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Consultation Response

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Ofgem consultation - Creating the right environment for demand-side response

Which? is the largest consumer organisation in Europe. It is an independent, not-for-profit consumer organisation with almost 800,000 members. Which? is independent of Government and industry, and is funded through the sale of Which? consumer magazines, services and books. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.

Introduction

Energy is an essential good - consumers have a right to safe, secure and affordable supplies. As a good that consumers have no choice but to purchase, it is crucial that the arrangements to supply energy both recognise and reflect this. Within the current retail market arrangements, consumers are designated the role of drivers of competition. However they are currently unable to fulfil this role due to flaws in the design and structure of tariffs.

As the energy system evolves to a low carbon system, the role of consumers will also evolve. They will contribute to the balancing of the system as well as driving competition in the markets. Therefore creating the right environment for consumers to participate in demand-side response (DSR) in the GB electricity market - in other words, ensuring that DSR meets the needs of consumers and empowers them to act - is crucial.

In this regard we support Ofgem's approach to look across the whole supply chain to determine how current market arrangements might constrain development. Consumers are an integral part of this system, as there can be no DSR without their engagement and participation. Ofgem's approach should be more explicit in ensuring that consumers are the focus and that market arrangements and DSR products work for customers, allowing them to act and realise the value.

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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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This document sets out our main considerations of the preconditions that Ofgem has proposed in its consultation document, *Creating the right environment for demand-side response*.¹ In summary:

1) The current retail arrangements cannot be ignored

- Household consumers, and their interaction with the current retail market, must be considered in conjunction with arrangements for DSR further up the supply chain.
- Ofgem's reform of tariffs does not go far enough.² New arrangements will be needed in the retail market to simplify it now and set it up for future Time of Use tariffs (TOU). A single unit price will make it easier for consumers to compare tariffs, switch and drive competition both now and in the future.
- This will help to break down the barriers to engagement, which is crucial if consumers are to be willing and able to participate effectively in DSR.
- Trust in energy companies and the energy sector is currently low. Improving this will be important if consumers are to trust the DSR offers from suppliers, and respond to the signals they are given. Good levels of trust are also particularly important for acceptance of automation, where consumers will be relinquishing control.

2) DSR offers must be designed for consumers

- The design of DSR offers must be consumer-focused, so that there is real, identifiable value for consumers. Otherwise there is a high risk that consumers will simply not participate.
- Quantitative trials will be crucial in establishing what works best for consumers, as well as what provides the best response to the other parties up the supply chain. The interests of all parties need to be aligned.

3) DSR products may lead to new potential for mis-selling by Third Party Intermediaries (TPIs) and suppliers

- Ofgem must ensure that mis-selling is prevented by companies, or by aggregators if these businesses move into the household sector. There must be a reasonable fit between DSR products and the households which sign up to them.
- We welcome work by Ofgem to publish an issues paper on the regulatory framework around Third Party Intermediaries (TPIs) and their activities.

Consultation Response

Below we set out responses to the questions relevant for Which?. We have focused on the second and third preconditions in the consultation document. Under precondition 2, we have answered questions 4 & 5, and we have responded to questions 7-10 under precondition 3.

Precondition 2 - the value of offering different DSR services needs to be signalled effectively to consumers

Which? agrees with the precondition that in order to create the right environment for DSR there will need to be clear, effective signalling to consumers. This must also include the design of products that will have real, easily identifiable value to consumers. Assuming that products with real value to consumers will naturally come about would be short sighted and does not reflect the history of the retail market. There has been a proliferation of complex and confusing tariffs, of unclear value to consumers.

¹ Ofgem Consultation Document, *Creating the right environment for demand-side response*, ref. 64/13, 30 April 2013.

² Which? Consultation Response: *Ofgem's Retail Market Review - Final domestic proposals*, 23 April 2013.



The needs of consumers must be considered from the outset if the right environment for demand-side response is to be fostered. We understand that there must be a starting point and that settlement reform and developments further up the supply chain are necessary for the industry to be incentivised, before it can in turn incentivise consumers, but we are concerned that the absence of discussion on consumers' needs in this consultation paper will mean that they are left behind at a crucial stage in development.

