

# Retail Energy Markets in 2016

## Report

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### Overview:

This is our second annual Retail Energy Market report. Drawing on a range of market monitoring indicators and consumer research, it looks at key trends in 2015-16, such as changes to market structure, prices and profits on the supply side, and developments in consumer engagement on the demand side. It also examines how well the retail market is delivering good consumer outcomes and identifies themes relevant to the outlook for 2016-17 and beyond.

## Context

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Our market monitoring and consumer research form a crucial part of our role as the regulator of the gas and electricity markets in Great Britain (GB). They provide insight into developments on the demand and supply side of the retail markets; inform how we develop new policy; and help us to assess the impact of existing regulation. Our monitoring publications serve as an authoritative source of information on different aspects of the energy markets, helping to build trust and confidence among consumers and investors (one of the strategic outputs that we aim to deliver). They help to track the contribution of the markets – including the way in which we regulate them – in achieving the outcomes for consumers set out in our strategy.<sup>1</sup>

As in 2015, this report is part of a wider package of monitoring publications, including an annual report on recent developments in the wholesale markets; a report detailing trends in liquidity in the wholesale electricity market; and an updated suite of energy markets and customer service indicators. Alongside this report, this year we have also published a consultation seeking views on how we should provide transparency on suppliers' expected costs.

## Associated documents

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[Wholesale Energy Markets in 2016](#) (August 2016)

[Wholesale power market liquidity: Annual report 2016](#) (August 2016)

[Monitoring trends in suppliers' expected costs \[SMI consultation\]](#) (August 2016)

[Consumer engagement in the energy market since the Retail Market Review: 2016 survey findings](#) (August 2016)

[Consumer research datasets](#) (August 2016)

[Remedy implementation strategy](#) (August 2016)

[Retail Energy Markets in 2015](#) (September 2015)

[State of the Market Assessment](#) (March 2014)

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<sup>1</sup> ['Our Strategy'](#), December 2014

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## Executive Summary

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This is our second annual Retail Energy Market report. Drawing on a range of market monitoring indicators and consumer research, it looks at key trends in 2015-16, such as changes to market structure, prices and profits on the supply side, and developments in consumer engagement on the demand side. It also examines how well the retail market is delivering good consumer outcomes and identifies themes relevant to the outlook for 2016-17 and beyond.

The report does not assess the state of competition in the retail markets - this was covered by the recently-concluded investigation by the Competition and Markets Authority (CMA)<sup>2</sup>. Throughout its investigation, we provided the CMA with information and assistance, and we do not aim to replicate its analysis here. The evidence in this report is consistent with the CMA's findings on the retail energy markets. We are committed to acting on the CMA's recommendations quickly and effectively, as explained in our Implementation Strategy<sup>3</sup> published today.

### **Supply side: new suppliers are entering the market at an increased rate, while existing small and medium-sized suppliers continue to expand**

The number of suppliers entering the market has continued at an increased rate. Between April 2015 and March 2016, fourteen new licensed suppliers became active in the domestic segment and nine in the non-domestic segment. These new entrants have a variety of business models such as not-for-profit, renewable and local supply schemes. The combined market shares of small and medium-sized suppliers in the domestic market also continued to grow by nearly 4 percentage points to 14% in March 2016.

In contrast, the six large suppliers<sup>4</sup> have continued to lose market share in both the domestic and non-domestic segments. This has contributed, together with price cuts, to reductions in their revenues in 2015 compared to 2014.

The large suppliers' financial statements have shown a marked difference in outturns for gas and electricity. Despite the fall in revenues, aggregate pre-tax profits from the supply of gas increased year-on-year, while for electricity they fell significantly. Averaging across the large suppliers, profit margins on both domestic and non-domestic supply have fallen compared to the previous year, although there were big differences between companies.

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<sup>2</sup> '[Energy market investigation - Final report](#)', CMA, June 2016

<sup>3</sup> '[Remedy implementation strategy](#)', August 2016

<sup>4</sup> We use the term 'six large suppliers' throughout this report as shorthand to refer to the former gas incumbent (British Gas), and the companies formed from the former regional electricity incumbents (EDF, E.ON, npower, ScottishPower and SSE).

**Demand side: switching rates have increased among domestic and business consumers but overall engagement remains largely unchanged**

Competitive markets need a sufficient number of engaged consumers who can access, assess and act on information about offers in the market. Although there have been some positive developments, there remains a large proportion of consumers who are still disengaged.

We have seen domestic switching rates in 2015 rise to 12% for electricity and 13% for gas - an increase of one and two percentage points respectively on 2014. We have also seen sustained rates of customers switching tariff with their existing supplier, at levels twice as high as the switching rates between suppliers. Evidence suggests that much of this can be accounted for by already engaged consumers, who tend to be heavily motivated by price and are most likely to take advantage of competitive fixed-term tariffs.

We have also seen that consumers' awareness of, understanding of and trust in the energy market have increased slightly. However, survey data suggests that the overall pattern of domestic consumer engagement with the market in 2016 is largely unchanged relative to 2015 and 2014. More than one in five consumers are very disengaged. They are predominantly on expensive standard variable tariffs, less likely to engage with information and more likely to be in vulnerable situations.

Non-domestic switching rates rose in 2015-16 in electricity and fell slightly in gas compared to 2014-15. Survey data indicates that microbusinesses and small businesses have more new contracts with both existing and new suppliers this year. This suggests that consumers are making more active choices at the end of fixed-term contracts. The picture is broadly flat for other aspects of engagement, including understanding contract terms.

**Consumer outcomes: retail markets continue to fall short of delivering for a large proportion of consumers**

The retail markets and the way they are regulated have a particular contribution to make in delivering four of the consumer outcomes described in our corporate strategy: lower bills, better quality of service, benefits for society as a whole and reduced environmental damage.

*Bills*

Domestic bills were subject to two opposing forces in 2015. Prices fell, while consumption increased on average as a result of colder weather. The combined effect was a reduction of two per cent in the average dual fuel bill for a domestic customer of the large suppliers between 2014 and 2015.

Consumers have not experienced these price reductions uniformly. Significant competition among fixed-term tariffs has continued, with suppliers using different approaches to acquire new customers (including via white labels or collective switches). On the other hand, despite some cuts in early 2015 and 2016, the

average standard variable tariff has not fallen as much as the cheapest tariffs in the market. The gap between these two groups of tariffs has widened and is currently around £300 per year. Although the proportion of customers on standard variable tariffs has reduced from 69% in March 2015 to 66% in March 2016, this still represents the majority of consumers.

The observed price reductions primarily reflected lower wholesale costs. Suppliers also reported reduced costs per household associated with government social and environmental programmes. For some suppliers, cost reductions were partly offset by higher operating costs.

Business customers have also seen gas prices come down, again largely driven by falls in wholesale costs. However, electricity prices for all but the smallest business customers have risen, partly as a result of higher charges to suppliers to meet the costs of government programmes intended to reduce the environmental impact of the energy sector.

### *Quality of service*

We expect competition between suppliers to stimulate improvements in quality of service over time, not just put pressure on prices. The picture over the last year was mixed. On the positive side, the total number of complaints by domestic consumers fell, as reported by suppliers, the Energy Ombudsman and Citizens Advice. This was mainly because a few suppliers resolved problems with their billing systems, which brought the number of complaints back to earlier levels. Customers are slightly more satisfied overall with domestic and non-domestic suppliers, with customers of small and medium-sized suppliers generally the most satisfied.

