

Consultation Response

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Ofgem's Retail Market Review - Final domestic proposals

Which? supports a number of aspects of the Final RMR Proposals¹ relating to billing, complaints and the Standards of Conduct. As we set out in our report "The Imbalance of Power: The Retail Market"² and our response³ to the previous RMR consultation,⁴ Which? agrees with Ofgem's analysis of the causes and outcomes of tariff complexity and segmentation of customers. However, we do not consider the combination of Ofgem's Final RMR proposals and the Prime Minister's 'lowest tariff' announcement sufficient to address the weak competition in the retail energy market.

By implementing Recommendations 1-6 from the Imbalance of Power - recommendations that we genuinely believe are aligned with Ofgem's direction of travel - Ofgem could deliver a framework that finally enables consumers to play their designated role and drive genuine, effective competition that keeps prices in check for everyone.

This response summarises our main concerns about the final proposals: tariff structure; segmentation and aspects of the information remedies, including the TCR.

Tariff structure

Which? does not support Ofgem's proposal that all tariffs should be comprised of a standing charge (the level of which is determined by the supplier) and a unit rate.⁵ As Ofgem is aware Which? favours the abolition of standing charge and 'tiered' formats and the structuring of tariffs as a single unit price (SUP)⁶, or series of unit prices for tariffs with time-differential pricing, such as Economy 7 and smart time-of-use tariffs. We consider the SUP to be the most effective tariff structure to make it easy for consumers to compare offers and identify the best tariff.

¹ The Retail Market Review - Final domestic proposals, Ofgem, March 2013

² The Imbalance of Power : The Retail Market, Which?, 2012 <http://press.which.co.uk/wp-content/uploads/2012/12/white-energy-treb.pdf>

³ Which? Consultation Response: Ofgem's Retail Market Review - Updated domestic proposals, Which?, December 2012

⁴ Ofgem's Retail Market Review - Updated domestic proposals, Ofgem, October 2012

⁵ The Retail Market Review - Final domestic proposals, Ofgem, March 2013, pg 43

⁶ The Imbalance of Power, Which?, December 2012, p 41.

Which? Is a consumer champion

We work to make things better for consumers. Our advice helps them make informed decisions. **Our campaigns make people's lives fairer, simpler and safer.** Our services and products put consumers' needs first to bring them better value.

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The SUP would instantly bring full comparability to all single-rate tariffs, which constitute around 80% of energy tariffs currently available⁷. Our research has found that the simpler tariff structure make it substantially easier for consumers to identify the cheapest tariffs; only 8% of consumers could identify the cheapest of six current tariffs that consisting of various elements such as standing charges and unit rates, whereas 89% of consumers could identify the cheapest tariff when the tariff was a simple, single unit price.⁸ The Final RMR proposals will not be as effective. Under the RMR proposals, price comparability will rely on the flawed Tariff Comparison Rate (TCR) - that our analysis has found could lead to millions of households buying the wrong tariff (set out below) - and the continued use of switching sites.

However, switching sites are not the panacea they are often made out to be. They do not guarantee that users will find the best deal or be able to understand all of the features of the offers they are presented with. This is partly due to barriers to getting the relevant data, and partly due to inbuilt errors in some of the calculations and unhelpful presentation of results. While around 20% of switchers used a price comparison service to find out about the tariffs on offer last time they switched, just 4% of all consumers have ever used one and even fewer have switched this way.⁹ In order to use a price comparison service effectively, consumers need to provide a considerable amount of information, such as their tariff name and ideally their annual actual usage, which they are unlikely to know automatically or have to hand. This information has to be obtained direct from the supplier or by looking at their bills or annual statement, where it may not be clear.

Fairer treatment of consumers

We believe that all tariffs should be available to all consumers regardless of payment preference (discussed below). In our Report we also set out a series of proposals regarding the treatment of surcharges and discounts to ensure all consumers are treated fairly. These are:

- Requiring the unit price to reflect the costs of paying by direct debit (the most common and lowest cost payment method) with any surcharge a supplier chooses to levy for other payment methods presented as an annual amount priced in pounds and pence and chargeable on a daily basis. This surcharge must be 'universal', ie the same on all of a supplier's tariffs; and
- Requiring dual fuel and online account management discounts also to be presented as a universal amount priced in pounds and pence and available on all tariffs offered by a supplier.