However, there are ongoing trials, such as the London Carbon Network Fund (LCNF) trials, which aim to gather evidence and greater insight into consumer attitudes, acceptance and the type of response that different groups of consumers may provide. This should deliver valuable evidence. Ofgem's approach to ensuring that consideration is given to consumers from the outset should include, but not be limited to, establishing more explicit links between this programme and the LCNF, so that the findings of these trials can feed into and inform the development of DSR products and signals.

Q.4 Are there any additional key challenges associated with effectively signalling the value of DSR to consumers? If so, please identify and explain these challenges.

The current retail market does not work for consumers

Which? regards the current complexity of energy tariffs as an additional key challenge associated with effectively signalling the value of DSR to consumers. As described in *The Imbalance of Power*, our policy report on the retail market, Which? does not believe that the current market works for consumers or allows them to play their allotted role in driving competition. Ofgem has recognised these problems and the low levels of consumer engagement.³

Consumers currently find tariffs difficult to understand and are generally overwhelmed. This means that the basis for introducing more complex offerings is not there. There is a risk that consumers will become even less engaged and potentially sign up to ill-suited tariffs, which will leave them worse off financially and feeling that the market is not working in their interests. A continued lack of understanding will act as a barrier to consumers engaging effectively and providing the response that is required. A key challenge therefore is enabling consumers to understand and engage with the market now.

Scrapping the standing charge and simplifying tariffs now, so that there is simply a unit rate along with transparent treatment of any discounts and surcharges will allow consumers to easily identify the best deal for them and increase transparency.⁴ This will also allow more complex tariffs, such as Time Of Use (TOU), to be displayed clearly, simply using a series of unit rates for the time bands. If the value is to be signalled effectively it must be straightforward for consumers to identify the best deal.

As set out in Which?'s consultation response to Ofgem's final RMR domestic proposals (May 2013)⁵, Ofgem's proposals are unlikely to sufficiently simplify tariff offerings and consumers' propensity to engage with the market. Recent Which? research provided evidence of the simplicity that the Which? proposals would bring. We compared Ofgem's TCR prompt and

³ Ofgem, *RMR - final domestic proposals*, March 2013.

⁴ See Which? report, *The Imbalance of Power: The Retail Market*, December 2012, for our recommendations on a single unit price and our proposals for the treatment of discounts and surcharges.

⁵ Which? Consultation Response: *The Retail Market Review - Final Domestic Proposals*, April 2013.



Which?'s proposal of a single unit price (SUP) and found that 65% of consumers preferred a SUP compared to 10% who preferred the TCR prompt. Furthermore only 28% chose the cheapest deal for them based on the TCR, compared to 84% using the SUP.⁶ If it is straightforward for consumers to identify the best deal, this will help to empower consumers and increase engagement. Signalling cannot be deemed effective if consumers do not understand and act upon these signals, and in turn without consumer response there will be no value passed on to any party.

The current level of understanding and engagement with electricity usage in the home is not a good starting point for the effective signalling of DSR offers

Consumers' understanding of and engagement with their energy use is a crucial variable for any estimation of domestic DSR potential. But this is lacking at even the most basic level i.e. understanding how much they use. Recent Which? research found that almost 6 out of 10 people could not even find their energy bill - a crucial communication for informing consumers of their usage and the price of this.⁷

If household electricity demand is to be shifted from peak times, it will be important that consumers are able to understand: first, the relationship between their usage and how they consume electricity i.e. at what times of the day and on which appliances, and second, how they can shift their usage and what the benefits of this will be. Qualitative Which? research in 2011 found that many consumers were not aware of the large proportion of consumption arising from space and water heating, relative to lighting and appliance use. Similarly, the Consumer First Panel qualitative research found that consumers did not think about the fact that the level of their electricity consumption varies across the day.⁸ Given these levels of knowledge, it is likely that it will be difficult for consumers to recognise the value of smart tariffs.

Value will only be effectively signalled to households if the design of DSR offers is focused on them.

As well as understanding consumption, for signalling to be effective it is important to assess the most desirable focus of consumers' willingness to engage and direct policy effort and resource into encouraging DSR accordingly.

In deliberative research carried out for Which?, consumers questioned how much they could actually adapt their behaviour in order to make a meaningful difference to the timing of their consumption.⁹ Qualitative research with Ofgem's Consumer First Panel in 2010 found that people felt that the most likely changes they could make to their consumption would be using appliances after midnight, as well as heating water at night. This suggests that many consumers may only shift electricity use where most convenient.