Less positively, in the context of fewer complaints overall, most suppliers are taking longer to resolve complaints. Evidence suggests more serious complaints have grown in volume for some smaller suppliers. Customers are also more dissatisfied with how suppliers are handling complaints, particularly among microbusiness customers. In other areas, including speed and reliability of switching, suppliers have made limited progress.

### *Benefits for society*

Consumers in vulnerable situations are a priority for Ofgem. We are concerned that these consumers continue to experience worse outcomes than others. Our analysis focuses on three key groups of consumers where there is ongoing evidence of detriment: consumers with prepayment meters, consumers in debt with their supplier and electric heating customers on certain types of restricted meters. For various reasons, as highlighted in the CMA's final report, these consumers continue to have a very limited tariff choice and face barriers to switching supplier, tariff, payment method and meter. In particular, the best offers in the market, most often fixed-term tariffs, are generally not available to these consumers, and they tend to be on more expensive standard variable tariffs.

Some positive developments should be noted. For example, the number of customer accounts in debt has continued to fall, including the proportion of prepayment customers in debt, and switching has become easier for them through improvements to the Debt Assignment Protocol. Suppliers have started offering a number of innovative and cheaper 'smart' prepayment tariffs. Suppliers have also identified and recorded more customers on the Priority Service Register and more people took up these services.

### *Environmental impact*

Over the last decade, consumption and energy intensity have followed a downward trend. Weather-adjusted domestic consumption fell in 2015 relative to 2014, by 0.9% in gas and 1.3% in electricity.

Retail market arrangements can facilitate consumers' access to information on their consumption (eg through smart meters with in-home displays) and send price signals that promote efficient and sustainable energy use.

Many developments are still in their infancy, but there has been a lot of progress in consumers generating their own energy and offering flexibility to the system. For example, the contribution of (mostly domestic) consumers self-generating electricity under the Feed-in Tariff scheme expanded by 28% in 2015. At the same time, there are more opportunities for the largest business consumers to offer flexibility services to the market, including balancing services and participation in capacity market auctions.

### **Future outlook: trends and policy improvements for 2016-17 and beyond**

We see a mixed outlook for consumers in 2016-17, driven primarily by a number of supply-side developments.

With more new entrants into the retail market, and the removal of restrictions on the tariffs offered by suppliers, there is more room for innovation. This should continue to put competitive pressure on prices and quality of service. In parallel, related proposals concerning the Confidence Code should also help stimulate competition among price comparison websites to offer attractive deals. The most active consumers are likely to benefit from this trend, but it is unclear to what extent benefits will spread to the most inactive before the CMA's remedies for engaging disengaged consumers come into effect.

Turning to prices, the steep falls in wholesale prices we have observed over the past two years are likely to continue to feed through to costs during 2016 for those suppliers that have purchased energy in advance of delivery. But in the first half of 2016 we have seen wholesale prices stabilise and then increase more recently – leading to some increases in the prices of fixed-term tariffs. There is also likely to be some upward pressure on prices as a result of new charges to suppliers for the costs of government's electricity market reforms. There will be a redistributive effect as a result of exemptions from certain environmental levies for large industrial customers, which will reduce prices for these consumers, but increase them for domestic and smaller business consumers.

Beyond 2016-17, we expect to see consumer outcomes improve, as the CMA's remedies take effect, smart meters are rolled out, and our wider package of reforms (eg to enable faster, more reliable switching and to reform settlement arrangements) are implemented.

Limited consumer engagement, especially in the domestic market, will be addressed primarily through our implementation of the CMA's remedies, including the database of disengaged customers and more effective prompts to engage consumers. Experience to date suggests that it will take time for these remedies to have an impact on engagement levels. In the case of microbusinesses, a positive, potentially more immediate impact, should come from the CMA's proposed order on suppliers to disclose their prices publicly.

We expect improvements also for consumers in vulnerable situations. Our programme of work for prepayment meter customers, which include the CMA's remedies, looks to address key areas of concern, such as barriers to switching and customer awareness.

Over the longer term, smart and advanced meters have the potential to improve a number of consumer outcomes. The information they provide should help consumers to better manage their energy consumption. Moreover, coupled with half-hourly settlement reforms, smart meters should also give suppliers more incentives to offer time-of-use tariffs and other innovative products which can in turn stimulate load shifting by consumers from peak to off-peak periods. The main installation phase of the smart rollout is due to start shortly and is due to be completed in 2020. We will continue to monitor suppliers' performance against their targets and start reporting in early 2017.



# 1. Introduction

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## The scope and purpose of this report

1.1. This report draws on our routine retail market monitoring and consumer research, covering a wide range of indicators. These activities form a crucial part of our role as the regulator of the gas and electricity markets in Great Britain.

1.2. The report looks at key trends over 2015-16, such as changes to market structure, prices and profits on the supply side, and developments in consumer engagement on the demand side. It also examines how well the retail market is delivering the consumer outcomes in our corporate strategy<sup>5</sup> and identifies themes relevant to the outlook for 2016-17 and beyond.

1.3. The report does not assess the state of competition in the retail markets - this was covered by the recently concluded investigation by the Competition and Markets Authority (CMA)<sup>6</sup> - and we do not aim to replicate their analysis here. In line with the CMA's recommendations for our annual reporting, we provide here an update on the evolution of prices, the profitability of key players and likely trends for the forthcoming year. We aim to address the CMA's further suggestions for coverage<sup>7</sup> from 2017 onwards.

1.4. By regularly publishing information about the markets we regulate, we aim to promote understanding and confidence among our stakeholders. As in 2015, this report is part of a wider package of monitoring and consumer research publications, including an annual report on recent developments in the wholesale markets, a report detailing trends in liquidity in the wholesale electricity market, and an updated suite of energy markets and customer service indicators.

1.5. We are keen to get your views on our retail market monitoring publications, and to understand how the retail markets are working for you. You can email us at [marketmonitoring@ofgem.gov.uk](mailto:marketmonitoring@ofgem.gov.uk). Feedback will be used to inform future monitoring outputs.

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<sup>5</sup> ['Our Strategy'](#), December 2014

<sup>6</sup> ['Energy market investigation - Final report'](#), CMA, June 2016

<sup>7</sup> The CMA recommended that the annual State of Market Report should also cover: the social costs and benefits of policies, the impact of initiatives relating to decarbonisation and security of supply and the trade-offs between policy objectives resulting from the extant regulatory framework.

## **The CMA investigation**

1.6. In June 2014 we referred the market to the CMA for a full investigation because we were concerned that, in the domestic and small business markets, competition between suppliers was not delivering the outcomes for consumers that we expect. Throughout the investigation we have provided information and assistance to the CMA.

1.7. On 24 June 2016 the CMA issued its final report. It identifies several aspects of the energy markets that work well for consumers, including the wholesale markets and the recent high level of entry in the retail markets. However, it also identifies substantial problems in three main areas: the lack of engagement on the part of many consumers, which suppliers are able to exploit by charging high prices; a combination of regulations and technical constraints that restrict competition to the detriment of consumers; and the broader regulatory framework, which hinders the timely development of policies and regulations in the interest of consumers.