These proposals should ensure fairer treatment of customers who do not - or cannot - pay by direct debit, manage their accounts online, or get a dual fuel tariff (because they don't have mains gas) because the value of these surcharges and discounts will be transparent and easy for the regulator and consumer bodies to scrutinise. This should limit the scope for suppliers to discriminate against certain groups of consumers and/or soften competition by using surcharges or discounts to significantly distort the presentation of prices.

⁷ Consumers on Economy 7 could be given an indicative 'weighted' unit rate for the purpose of comparison, calculated using the average 'split' between day-time and night-time use.

⁸ Energy Tariff Investigation, Which? November 2012

⁹ Using the more accepted industry DECC figure of 4.2m annual switches

(www.decc.gov.uk/assets/decc/statistics/source/prices/qep271.xls) and Ofgem's 2012 Tracking Survey, which sets out that 16% of energy customers completed their last switch directly through an online price comparison service, we consider it likely that those switching more regularly will be higher users of comparison sites, so the 16% is an underestimate. The majority of switches though take place either by phoning the supplier (28%) or doorstep (28%). Using the 16%, means approximately 673k customers switch via a switching site in 2011. This equates to 2.5% of all households (based on 26.8 million households in the UK).



Distributional impact of SUP on vulnerable consumers

We believe that a radical simplification of energy prices through the implementation of the SUP would deliver benefits to vulnerable consumers, who feature significantly among disengaged groups. They would find it easier to search the market than at present and find a better deal, and would also benefit from wider competitive pressure driven by consumers finally being able to understand energy prices and move to the cheapest deals. While not all vulnerable consumers are low income, many are, and it should be recognised that being able to realise even small savings in energy bills can make a significant difference to poorer households, who spend a much higher proportion of their income on energy.

Which? has conducted modelling¹⁰ in order to understand the distributional impact of moving to an SUP structure for low income households both with high levels of energy consumption and low levels of energy consumption.

There are 3.8 million households in this ‘low income, low consumption’ (LILC) group, compared with around 600,000 in the LIHC (non-E7) group. Our modelling shows that the LILC group benefit from a collective reduction in their bills of £202m, whereas the LIHC see their energy spend increase by around £32m. The net effect of the SUP on the total low income population is, therefore, to remove around £170m from their combined energy spend.

Furthermore, there are a number of important considerations that should inform views on how the impact of SUP on LIHC consumers could be mitigated. Most of the following points are recognised in the Hills Review itself:

- Around 90% of the fuel poverty gap (defined as the amounts by which the assessed energy needs of fuel poor households exceed the threshold for reasonable costs) is accounted for by households living in homes that have energy ratings of E, F and G. Measures to improve thermal efficiency are therefore likely to offset any increase in bills caused by single unit pricing. *A priori*, rising block tariffs (RBT) would have an even greater negative impact on LIHC households than single unit pricing. However, the Review describes such tariffs as “intuitively appealing” and qualifies this point by saying “fuel poverty should be addressed through more targeted energy efficiency measures before any move to RBTs could be made”. We would assume similar conclusions would apply to single unit pricing.
- As previously mentioned, there are likely gains to be made by low income households from a more transparent and simple market. These would further offset any increase in bills caused by single unit pricing. The Review states that the level of fuel poverty under the current indicator would have been 15% lower in 2009 had households in the lowest three income deciles been on the lowest tariffs.
- The Government must ensure that policies that seek to improve the relative position of the fuel poor are properly targeted. As the Review notes, while tax-funding does not change the impact of policy interventions, funding through levies on bills can increase the fuel poverty gap of those who pay for policies but do not benefit from them. For example, only 25% of core group households currently receiving the Warm Homes Discount would be considered fuel poor under the new indicator proposed by the Review. However, we recognise that the benefits of better targeting would need to be costed as there are additional complexities, eg adjusting household incomes for size and composition, as well as taking thermal efficiency into account.