As automated products become more widespread, this has the potential to be a more convenient way for consumers to provide demand-side response. However consumers tend to prefer to have the option to override automation which could undermine the value of the response somewhat. If consumers and the media continue to be nervous of automation - and trust levels in the energy sector do not improve - there will be a challenge in convincing consumers of the value, even if trials suggest that automation is the most convenient option

⁶ Which? Energy Tariff Research, May 2013.

⁷ 57% of respondents could not find their bill. Which? Energy Tariff Research, May 2013.

⁸ Ofgem's Consumer First Panel 2010.

⁹ Research carried out for Which? by Quadrangle, between September and November 2011.



to help households shift their electricity use. This would result in consumers, as well as parties across the supply chain, losing out. Therefore it is important to design consumer-focused DSR offers, which are as simple as possible to understand. Failure to do so is likely to lead to further erosion of trust and engagement, and therefore limited take up.

Ofgem and the various parties across the supply chain should also be aware that some consumers may not be particularly interested in DSR products and may see providing the required response as an off-putting 'hassle'. Qualitative research carried out for Which? found that the level of perceived hassle involved would put some consumers off smart tariffs.¹⁰ This may be particularly true for those consumers whose main concern is managing their household budget, and who therefore prefer to know how much they will need to pay each month. There will also be a challenge in attracting consumers with very peaky demand - those who have greater demand at peak times - who are likely to prefer flat tariffs, rather than trying to shift their demand.

Lack of trust

A lack of trust - both in suppliers and in the energy market as a whole - is a further key challenge to the second precondition (the value of offering different DSR services needs to be signalled effectively to consumers) and is closely linked to engagement. In the monthly Which? Consumer Insight Tracker (carried out May 2013) energy prices were consumers' top concern, with 83% of people worried about them.¹¹ Only 22% of consumers said that they trust gas and electricity companies, and there was a 3% increase on the April Tracker in those who said they actively distrust companies.¹²

This could create problems for the effectiveness of a signal that a supplier wants the consumer to respond to. In order for signalling to be effective, consumers will need to trust the signals and the reliability of their source (as well as seeing the value). Trust is particularly important where DSR involving some level of automation is involved (as described above). Evidence from some of the trials has shown that initial hesitation about automation can be tackled by giving consumers the option to override an automated response whenever they choose.¹³ This suggests that for the electricity system to really benefit from domestic DSR, the industry will need to tackle the low levels of trust so that consumers feel comfortable in providing the response that will be needed to prove the signals effective.

Q. 5 Do you agree that signals to customers need to improve in order for customers to realise the full value of DSR? Does improving these signals require incremental adaptation of current arrangements or a new set of arrangements?

A new set of arrangements is needed in the retail market to break down the barriers to engagement and trust, which are crucial to creating the right environment for DSR

As previously discussed, Which? thinks that the current levels of consumer engagement in the energy market need to be improved before signals will be effective and allow consumers to realise the value of DSR. Ofgem's categorisation of consumer groups by switching behaviour

¹⁰ Research carried out for Which? by Quadrangle, between September and November 2011.

¹¹ [http://consumerinsight.which.co.uk/tracker?utf8=%E2%9C%93&d\[age_band\]\[\]=&d\[income_band\]\[\]=&d\[region\]\[\]=&d\[sort_by\]=default&d\[open_in\]=worry&d\[v\]=37](http://consumerinsight.which.co.uk/tracker?utf8=%E2%9C%93&d[age_band][]=&d[income_band][]=&d[region][]=&d[sort_by]=default&d[open_in]=worry&d[v]=37)

¹² [http://consumerinsight.which.co.uk/tracker?utf8=%E2%9C%93&d\[age_band\]\[\]=&d\[income_band\]\[\]=&d\[region\]\[\]=&d\[sort_by\]=default&d\[open_in\]=trust&d\[v\]=37](http://consumerinsight.which.co.uk/tracker?utf8=%E2%9C%93&d[age_band][]=&d[income_band][]=&d[region][]=&d[sort_by]=default&d[open_in]=trust&d[v]=37)

¹³ Frontier Economics & Sustainability First for DECC, *Demand side response in the domestic sector - a literature review of major trials: Final report*, August 2012, p.27.



concluded that 40-60% of consumers are disengaged from the market in some way. Which? believes that this is driven by a number of factors including unnecessarily complex tariffs which do not allow at-a-glance comparisons and require the use of switching sites, obscure prices, have anti-consumer sales and marketing practices and ‘herd-like’ pricing behaviour. These issues need to be addressed - with increased consumer engagement and satisfaction as measures of success - before signalling the value of DSR to household consumers can be effective.