1.8. To tackle these problems the CMA has issued an extensive package of remedies. The most relevant ones that concern the retail markets are:

- Remedies to help consumers engage – these include the recommendation that we establish an ongoing programme to test and implement information measures to improve consumer engagement, the recommendation that we create a database of customers that have been on a standard variable tariff for three years or more to allow rival suppliers to prompt them to engage, and the removal of certain restrictions on intermediaries' ability to operate and to access data. In addition, and specifically for microbusinesses, the CMA will also issue an order on suppliers to disclose their prices publicly.
- Remedies to create a framework for effective competition – these include the replacement of restrictive tariff rules with a principle-based approach to ensuring that tariffs are easily comparable for consumers, the recommendation that we implement a more rational, efficient system of gas and electricity settlement and a number of specific remedies to help address constraints in the prepayment infrastructure that currently limit the number of available prepayment tariffs.
- Remedies to protect consumers who are less able to benefit from competition – the CMA has decided to impose a price cap on the prices offered to prepayment customers during a transitional period (2017-2020), which will move every six months in line with a range of cost indices and will not apply to fully interoperable smart meters.

1.9. We consider that the analysis set out in this report is consistent with the CMA's findings and supports remedies concerning retail markets. We will now take action to implement the CMA's recommendations quickly and effectively, as explained in our Implementation Strategy<sup>8</sup> published today.

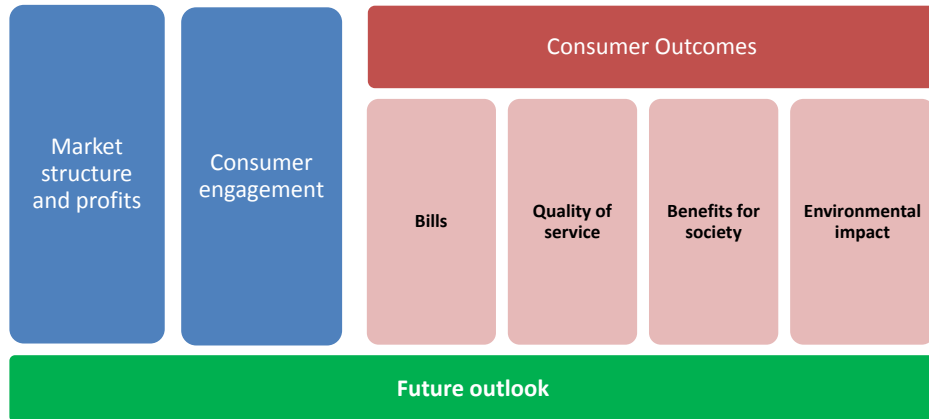
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<sup>8</sup> ['Remedy implementation strategy'](#), August 2016

## The structure of this report

1.10. As shown in Figure 1.1 the structure of the report is similar to that used for our first Retail Energy Market report published last year. The main difference is the inclusion of a section, at the end of each chapter, which identifies themes relevant to the outlook for 2016-17 and beyond.

FIGURE 1.1: **Structure of this report**



1.11. We include two appendices at the end of the report. Appendix 1 provides a list of the key datasets underpinning the analysis in the report, as well as a description of each dataset and the period it covers. Appendix 2 provides a glossary of the key terms used in the report.

## 2. Market structure and profits

### Chapter Summary

New suppliers are continuing to enter the market at an increasing rate. Fourteen new licensed suppliers became active in the domestic segment and nine in the non-domestic segment. These new entrants have business models such as not-for-profit, renewable and local supply schemes. The combined market shares of small and medium-sized suppliers in the domestic market also continued to grow, by nearly four percentage points to 14% in March 2016.

In contrast, the six large suppliers have continued to lose market share in both the domestic and non-domestic segments. This has contributed, together with price cuts, to reductions in their revenues between 2014 and 2015.

The large suppliers' financial statements have shown a marked difference in outturns for gas and electricity. Despite the fall in revenues, aggregate pre-tax profits from the supply of gas increased year-on-year, while for electricity they fell significantly. Averaging across the large suppliers, profit margins on both domestic and non-domestic supply have fallen compared to the previous year, although there were big differences between companies.

Looking to the future, technological developments will continue to create opportunities for new business models, which may in turn fuel further entry and expansion and put additional pressure on the revenues of the large suppliers.

2.1. This Chapter looks first at key market structure trends in both domestic and non-domestic segments, focusing on new entrants and existing suppliers' market shares. It then provides an overview of the six large suppliers' financial performance.

### Market structure

#### Domestic

2.2. As of March 2016, there were 43 active licensed suppliers in the domestic retail markets, in most cases offering both gas and electricity. These consisted of the six large suppliers,<sup>9</sup> which are vertically-integrated former gas or electricity incumbents<sup>10</sup> and 37 suppliers which have entered the market since liberalisation, and which in most cases are not vertically integrated ('medium sized' and 'small' suppliers).<sup>11</sup> In addition, there are currently eight 'white label' suppliers –

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<sup>9</sup> We use the term 'six large suppliers' throughout this report as shorthand to refer to the former gas incumbent (British Gas), and the companies formed from the former regional electricity incumbents (EDF, E.ON, npower, ScottishPower and SSE).

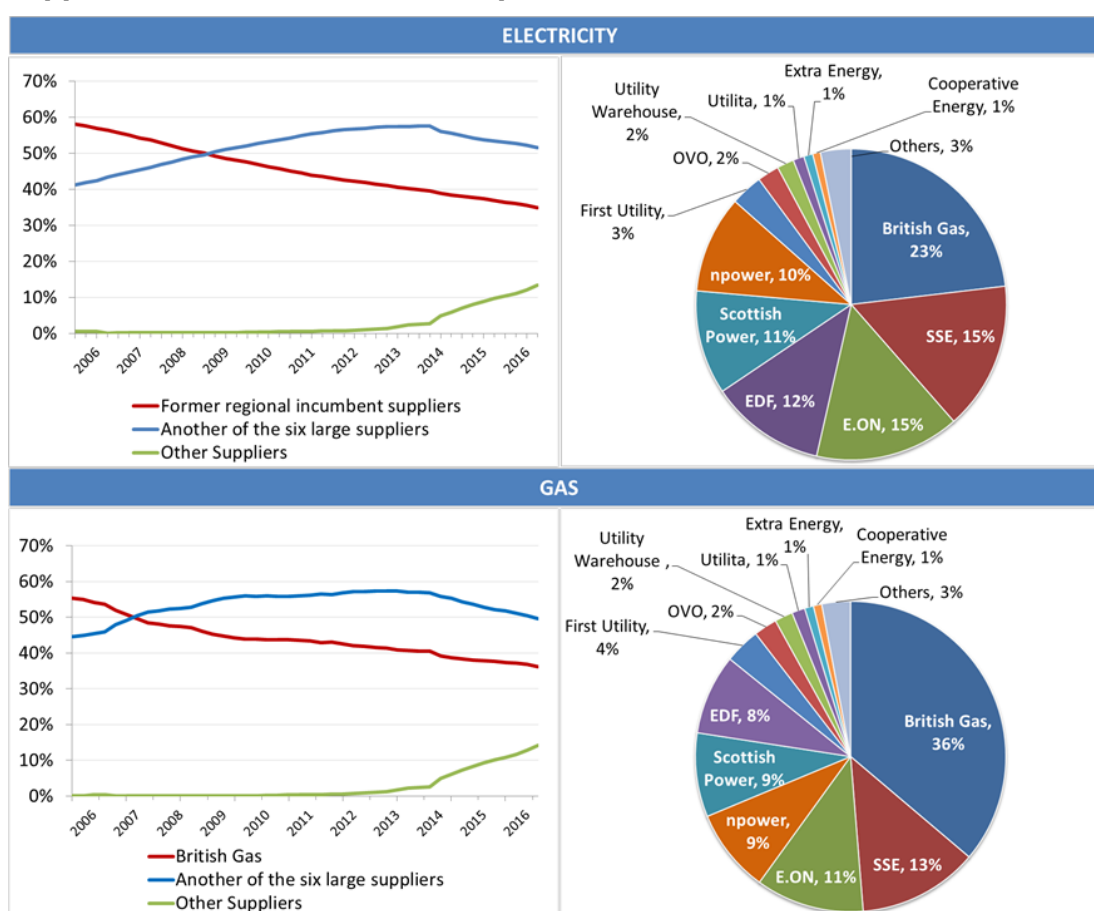
<sup>10</sup> While we present certain information averaged or aggregated across these six large suppliers in this report, we note that there are some significant differences in the different firms' business models, and how they are organised.