Consequently, while LIHC consumers may see an increase in their tariff rates, the root cause of this can be addressed by tackling the thermal and energy efficiency of these dwellings.

¹⁰ See Appendix 1 for distributional impact methodology

Limiting segmentation

Ofgem's final proposals do little to address the problem of segmentation of the domestic energy market. As we set out in our report,¹¹ there are a number of steps that would begin to address the segmentation in the markets and so address the outcomes of this. These include limiting suppliers to a single variable rate (SVR) and requiring suppliers to make all tariffs available on all payment methods.

However, suppliers will not be limited to a SVR tariff, they will have the option of having up to four variable rate tariffs. Suppliers will also not have to make all tariffs available across all payment types, they will be able to choose which payment methods they offer for each of their tariffs.¹² As a result, there is little to suggest that the 75% of households that find themselves on some of the most expensive tariffs and who collectively overpay in the region of £4billion annually will fare any better under the new proposals or that competition in the retail market will be effective.

Dead tariffs

In October 2012 the Prime Minister announced that suppliers would have to move their customers to their cheapest tariff. This has since evolved into a proposal whereby suppliers will have to move consumers from dead tariffs (ie those not open to new customers) to the cheapest evergreen (variable rate) given the customer's payment and online preference. Consequently, for as long as suppliers can have more than one variable rate tariff and they do not need to offer all tariffs on all payment methods, the suppliers can maintain the steadfast 'standard' that is often amongst the most expensive on the market. As a result consumers are likely to continue to languish on a 'live' but poor value tariff, and the suppliers will have fulfilled their requirements.

The TCR

We recognise that the TCR proposals have changed since Ofgem's last consultation moving to a single consumption level (medium) and regional pricing.¹³ However our position remains unchanged. We do not believe that the TCR will provide the clarity and instant comparability of prices that is needed to drive effective competition in the energy market. As we have previously set out, while the idea of a 'common currency' for otherwise non-standardised products is intuitively attractive and has been employed with some success in financial services, we consider it a poor alternative to unit pricing. In "The Imbalance of Power: The Retail Market" and our response to the Updated domestic proposals in December 2012, we set out a series of reasons why the TCR may confuse or mislead consumers. Building on this we commissioned consumer research to better understand consumers' engagement with the TCR and what the outcomes for consumers using the TCR are likely to be.

A prompt in the wrong direction

While Ofgem may consider the TCR a prompt to encourage consumers to further investigate the best tariff for them, we believe there is a serious risk that many consumers will use the TCR alone to choose a tariff to switch to as it looks like price information. Reflecting this, we modelled how many consumers could be misdirected to a more expensive tariff on the basis of using the TCR alone to buy a tariff, ie how many consumers could mis-buy and by how much would they mis-buy.

¹¹ The Imbalance of Power, Which?, December 2012, p 44.

¹² The Retail Market Review - Final domestic proposals, Ofgem, March 2013, pg 37

¹³ The Retail Market Review - Final domestic proposals, Ofgem, March 2013, pg 78



If a consumer just uses the TCR to choose a tariff, unless their consumption is spot on the medium usage for that fuel, including those in the ‘medium range’ but not on the absolute medium value, there is the potential for the TCR to suggest a different tariff to the one that is truly cheapest for their situation.

Using medium consumption values the TCR was calculated for tariffs that are currently available (using the methodology set out in final proposals consultation). The TCR was then calculated for every single tariff currently available to consumers at different consumption points - 91 for electricity (going from 1500 to 6000 kwh in steps of 50kwh) and 73 for gas (going from 8250 to 26250 kwh in steps of 250 kwh). For each usage point, we then calculated exactly which tariff would be the cheapest for a consumer using that amount of gas or electricity, and which tariff the medium-only TCR would indicate was the cheapest. By calculating the difference in cost between these two tariffs, we estimated the size, if any, of the mistake that might be made if the consumers simply chose the tariff suggested on the medium TCR tariff.