Many of these features have been recognised by Ofgem, government and to some extent the suppliers. Whilst Ofgem and government have put forward remedies and some suppliers have made changes to their practices, Which? does not believe that these go far enough. As a result, we see the need for a new set of arrangements in the retail market, in order to remove the barriers to engagement and trust - as set out above, these begin with the introduction of single unit pricing. We believe that this, along with further recommendations in the *Imbalance of Power*, will simplify the market for consumers, increase transparency and ultimately engagement.¹⁴ This will then provide the right basis for signalling to consumers so that they are able to realise the full value of DSR.

It will be important to establish which signals and products work best for consumers in order to improve them so that consumers can realise the value of DSR

There is also evidence that consumers don’t adjust the level of their energy consumption in response to price - so as well as not switching, they don’t reduce their usage levels.¹⁵ Understanding the reasons and how to overcome this is likely to be challenging, but essential.

Signals need to be designed with the consumer at the forefront, and with realistic expectations of household take up and response. It will be important to establish which products give the most effective response and work for consumers. Signals will not be meaningful to consumers if they do not realise the value following their response. This may require more than incremental adaptation of current arrangements to make DSR work for household consumers, depending upon what is found to be the best option for them. The costs of changes that might be required to enable certain types of tariffs, such as Critical Peak Pricing (CPP) and other dynamic tariffs, will need to be weighed up against the benefits of the likely response.

Precondition 3: Customers need to be aware of the opportunities to provide DSR, able to readily access information on options and able to act.

Q. 7 Are there any additional key challenges associated with customer awareness and access to opportunities around DSR? If so, please identify and explain these challenges.

Ofgem has identified that consumers have a limited understanding of how the electricity system works, that costs are different at different times of the day, and therefore of why demand-side response can be valuable across the supply chain. Which? agrees that the rollout of smart metering should help consumers to be more engaged and start to understand how their behaviour and use of different appliances makes up their electricity use.

¹⁴ Which?, *The Imbalance of Power: The Retail Market*, December 2012.

¹⁵ Rutledge, I., and Wright, P., *UK Energy Policy and the end of Market Fundamentalism* (chapter 8), September 2010.



Design of DSR products must be consumer-focused and marketing will need to be carefully monitored

Which? agrees that customers need to be aware of the opportunities to provide DSR, able to readily access information on options and able to act. In order for consumers' awareness to develop, and for them to access information to help them take action, industry will need to do more than 'inform, educate and persuade customers' of the benefits¹⁶. They will need to design offers that are actually of value to consumers with realistic expectations of the behavioural changes in how people use electricity at home. Ongoing trials will help industry to understand the needs of consumers to overcome this challenge. While it is obvious that awareness and information will be crucial to consumer take up of DSR products, it is essential that these products are designed to allow consumers to realise the value. If this does not happen, this increases the potential for consumers to be sold the wrong products.

Mis-selling has again recently been a problem in the retail market, with SSE being fined a record £10.5m by Ofgem for prolonged mis-selling. The introduction of new, more complex, tariff structures could result in new examples of mis-selling. To prevent this, clear direction from Ofgem will be needed around how smart tariffs and their potential benefits are marketed. Some research has revealed that consumers do not find it all that easy to estimate what percentage of their usage takes place during peak times.¹⁷ More generally, suppliers will need to make clear the significant impact that any change in circumstances, such as having a baby or retiring, might have on consumption patterns and consumers' potential savings.