<sup>11</sup> Throughout this report we use the term 'medium-sized' to refer to the suppliers that, as of

organisations without supply licences that partner with an active licensed supplier to offer gas and electricity using their own brand. Levels of new entry have been very high recently: 14 new suppliers became active between April 2015 and March 2016, compared to five between April 2014 and March 2015.

2.1. In March 2016, there were around 28 million domestic electricity and 21 million domestic gas customers in GB, accounting for 36% of electricity and 61% of gas consumption respectively<sup>12</sup>. The great majority of these customers were supplied by one of the six large suppliers, with the largest market shares in each segment being held by British Gas and the second largest being held by SSE.

**FIGURE 2.1: Share of GB domestic meter points served by different types of supplier - 2006 to 2016, and snapshot for March 2016**



Source: Ofgem analysis of data provided by DNOs, iDNOs and Xoserve.

March 2016, had individual market shares above 1%, ie First Utility, OVO, Utility Warehouse, Extra Energy, Coop and Utilita.

<sup>12</sup> Ofgem calculation based on data received from Elexon and Xoserve. Only gas supply points connected to the national transmission system are included within this calculation.

2.2. The market share of the six large suppliers has been falling over time – from 90% to 87% between March 2015 and March 2016 for electricity, and 90% to 86% for gas over the same period. Correspondingly, the market share of other suppliers has increased and six of them (First Utility, OVO, Utility Warehouse, Extra Energy, Co-operative Energy and Utilita) have individual market shares above 1%.

2.3. As shown in Figure 2.1, the rapid growth of suppliers other than the six large energy companies is a relatively recent development. These suppliers form a heterogeneous group with a large variety of entry pathways and business models (although, in nearly all cases their entry and expansion has taken place organically). They include, for example, suppliers with business models centred on acquiring customers via offering the cheapest tariffs available on price comparison websites; suppliers with smart prepayment offers; suppliers with a service targeted specifically at tenants; green energy suppliers; and not-for-profit suppliers, often with a community focus. Box 2.1 shows a list of the new suppliers that have entered in the year to March 2016 and some further information about the diversity of business models employed.

**BOX 2.1: Entry in the domestic market between April 2015 and March 2016**

2015			2016
Q2	Q3	Q4	Q1
Robin Hood Energy Tempus Energy (E)	Bulb Places for People	Bristol Energy Octopus Energy Our Power Energy Future Energy So Energy Cardiff Energy (G) UK National Gas (G)	Affect Energy Avro Energy IRESA (E)

Source: DNOs, iDNOs and Xoserve

Note: (E) – electricity only and (G) – gas only.

All but four of these new entrants offer both electricity and gas. Most have focused their marketing on promising better service, lower prices, or have emphasised the simplicity of their tariffs and/or the switching process. Some are owned by local councils. For example, Robin Hood Energy (launched by Nottingham City Council) and Bristol Energy are both local authority energy suppliers. Both started with a regional offering, but now operate nationally. Places for People Energy describes itself as a not-for-dividend organisation, which reinvests any profits that it makes into social causes.

Others focus on green energy – for example Bulb, a renewable energy supplier with a single tariff. Tempus Energy's offer is based on smart technology and encouraging demand flexibility among customers with the potential to be flexible in a proportion of their energy use.

As part of their customer acquisition strategy, some of these new suppliers have focused on offering among the cheapest tariffs available on the market. For example, as of 24 May 2016 the cheapest tariff available for a direct debit customer with typical consumption was the 'simple and connect' online tariff offered by new entrant Avro Energy.

2.4. Compared to the six large suppliers, the other domestic suppliers with market shares above 1% tend, on average, to have a greater proportion of customers on fixed-term tariffs (55% in March 2016, compared to 32% for the six large suppliers). They also have on average a greater proportion of direct debit accounts (78% compared to 61%) and online accounts (53% compared to 36%). These suppliers also tend to supply fewer customers with restricted electricity meters. However, there is considerable variation from one supplier to the next, depending on their business model.

2.5. As described in last year's Retail Energy Market report, major differences remain in the structure of the domestic electricity market between regions. In particular, although the former electricity incumbent suppliers lost on average around 2% of their market share in their historic home regions between March 2015 and March 2016, on average they have market shares between three and five times as high in these compared to other regions.

### **Non-domestic**

2.6. The non-domestic segment includes a range of different customers, from small businesses (including microbusinesses) up to large industrial and commercial users. Despite only making up a relatively small proportion of all customers, as of March 2016, business users accounted for 64% of total electricity consumption and 39% of total gas consumption.<sup>13</sup>

2.7. As of March 2016, there were 65 active suppliers in the non-domestic market (some of which also supplied domestic customers). Of these, 26 supplied both gas and electricity, 21 only gas and 18 only electricity. They included the six large suppliers, a number of other firms with upstream gas production or power generation businesses, and various smaller suppliers. Many suppliers focus on a single fuel, as businesses negotiate separate contracts for gas and electricity, and many do not have a gas supply (only 41% of micro- and small businesses report using both mains electricity and mains gas).<sup>14</sup>

2.8. Historically, rates of entry have been higher in the non-domestic segment than domestic. Like in the domestic segment, entry levels have risen rapidly in recent years. Five new suppliers have entered the non-domestic gas market since April 2015, two have entered the electricity market and two have entered both.

2.9. Table 2.1 shows the market shares of the largest non-domestic suppliers in March 2016 for different groups of business customers.<sup>15</sup> For the larger customers,

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<sup>13</sup> Ofgem calculation based on data received from Elexon and Xoserve.

<sup>14</sup> ['Micro and small business engagement in the energy market 2016 - quantitative research report'](#), BMG/Ofgem, May 2016.

<sup>15</sup> For electricity, we look separately at supply to non-half hourly (nHH) meters for profile classes 3 and 4 (typically smaller businesses) and nHH meters for profile classes 5 to 8 or half hourly (HH) meters (typically larger businesses with higher electricity consumption), as recorded by DNOs, iDNOs and Elexon. For gas, we look separately at supply to consumers with

the shares are based on the total volumes of energy supplied rather than the number of sites: this reflects the heterogeneity of business customers' energy use.

2.10. As the table shows, the smallest business customers are typically served by one of the six large energy suppliers. In contrast, the majority of gas sold to larger businesses is supplied by firms other than these suppliers, as is a significant proportion of the electricity supplied to large non-domestic users.

2.11. The past year has seen a continuation of the longer-term trend of a declining share of non-domestic demand being served by the six large suppliers. For example, British Gas has continued to lose market share among non-domestic gas customers with consumption less than 73.2MWh: from 37% in March 2015 to 32% in March 2016. Over the same period, Total Gas & Power, CNG Ltd and Opus Energy each increased their shares by 1-2 percentage points. The six large suppliers have also seen a fall in market share among larger non-domestic electricity customers: from 73% in March 2015 to 68% in March 2016.