We did this for a range of different consumer cohorts based on payment preference, tariff type and fuel type preference based on Ofgem’s 2010 market breakdown. The proportions of low, medium and high users across households were then derived from the CSE DIMPSA database and applied this to the different market segments. Combining these datasets and multiplying the size of the potential mistake by the number of households in that cohort, provided an estimation of how many households could be pushed towards a mistake by relying solely on the TCR.

Using this method, in total, we estimate that 3.43 million households could make a mistake giving a combined value of over £55 million (these figures are correct as of 14 April 2013). A breakdown reveals that households along the consumption spectrum and consumption combinations are affected, but it is the extremes of consumption that make up the greatest proportions and that could mis-buy by amongst the largest amounts:

- Low electricity - 18%, collective misbuy of £10 million
- Low electricity and low gas - 15%, collective mis-buy of £11 million
- High electricity and high gas - 16%, collective mis-buy of £14 million

That is it the extremes that are more affected is not surprising given that only 26% of households fall within the medium range for both fuels.

The structure of tariffs is key to this problem

Currently credit meter tariffs tend to fall broadly into two categories. The first are tariffs that are the cheapest for all consumption levels. The second group of tariffs are those that good for particular consumption levels. These tariffs either have an extremely high standing charge with a low unit rate - ie good for high users; or a low standing charge with high unit rate - ie good for low users. For the second type, consumption is therefore critical to choosing the right tariff, and the TCR fails to address this. It is as a result of this, that our analysis found that 26% of households with low levels of gas and electricity consumption would be directed to a tariff that was more expensive than the best one for them.

This is based on existing tariffs but the mix of tariffs may evolve once the new rules are implemented.



Consumers would be unaware

Accurate and effective use of the TCR will require consumers to have an understanding of their gas and electricity consumption levels, specifically whether or not they are medium users for either fuel. This presents an immediate problem for consumers who have recently moved into a property and do not have a record of historical usage. There is also evidence that many consumers have little awareness of the level of their energy consumption.¹⁴ Ofgem's own analysis found that only half of consumers were able to correctly identify themselves as a high, medium or low user of electricity. The research also found that consumers used heuristics, including consideration of potentially highly relative and/or subjective factors, rather than making reference to the actual volume of energy used.¹⁵

We see little difference between this mis-buying and the way many, many households were unaware that they had been mis-sold tariffs.

Information overload

We support Ofgem's proposals to ensure that suppliers provide consumers with better information. However we are concerned that the combination of multiple pieces of information with multiple, and potentially confusing, pieces of price and cost related information may bamboozle consumers.

Bills, annual statements, price increase notifications and end of fixed term contract notifications will all display:

- The TCR¹⁶
- The Personal Projection¹⁷
- The Cheapest Tariff narrow¹⁸
- The Cheapest Tariff wide¹⁹

The TCR will also be included in the Tariff Information Label²⁰. The Tariff Information Label is to be included alongside the principle terms of the tariff, and so potentially may be included in billing information.

If a supplier had four tariffs that were as set out as the Table 1, a low consumption consumer for example, could be given:

- TCR = p/kwh medium consumption x tariff 1
- Personal projection = £/ annum low consumption x tariff 1
- The Cheapest Tariff Narrow = tariff 2, reflecting preference of variable type
- The Cheapest Tariff Wide = tariff 3, reflecting wider tariff preference

The inclusion of a Tariff Information Label would add another TCR and a different projected annual cost based on medium consumption not the consumption to date.

Further, if the supplier chose to provide a ranking of its four tariffs on the bill based on the TCR, this could result in a different tariff, for example tariff 4 from below, being ranked as

¹⁴ http://ec.europa.eu/consumers/consumer_research/market_studies/docs/retail_electricity_full_study_en.pdf (p403)

¹⁵ http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_Appendices.pdf (p56)

¹⁶ The Retail Market Review - Final domestic proposals, Ofgem, March 2013, pg 78

¹⁷ The Retail Market Review - Final domestic proposals, Ofgem, March 2013, pg 78

¹⁸ The Retail Market Review - Final domestic proposals, Ofgem, March 2013, pg 85

¹⁹ The Retail Market Review - Final domestic proposals, Ofgem, March 2013, pg 85

²⁰ The Retail Market Review - Final domestic proposals, Ofgem, March 2013, pg 89

the cheapest and appearing to conflict with the cheapest personalised tariff messaging also on the bill.