Positive consumer attitudes will help to increase awareness and action

The Ofgem consultation document adopts the approach used in the RMR to frame the challenges: consumers need to be aware, able to access and assess, and able to act.¹⁸ Which? believes that there is another challenge in terms of attitude, which underpins consumers' awareness and propensity to access and act. Our view is that if robust reform, as recommended in *The Imbalance of Power*, is implemented in the retail market now, this will help to change consumer attitudes towards the energy sector going forward. Trust is currently very low, with only 22% reporting that they trust gas and electricity companies in our monthly Consumer Insight Tracker. On the other hand, there are some more promising signs - Consumer Focus research found that 50% of consumers on existing TOU tariffs do use appliances at off peak times in order to save money.¹⁹

Automation

Ofgem has recognised the challenge for household consumers in the up-front investment required in order to enable automation. This may be a barrier to uptake, even if action is simplified for consumers because the need for a time-critical response is removed. As previously discussed with regards to take up of automation, there is also a challenge in increasing levels of consumer trust and understanding so that people feel comfortable with giving up some control over when they use electricity. Industry will need to win consumer trust if they are to see a collective response which puts value back into the system.

¹⁶ Ofgem, *Creating the right environment for demand-side response*, April 2013, p. 35.

¹⁷ VaasaETT, *Empower Demand: the potential of smart meter enabled programmes to increase energy and systems efficiency: a mass pilot comparison*, 2011, p.51.

¹⁸ Ofgem, *Creating the right environment for demand-side response*, April 2013, p. 35.

¹⁹ Consumer Focus, *From devotees to the disengaged - Economy 7*, October 2012.



Q. 8 Is any additional work needed to explore the role of third parties in helping customers to access and assess DSR offerings?

Which? welcomes Ofgem's Third Party Intermediaries (TPIs) project and an issues paper on the current regulatory framework around the TPI market. This should allow for assessment of how the market may develop and the consequences of this for regulatory options to protect consumers in the future. There is value in looking at the types of TPIs that may establish themselves, and how they would work with a smarter energy system, for example how consumers could use the new data that they will have available to them from smart meters to find the best DSR products for them using switching sites.

The extension of aggregators into the domestic sector would need to be carefully monitored with the appropriate regulation put in place to ensure that consumers are protected. If this market is to develop for household consumers, the potential for mis-selling, or up-selling, must be recognised and prevented. For example, rules around what would happen in the instance that the response promised by the aggregator to the supplier is not met by consumers. This could create problems across the supply chain where balancing has been arranged according to a certain response. Over or under-demand would result in parties across the supply chain losing out and Which? would not want to see consumers being penalised as a result.

Q.9 Are there any additional preconditions for delivering the right environment for DSR? If so, please explain what these are and why they are important, as well as attaching a priority relative to those challenges we have already identified

1. Reform of tariffs in the current market so that consumers engage and act. (high priority)

The introduction of smart tariffs will add further complexity to a market that many consumers already have difficulty in navigating. Which? believes that the introduction of a single unit price, with straightforward and transparent treatment of surcharges and discounts, would remove barriers to engagement and switching, driving a more effective market and ultimately increasing trust in the sector as a result of more households getting better deals. This starting point will be crucial to creating the right environment for consumers to participate in DSR. Furthermore, single unit pricing would also help to make TOU tariffs more accessible. A single unit price for each time band would be simpler to understand.

2. Clear identification and understanding of the value to be signalled to consumers. (high priority)

The value needs to be properly identified before it is signalled. Which? recognises that there is on-going work in this important area, as well as on-going trials which will provide more data and evidence on where the value is, and the realistic consumer response. Although this may seem implicit in the system, Which? regards clear understanding of the value of DSR offers to consumers as a precondition to creating the right environment. This also includes an understanding of what role automation will need to play and who the other parties are.

3. Increased consumer trust in both stakeholders and offerings. (high priority)

It is widely recognised that the low levels of trust in the energy sector are a problem. Therefore Which? thinks that this should be accepted as a separate precondition to creating the right environment for DSR. It is likely that this problem will become even more apparent when industry expects more widespread take up of more complicated tariffs. The potential for issues around mis-selling/mis-buying could also undermine trust and should be regarded as



a serious risk.

Q.10 Do you agree with the priority and timing we have attached to addressing each of the key challenges identified above?

Challenges around ‘customer protection with more cost-reflective charges’ should be rated ‘High’ priority. Consumers are essential to DSR and so they should not be left behind. We recognise that the current focus is concentrated further up the supply chain, but as there would be no DSR without consumers, we do not think that consumers should only feature in the medium to long term. The right environment for DSR will not be created without addressing the key consumer challenges from the start.

Which?
July 2013