**TABLE 2.1: Non-domestic market shares for different segments, March 2016**

GAS				ELECTRICITY			
Customers with annual consumption 0-73.2MWh*		Customers with annual consumption >73.2MWh~		Customers with NHH meters (profile classes 3 and 4)*		Customers with NHH meters (profile classes 5-8) and HH meters~	
British Gas	32%	Total Gas & Power	19%	SSE	17%	EDF	19%
E.ON	15%	Gazprom	16%	E.ON	17%	npower	18%
Total Gas & Power	10%	Corona	13%	British Gas	17%	E.ON	11%
Opus Energy	7%	DONG Energy	11%	npower	13%	SSE	11%
npower	7%	E.ON	8%	EDF	12%	Haven Power	7%
CNG Ltd	7%	British Gas	7%	Opus Energy	8%	SmartestEnergy	7%
Corona	6%	Engie	6%	ScottishPower	8%	Engie	6%
Other	17%	Other	20%	Other	8%	Other	21%

\*Shares based on number of meter points. ~Shares based on volume of gas and electricity

Source: Ofgem analysis of data provided by Elexon (electricity) and Xoserve (gas).

2.12. As in the domestic market, the former electricity incumbents continue to have relatively large market shares among smaller non-domestic electricity customers. On average, their market shares are between one and three times as high in their historic home regions compared to others, slightly lower than in the domestic electricity market. However, in all regions except Northern Scotland they have seen their historic home region market share fall compared to 2015. In most areas British Gas is the second largest supplier, although it is also losing market share, particularly in the Eastern and South Eastern areas where it is no longer the second largest supplier.

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annual consumption below 73.2MWh, and those with consumption above 73.2MWh.



## The financial statements of the large suppliers

2.13. Ofgem requires that the six large suppliers publish annual statements<sup>16</sup> of their revenues, costs and profits for their generation and supply businesses, known as the Consolidated Segmental Statements (CSS). This information allows us to understand trends in these companies' financial performance and provides greater transparency around their profitability.

2.14. We are committed to improving the quality of the financial reporting that the energy companies are required to carry out. The CMA has made a number of recommendations in this area – including adding a requirement for the energy companies to provide information on their balance sheets. Following these recommendations, we will be engaging with stakeholders later this year about potential changes to the reporting requirements.

### Domestic supply

2.15. As discussed in paragraph 2.4, the large suppliers continued to lose customers in 2015, while prices fell - leading to an overall reduction in domestic supply revenues aggregated across the six energy companies from £26.0bn in 2014 to £24.6bn in 2015<sup>17</sup>. For gas, this was despite overall volumes increasing year-on-year as a result of higher consumption per household, driven by colder weather.

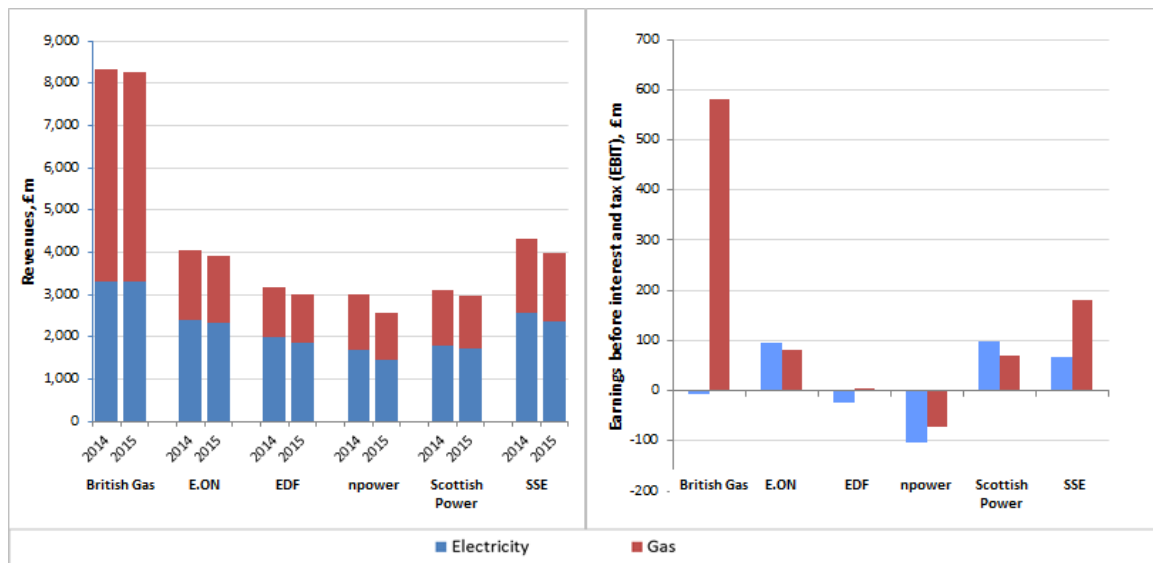
2.16. Customer losses varied significantly between suppliers, with Centrica, E.ON and ScottishPower experiencing a significantly smaller percentage reduction in their customer numbers in 2015 compared to npower, SSE and EDF.

2.17. Total domestic supply profits aggregated across the six companies – measured as earnings before interest and tax (EBIT) – also fell between 2014 and 2015, from £1,159.7m to £973.8m. There was a notable contrast between gas and electricity. In particular, profits on domestic gas supply increased from £615.7m to £845.0m as wholesale cost reductions outpaced cuts to prices. At the same time, on aggregate the six suppliers' profits on domestic electricity sales fell significantly, from £544.0m in 2014 to £128.7m in 2015, resulting from a combination of lower sales, and increases in non-energy costs for some suppliers (for a fuller discussion of drivers of trends in suppliers' costs, see chapter 4).

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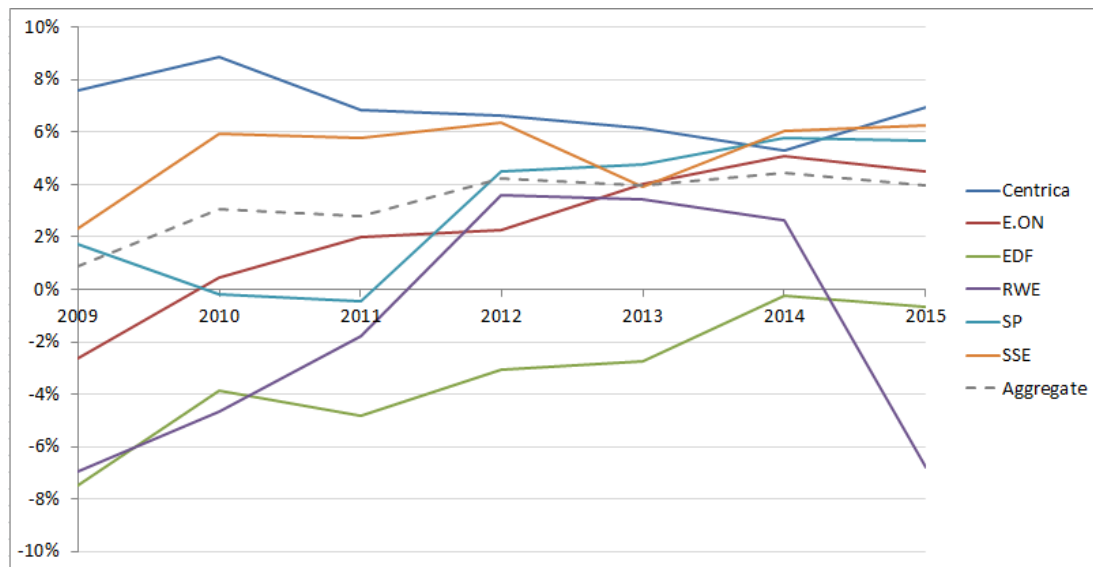
<sup>16</sup> We provide links to the suppliers' statements in [this](#) document.

