in' to subsequent contracts which could be more expensive or may not fit consumers' needs. For example, it is important to ensure that when consumers do not confirm a roll-over to another contract, whatever contract they move to does not permit termination fees. Therefore we are proposing that if consumers do not provide confirmation, they would default onto the cheapest equivalent evergreen tariff.[205] This will allow them to exit the contract at any point without fear of penalty if they identify a better deal.

8.230. We expect that prohibiting auto-rollovers to fixed term offers would positively affect consumer engagement by eliminating barriers to switching and creating a trigger point for consumers' decision-making. The advantage of Option 1 is that it directly addresses key reasons that contribute to consumer disengagement and lack of trust in the fixed term market. [206]

8.231. In our view, prohibiting auto-rollovers to fixed term offers would reduce suppliers' ability to take advantage of consumers' behavioural biases. We expect that this will lead to an increase in consumer engagement and trust and will contribute to competitive pressure in the fixed term market.

8.232. Given our analysis, our proposal is to implement Option 1: a prohibition on automatic contract rollovers to fixed term offers.[207]

Implementation options

8.233. We also sought to address concerns relating to current supplier practices around fixed term offers.[208] In particular, to ensure that the consumer switching experience is not negatively affected.

8.234. This section explains the specific implementation options considered to implement a prohibition on auto-rollovers to fixed term offers, including how we have considered:

- Options for the default tariff when consumers do not take appropriate action by the end of the contract period.
- Options for a consumer notification period for consumers to receive a written statement before the contract end date.
- Options for switching window arrangements before the contract end date.

[205] Refer to March 2013 RMR consultation details of cheapest equivalent evergreen tariff.
[206] We explore the full default tariff options later in this chapter.
[207] More details on implementation costs and unintended consequences can be found in Chapter 4 and 7 of the IA, respectively.
[208] For a more detailed description of these practices please refer to Ofgem (January 2011), 'Consultation on practices concerning Fixed Term Offers', Reference (09/11).

- Options for price protection arrangements for consumers whose switching process ends after the contract period.

8.235. We assess these policy implementation options below.

Default tariff options

8.236. Our proposal is that at the end of a fixed term tariff, suppliers must transfer consumers to the supplier's cheapest equivalent evergreen tariff.[209] We considered whether suppliers should have discretion around the evergreen tariff the consumer should default to (e.g. if a supplier offers more than one).

8.237. We recognise this discretion might involve fewer implementation issues. Suppliers may also feel better able to tailor the default tariff to their perception of their customers' needs. However, we consider there is a risk that consumers would end up on an uncompetitive evergreen tariff. Additionally, it could increase the risk of deliberate use of 'bait and switch' strategies,[210] which some consultation respondents were concerned about. We therefore consider our proposal is an appropriate requirement.

8.238. Some stakeholders have expressed concerns that consumers on ToU tariffs might lose their ToU benefits under both options. Our proposals have evolved so that for consumers on ToU tariffs, consumers default to the cheapest equivalent evergreen tariff for their meter type. This ensures that consumers do not lose the benefits of their ToU tariff as a result of our proposals.

8.239. Finally, we explored whether to distinguish between online and offline consumers for the purposes of the default tariff. We concluded that applying a distinction is appropriate. Firstly, we are concerned that if a supplier's cheapest evergreen tariff includes online account management, an offline consumer could default to it with no way of accessing their account or billing information. Secondly, the auto-rollover is a new policy and without additional clarity, it could be misinterpreted. Finally, we consider that the industry welcomes additional prescription where it is warranted.

Switching window and consumer notification options

8.240. We considered whether providing consumers with a switching window before the contract end date where no termination fees or notification periods applied was an appropriate implementation measure.

8.241. As already noted in this section, evidence suggests that termination fees can distort switching incentives. Hence, a switching window with no termination fees will

[209] For the avoidance of doubt a supplier's tariffs include those of any tariffs of a related 'white label' provider and vice versa.
[210] In this context, a 'bait and switch' strategy consists of a supplier providing a low profitable fixed term offer with the expectation that profits will be recouped on inactive consumers that default to higher priced evergreen tariff at the end of the initial fixed term contract.

address this negative effect. In addition, the lack of a notice period eliminates potential hurdles and makes the switching process easier for consumers. To make the process as transparent as possible, the switching window and the notification period will be aligned providing sufficient time for consumers to switch if they so wished.

8.242. As a result, we expect that a switching window will create an appropriate space for consumers to engage in the market, assess their options and switch without incurring any additional costs.

8.243. In determining the length of the switching window and when the consumer notification should occur, we took account of stakeholder feedback to our December 2011 and October 2012 consultations, and to a number of other factors. These are that it should:

- Allow for sufficient time for a consumer to consider switching and to assess their options.
- Ensure that a customer receives the latest bill possible and is able to make informed decisions regarding budgeting and consumption, in order to manage and pay off debt.
- Provide sufficient time for the customer to actually complete a switch before the end of the contract period.
- Account for industry best practice. From our 2010 information request into suppliers' practices regarding fixed term contracts[211], best practice was to provide an end of contract notification six weeks before the contract ended.

8.244. Suppliers responding to our 2012 consultation expressed concern about the prescriptive nature of the switching window. They argued that to send an end of fixed term notice at 42 days was too specific and would put undue pressure on their processes and systems to deliver.