Table 1 Hypothetical series of four tariffs

	Type	Standing Charge	Unit rate	Payment options	Online/ offline
1	Variable	High	Medium	All	Offline
2	Variable	Low	Medium	Direct Debit	Online
3	Fixed 1 year	Low	Medium	Direct Debit	Online
4	Fixed 2 year	High	Low	Direct Debit	Online

Consequently, while the consumer may be armed with all the possible information, assuming they open their bill or annual statement, the consumer may be equally confused by which information is appropriate to use and at a loss as to where to start. Ofgem needs to consider more widely the impact that this could have on consumers' propensity to engage.

National Pricing

Which? believes that introduction of national pricing²¹ should be given further consideration. National pricing has a number of attractions given its potential to drive competition by making prices more visible. As we set out in our report and response to the previous consultation, we recommend that Ofgem should undertake a review of the benefits of national pricing, reporting no later than Autumn 2013.

Which?, April 2013

²¹ The Imbalance of Power, Which?, 2012, p 27,45.



Appendix 1

Using the Which Switch? tariff database, we converted all tariffs that have existed in the database since 1st January 2011 until March 2013 into an SUP equivalent. The consumption level was fixed for the calculation using Ofgem's value for a medium consumer to balance the effect on low users with the effect on high users and ensure that any change is revenue neutral. This allowed us to estimate the annual cost of different usage levels under an SUP structure. By comparing these estimates with the real existing annual cost, we assessed the impact of moving to an SUP approach on different consumer groups.

In our model, low income high cost consumers are represented by those in the lowest quintile of the national income distribution and who have above - median energy consumption (ie in deciles 6-10 of national energy use). In order to establish the effect on this group, we have sourced consumption and population size data from the Centre for Sustainable Energy using its Distributional Impacts Model for Policy Scenario Analysis (DIMPSA), which is now used under license by DECC for the Government's own assessments of the distributional impacts of policies. Although we consider that this dataset provides 'best available' information on the relationship between income and energy usage, one limitation is that it only allows analysis of the impact of the change on the average (mean) level of consumption for each energy use decile. It does not allow us to model the impact on consumers whose consumption is above or below the mean, and therefore does not account for the fuel poverty gap faced by individual households.

DIMPSA provides the electricity and gas distributions separately so we first considered consumers in the bottom quintile of incomes and in the top five deciles of usage for each energy type:

Table 1: Number of low income high consumption households

Energy type	Household Count	Mean Energy Use (kWh per year)
Gas	705,473	18,752
Electricity	1,062,636	6,978

To give a more accurate representation of effects, we adjusted the population to exclude those with extremely high electricity usage as it is likely that this high usage comes from consumers who use electricity to heat their home, a large proportion of whom are likely to be on Economy 7 or 10 tariffs that are not covered by the SUP estimate. We then calculated the annual cost for this adjusted population (ie minus those with extremely high electricity usage) and the SUP estimate. This gives the following effects:

Table 2: Estimate of change in annual bill for low income high consumption households under SUP (not including very high electricity users who)

Energy type	Real Cost	SUP Cost	Change
Gas	£821.14	£843.76	+£22.62
Electricity	£623.28	£655.22	+£31.94
Combined	£1,444.42	£1,498.98	+£54.56

For comparison purposes, we look at the effect of the SUP on the remaining low-income group with energy use in the bottom five deciles:

Table 3: Estimate of change in annual bill for low income low consumption households under SUP

Energy type	Real Cost	SUP Cost	Difference
Gas	£526.25	£493.72	-£32.53
Electricity	£380.91	£360.81	-£20.10
Combined	£907.16	£854.53	-£52.63