<sup>17</sup> Note that here and below where we refer to 2014 and 2015, we mean the relevant financial year, covering the period January to December for all of the large suppliers except for SSE, for which it covers the period from April to March of the subsequent calendar year.

**FIGURE 2.2: Domestic supply revenues (2014 vs 2015) and profits (2015)**

Source: Ofgem analysis of CSS.

2.18. Figure 2.3 shows the differences in domestic combined gas and electricity EBIT margins between the large suppliers. British Gas (with its relatively large proportion of gas customers) reported an increase in its domestic margins from 5.3% to 7.0% between 2014 and 2015, while SSE reported a smaller increase from 6.0% to 6.2% year-on-year. The other suppliers saw reductions in margins. In particular, npower incurred significant losses in 2015, partly as a result of high costs associated with issues with its billing system.

**FIGURE 2.3: Domestic combined gas and electricity supply margins**

Source: Ofgem analysis of CSS.

## **Non-domestic supply**

2.19. The combined non-domestic supply revenues of the six companies also fell between 2014 and 2015, from £16.8bn to £16.1bn. As with the domestic segment, the large suppliers lost non-domestic customers overall – however there were some exceptions, for example both npower and SSE increased their number of non-domestic gas and electricity accounts.

2.20. Looking across the six suppliers, non-domestic profits as a whole increased slightly for gas, and fell significantly for electricity. Averaging across the suppliers, combined gas and electricity profit margins fell, although again there was significant variation across suppliers. For example, while British Gas saw a particularly large reduction, with its margin on the supply of gas and electricity to non-domestic customers falling from 4.5% in 2014 to -0.7% in 2015, SSE reported an increase in its supply non-domestic margin from 2.0% to 4.0%. As with the domestic segment, there was a significant difference between gas and electricity, with the average non-domestic gas margin of the six suppliers slightly increasing from at 6.0% to 6.5%, while the average non-domestic electricity profit margin fell from 2.0% to 1.0%.

2.21. Note that the mix of business customers served by each supplier – particularly in the number of larger industrial and commercial customers compared to smaller business customers – is likely to vary both across suppliers and across time. This means that it is difficult to compare the non-domestic results of the different suppliers. The CMA's final report has illustrated that profitability varies significantly by segment – with suppliers typically earning much higher margins on their smaller business customers.

## **Future outlook**

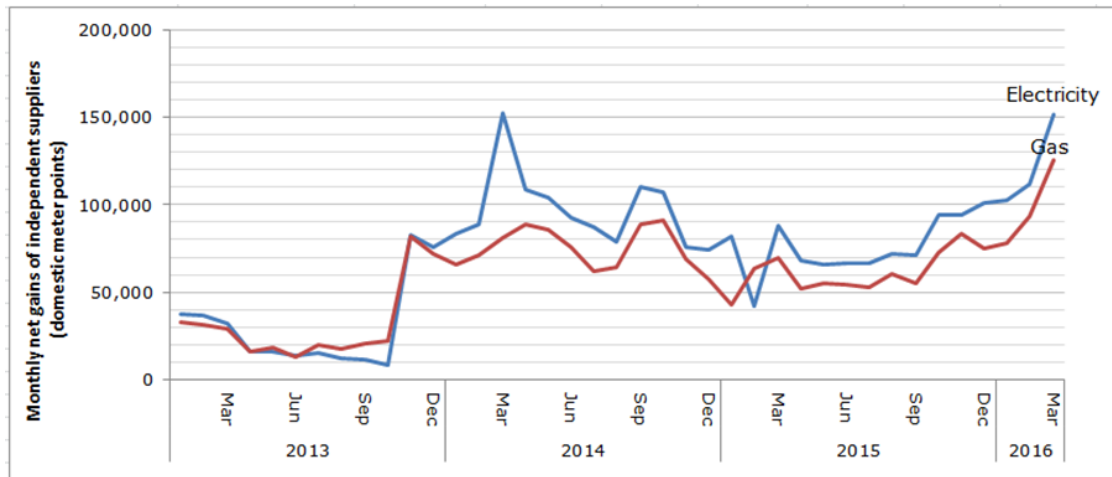
2.22. We have seen the number of domestic electricity and gas licenses increase by 46 and 40<sup>18</sup> respectively between April 2015 and March 2016, which may lead to new suppliers becoming active in the near future.

2.23. Recent switching figures indicate that small and medium-sized suppliers continue to expand, as shown in Figure 2.4. If this trend continues, it will also put more pressure on the revenues and margins of the large suppliers. As described in Chapter 4, we have seen increasing signs of the large suppliers competing by offering cheap fixed-term tariffs. At the same time, the levelling out (and recent increases) in wholesale prices may affect the balance of costs between different suppliers, depending on the extent to which they have hedged their customers' energy in advance.

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<sup>18</sup> This resulted from the award of 48 new licenses and 2 license revocations in electricity and 44 new licenses and 4 license revocations in gas.

**FIGURE 2.4: Monthly increases in the total number of domestic gas and electricity meters supplied by small and medium-sized suppliers**



Source: Ofgem analysis of data provided by Xoserve, DNOs and iDNOs.

2.24. Intermediaries<sup>19</sup> can help drive rivalry among suppliers, through innovation and by encouraging greater consumer engagement (this is discussed in more detail in Chapter 3). Another recent development, with potential to attract consumers, is the increasing number of local supply projects, such as the multi-party Local Supply Community<sup>20</sup> project, which is exploring new ways to strengthen the links between local generation and supply, and the trial of Piclo<sup>21</sup>, a peer-to-peer marketplace for renewable energy that allows consumers and generators to buy and sell directly through an online platform.

<sup>19</sup> Intermediaries are currently non-licensed companies acting in the market between a licensed party (typically a supplier) and a consumer. They may take many different forms, ranging from price comparison websites, to brokers, face-to-face advisors and aggregators and they may offer different services (combined or in isolation), such as offer comparison, switching services, energy efficiency advice and aggregation

<sup>20</sup> This is led by Pixie Energy, a new venture lead by Nigel Cornwall, involving a range of local authorities, generators and other industry participants supported by consultants from Cornwall Energy.

<sup>21</sup> Piclo is a joint-venture between Open Utility and Good Energy, with funding from the Nominet Trust and DECC's Energy Entrepreneurs Fund. At the moment it is exclusively non-domestic, due to data resolution requiring real time half-hourly data.

## 3. Consumer engagement

### Chapter Summary

Competitive markets need a sufficient number of engaged consumers who can access, assess and act on information about offers in the market. Although there have been some positive developments, there remains a large proportion of consumers who are still disengaged.

We have seen domestic switching rates in 2015 rise to 12% for electricity and 13% for gas - an increase of one and two percentage points respectively on 2014. We have also seen sustained rates of customers switching tariff with their existing supplier. Evidence suggests that much of this can be accounted for by already engaged consumers, who tend to be heavily motivated by price and are most likely to take advantage of competitive fixed-term tariffs.