8.245. We consider that the 42-day period is the correct minimum length of switching window. However, additional flexibility could help suppliers to adapt their systems and ensure they send the end of fixed term notice at the required time in every case. Therefore, we propose that suppliers will have a window of between 42 and 42+7 calendar days to send the end of fixed term notice.

8.246. We note that depending on when the switching process takes place, in exceptional circumstances a 42 calendar day notification window will not ensure that the switch completes before the contract end date. We are incorporating additional measures to ensure that these consumers are not worse off in these circumstances. These measures are discussed immediately below.

[211] Ofgem (January 2011).

Options for price protection arrangements for consumers whose switching process ends after their contract period

8.247. A price protection window ensures that a homogeneous set of rules apply across the energy market. This reduces complexity and ensures that consumers pay a 'protected' price for their energy during the switching process. Our proposal is that consumers should benefit from a price protection window for the time it takes to switch supplier or a 20 working day window for a new contract with the same supplier to come into effect, assuming the following conditions specified in the consultation document apply. Where a customer wishes to switch supplier the main condition is that the proposed new supplier notifies the current supplier within a 20 working day period via industry code processes. This is effectively an extension from the current 15 working day notification window which applies to standard condition 23 (e.g. in respect of price increase notifications), but applied in the context of what happens at the end of a fixed term period.

8.248. Stakeholders argued that this price protection window might potentially impose additional price and hedging risk upon suppliers. However, we expect that suppliers will be able to adapt their hedging strategies to minimise this impact. Furthermore, there is a risk that without a price protection window, consumers could be subject to price shocks during the switching process which could provide a disincentive for consumers to switch.

8.249. In addition, considering how the switching process works in practice, we also consider that the extension of the notification window from 15 to 20 working days is appropriate. The proposed extension to the notification window allows more time for industry switching processes to be completed, without requiring consumers to move onto tariffs they had not selected.

8.250. We consider that our updated proposals are appropriate. They reduce complexity for consumers, and mitigate the risk that they do not benefit from price protection if they engage late in the switching process.

Price increases and other adverse unilateral variations – developments since December 2011 and October 2012 proposals

8.251. Our evidence suggests many consumers have difficulty understanding fixed term tariffs, and specific variants such as tracker tariffs. Our proposals seek to resolve these issues by prohibiting price increases and other adverse unilateral variations (subject to exceptions). In addition, we propose provisions to regulate the way in which consumers are notified of, and consent to, any mutual variations to the terms and conditions of their contracts.

8.252. Responses to our December 2011 and October 2012 consultations were varied:

- Consumer groups and some suppliers were broadly in favour of our proposals (detailed reasoning was not provided).

- Some suppliers were opposed to our proposals, highlighting concerns around potential lack of evidence of consumer harm, loss of preferred tariffs for certain consumers, and that limitations in the fixed term market may push consumers into the evergreen market, potentially leading to higher prices for those consumers.

- Some additional exceptions to a prohibition were suggested (e.g. market tracker tariffs) – these could potentially fall within the scope of our exemptions if industry developed a transparent and published index.

8.253. We have considered the two following options in the development of our proposals for price increases and other adverse unilateral variations:

Option 1: prohibition of price increases and other adverse unilateral variations to fixed term tariffs (subject to exceptions)

Option 2: ensuring alignment of fixed term tariffs with relevant consumer protection legislation and SLC 23

8.254. Option 1 would implement our proposals, including our proposed provisions to clarify and tighten the rules for mutual variations (which would not be prohibited). Under this option, there would be exceptions for certain mechanisms for automatic variations and variations set out in advance. These are set out in more detail in our consultation document.

8.255. Under Option 2 there would be tightening of practices regarding communication of contract terms and variations for fixed term tariffs, as well as guidance regarding tracker tariffs[212] (to restrict tariffs which track a supplier's standard tariff, or other suppliers' tariffs). This would not include a full prohibition.

Assessment of options

8.256. In our view, only a full prohibition (Option 1) would improve the clarity of a fixed term tariff's principal terms, and provide predictability of price increases and other adverse variations. Any allowed exceptions would not be subject to the supplier's discretion and would be clearly set out in advance of contract agreement (or through mutual variation). This would provide additional protection for consumers by prohibiting non-exempted tracker tariffs and by allowing provisions for mutual variations. Overall, these measures will simplify fixed term tariffs, improve comparability, and give consumers confidence during the sign-up process.

8.257. Option 2 has one main disadvantage. Whenever there is a price increase or adverse unilateral variation (which would not be prohibited), suppliers would be required to comply with the variation notification requirements of SLC 23. For example, if a consumer picked a fixed term offer, they would need to switch to a new contract part way through if they wished to avoid one or more price increase or other

[212] This could take various forms, e.g. non-binding guidance, provisions within licence conditions.

adverse unilateral variations. This risks confusion for consumers, if they had not fully understood the variability of their fixed term contract, as well as adding to switching costs. Given that suppliers could see a large proportion of their consumers switch from the offer in such a circumstance, it may be that such fixed term offers would cease to be offered by suppliers in future; if this was the case this might lead to the same effect of the ban.

8.258. We also note that by limiting the types of tariff available in the market, this will reduce tariff proliferation, thereby improving engagement and trust in the market. We recognise that under Option 1 there may be implementation issues and costs for suppliers associated with implementing this prohibition, particularly in terms of altering the fixed term offers they present to the market.

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