We've also seen that consumers' awareness of, understanding of and trust in the energy market have increased slightly. However, survey data suggests that the overall pattern of domestic consumer engagement in 2016 is largely unchanged relative to 2015 and 2014. More than one in five consumers are very disengaged. They are predominantly on expensive standard variable tariffs, less likely to engage with information and more likely to be in vulnerable situations.

Non-domestic switching rates rose in 2015-16 in electricity and fell slightly in gas compared to 2014-15. Survey data indicates small and microbusinesses have more new contracts with both existing and new suppliers this year. This suggests that consumers are making more active choices at the end of fixed-term contracts. The picture is broadly flat for other aspects of engagement, including understanding contract terms.

Beyond 2017, limited consumer engagement, especially for domestic consumers, will be primarily addressed through our implementation of the CMA's remedies, including the database of disengaged customers and the development of more effective prompts to engage. We expect that improved and better targeted prompts, the increasing role of intermediaries and faster and more reliable switching should all help facilitate engagement. Experience to date suggests it will take time for remedies to have an impact, and active consumers are most likely to benefit from changes - such as more innovative tariffs - in the shorter term. In the case of microbusinesses, more immediate benefits should come from the CMA's proposed order on suppliers to disclose their prices publicly.

3.1. The CMA found evidence of weak demand response for domestic and microbusiness customers, and concluded that suppliers were able to exploit it by charging high prices. Our concerns on engagement barriers, such as a lack of clear information about tariffs, products and contract terms and a lack of trust in suppliers and the market, were also a key factor in our decision to refer the energy market for investigation in June 2014.

3.2. This chapter looks first at domestic consumers, considering switching and overall engagement trends as well as key enablers and barriers to engagement. We then discuss recent developments in engagement among business consumers. We conclude by considering relevant themes for the coming years.

## Domestic consumer engagement

### Switching trends

3.3. As part of our regular market monitoring we analyse rates of switching between suppliers, rates of switching with the same supplier and the number of customers on different tariff types.

#### *Rates of switching between suppliers*

3.4. We have observed an increase in domestic electricity and gas switching rates in 2015 relative to 2014, which reverses a trend of decline that started in 2008. In 2015, approximately 3.3 million domestic consumers switched their electricity supplier and 2.6 million their gas supplier. This represents an annual switching rate of 12% for electricity and 13% for gas, respectively one and two percentage points higher than in 2014. The increase was relatively uniform across GB, although regional differences remain especially for electricity (eg Scotland showed an electricity switching rate of 10% in 2015).

3.5. As shown in Figure 3.1, switching rates have continued to rise in early 2016, reaching levels last seen over four years ago. The number of switches in the first quarter of 2016 was 25% higher compared to the same period in 2015 and we are observing a similar trend in more recent months.<sup>22</sup> Several factors are likely to have contributed to this increase, including the continued emergence of cheaper fixed tariffs following the downward trend of wholesale prices, the information campaigns led by Ofgem<sup>23</sup> and DECC<sup>24</sup> and the announcement of price cuts by suppliers in late January.

3.6. Monitoring data shows there is a declining proportion of consumers who have never switched supplier. Data from electricity distribution network operators show that 29% of meter points did not change supplier between 2002 and 2015, down one percentage point relative to 2014. The equivalent figure for gas, although covering the period up to May 2016, was 15%, down from 18% in March 2015<sup>25</sup>. Survey data typically points to a higher proportion of domestic consumers never having switched supplier compared to data based on meter points (45% in 2016 compared to 43% in

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<sup>22</sup> See the chart 'Number of domestic customers switching suppliers by fuel type' within our [website retail indicators](#).

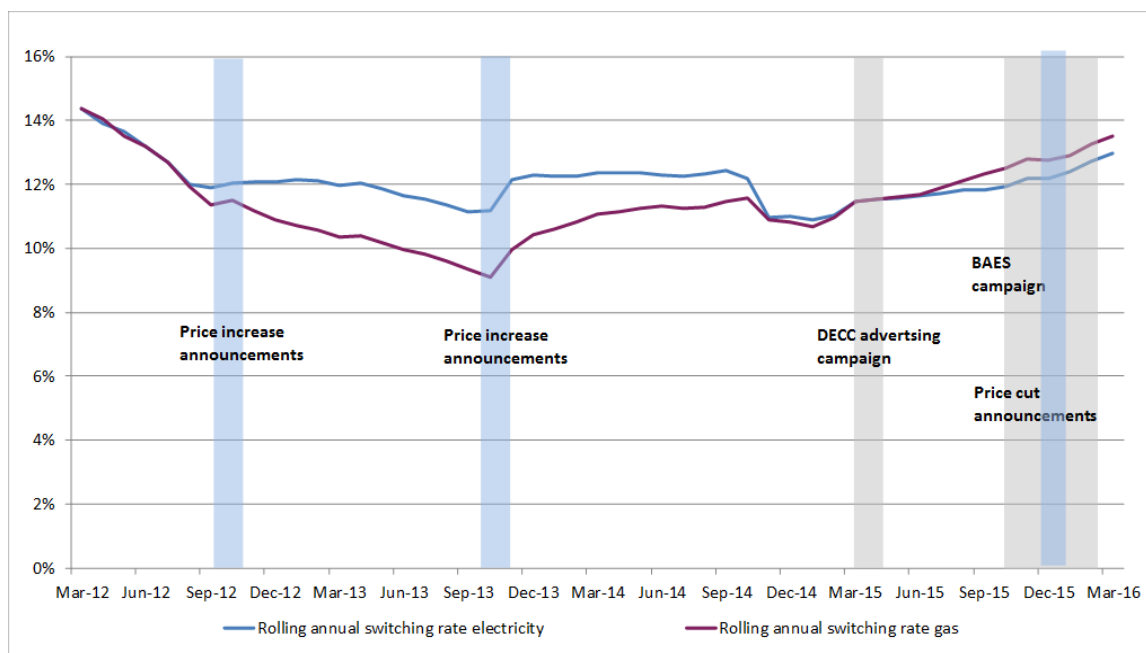
<sup>23</sup> 'Be an Energy Shopper Campaign 2015-2016', February 2016

<sup>24</sup> 'Power to Switch Campaign 2015', DECC, February 2015

<sup>25</sup> This is based on information provided by British Gas on the number of meter points which stayed with it in the period 2002 to May 2016.

2015 according to our consumer engagement survey). This suggests that some may struggle to recall switches, and may also, in part, be accounted for by factors such as house moves.

**FIGURE 3.1 Rolling annual switching rates 2012-2016**



Source: Ofgem analysis of data provided by DNOs, iDNOs and Xoserve.

#### *Rates of switching with the same supplier*

3.7. In addition to switching supplier, consumers can switch tariff and other contractual elements with their existing supplier. Rates of such 'internal' switching continued to be higher than switching between suppliers during the past year.

3.8. We monitor the internal switching rates for the six large suppliers' domestic gas and electricity customers.<sup>26</sup> This measures the proportion of domestic consumers switching to an alternative tariff, payment method or online/offline account management while staying with the same supplier. It also shows tariff changes where a consumer made an active choice (as distinct from a potentially passive move from a fixed or dead tariff onto the relevant cheapest standard variable tariff).

3.9. The proportion of consumers making any change to their tariff with their existing supplier in a given month varied between 3% and 6% over the period April 2015 - March 2016, while 1.5% to 4% made an 'active' switch between tariffs each

<sup>26</sup> See the chart 'Large suppliers: internal and external switching rate by fuel type' within our [website retail indicators](#).

month. Internal switching only reflecting an active tariff choice was mainly driven by engaged consumers moving between fixed tariffs. Overall, internal tariff switching has remained approximately twice as high the rate of switching between suppliers.

#### *Customers on Standard Variable Tariffs (SVTs)*

3.10. As discussed in more detail in Chapter 4, nearly all customers are currently on one of two types of tariffs: SVTs and fixed tariffs, with the former being the tariff customers default to if they do not make any active choice. Disengaged customers are more likely to be on SVTs and tend to remain with the same supplier for several years, although more active customers can also be on SVTs for short periods of time (eg having defaulted from a fixed term tariff). A snapshot comparison between March 2015 and March 2016 shows that the total number of gas and electricity SVT accounts fell from 69% to 66%. Of this reduction, it is unclear what proportion related to customers that were with the same supplier for several years, hence this evidence does not tell whether there has been an equivalent fall in the number of disengaged customers.

### **Engagement behaviour trends**

3.11. Alongside analysis of market monitoring data, we carry out consumer research<sup>27</sup> to understand how engagement patterns are changing over time.

#### *Overall levels of consumer engagement*

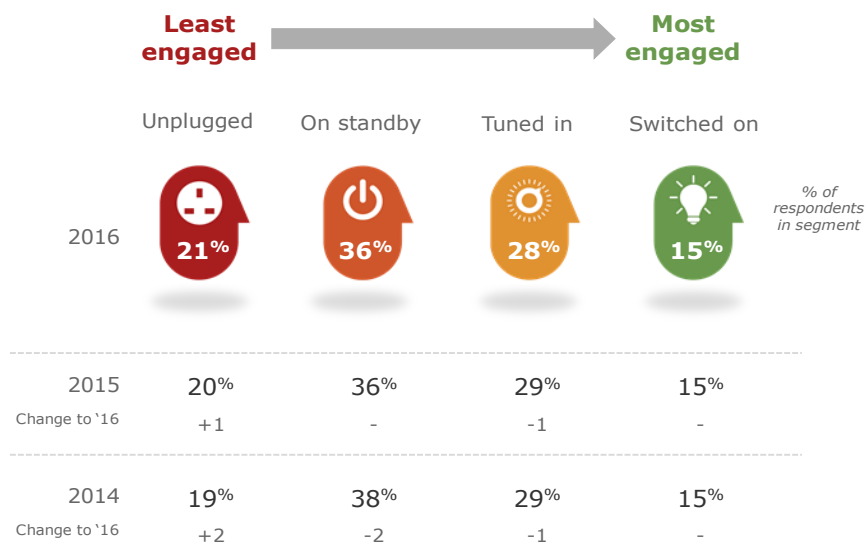
3.12. Since 2014 we have used the same consumer segmentation approach to monitor changes in levels of engagement over time. The 'index of engagement' scores consumers on their awareness and activity across a range of indicators, and places them in different engagement segments depending on their score<sup>28</sup>. Typically those at the more engaged end of the spectrum are more likely to compare and switch tariffs or suppliers, and read routine communications in detail. Those that are less engaged tend to have glanced at a bill, for instance, but have not interacted with the energy market beyond that.

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<sup>27</sup> Unless specified otherwise, all survey results reported in this section are based on '[Consumer engagement in the energy market since the Retail Market Review: 2016 survey findings](#)', August 2016.

<sup>28</sup> The segmentation methodology can be found in the TNS technical report included in '[Consumer engagement in the energy market since the Retail Market Review](#)', August 2016.



FIGURE 3.2: **Consumer engagement segments in 2016**

Source: '[Consumer engagement in the energy market since the Retail Market Review: 2016 survey findings](#)', August 2016

3.13. Figure 3.2 shows the proportion of domestic consumers falling into each segment. The distribution of consumers between the four segments in 2016 is broadly similar to those observed in 2014 and 2015. It continues to show that there is a substantial proportion of customers who are disengaged (the slight increase in the size of the 'Unplugged' segment may be explained by an overall downward shift in some of the behaviours that make up the index, such as contacting previous suppliers and reading communications in detail).

3.14. Consumers in certain socio-demographic groups continue to be disproportionately represented in the less engaged segments. For example, 'Unplugged' consumers (making up around a fifth of all consumers) are more likely to be in vulnerable situations, in social grade DE, to live in rented accommodation and to be on a prepayment meter. The age profile of this group has changed since 2014, with more consumers now falling into the middle age bracket. Less than two-thirds were regular internet users. Nearly four in five (79%<sup>29</sup>) are on SVTs, and report higher average energy spend than other groups, underlining the link between being disengaged from the energy market and getting a poorer deal. In contrast, the more engaged groups are more likely to be from higher social grades, to be home owners and regular internet users.

<sup>29</sup> This is calculated as the sum of 58% who reported being on an SVT and 21% who did not know. For the latter, the assumption is that the customer has not made an active choice and therefore would be on an SVT.

### *Engaging with supplier communications*

3.15. Communications from suppliers - such as bills and annual summaries - are one of the key sources that consumers need to access information about their existing energy arrangements, and help make an informed choice about whether or not to switch tariff. While the number of consumers able to recall supplier communications remains broadly similar to previous years<sup>30</sup>, they are generally paying less attention to some of these communications. The bill is what people recall the most – 70% of consumers recall receiving at least one bill or direct debit/prepayment statement (69% in 2014). However, the proportion who read their annual summary in detail has fallen since 2014 by three percentage points (from 42% to 39%) and by two percentage point (from 42% to 40%) for bills. Older consumers, those from higher social grades and those on online tariffs are more likely to recall receiving communications.

3.16. Overall we have observed some positive change in the proportion of consumers reporting that receiving a communication made them think about switching tariffs with their existing supplier or a different supplier. But we do not see a change in the level of action prompted by this communication beyond just thinking about switching. The end of fixed term notification continues to be the best trigger for engaging, followed by price increase notifications. A third of consumers (34%) recall seeing a savings message (ie cheapest tariff messaging), but only a minority of those were then encouraged to take action. Those in the 'Switched on' segment are more than five times as likely as the 'Unplugged' consumers to recall seeing a savings message (62% compared with 11%). Further to this, consumers who pay by prepayment meter remain half as likely (18%) to recall seeing a savings message as those paying by direct debit (38%).

### **Key enablers and barriers to engagement**

3.17. There are a number of practical barriers to engaging with the market. They include not having access to the internet, being on a prepayment meter, being in debt or being in rented accommodation. There are also behavioural barriers relating to attitudes to switching, perceptions of the energy market and/or experiences of having engaged in the past. Many of the practical barriers are covered in Chapter 6. This section explores the motivations and influences behind consumer engagement and examines actual and perceived barriers to accessing information, identifying the best-value offers and switching accordingly.

### *Awareness of alternatives*

3.18. Most domestic consumers are aware that they can switch supplier, or change tariff or payment method with their current supplier. Over the last two years we have observed a five percentage point increase in the number of consumers who are

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<sup>30</sup> The exceptions being recall of Price Increase Notifications which has fallen significantly, likely due to fewer being sent by suppliers in the context of falling prices; recall of annual summaries has also increased by five percentage points on 2014 figures.

aware of all of these potential actions (80% in 2016, up from 75% in 2014). Just 5% of consumers report being unaware of any of these options to engage.

#### *Attitudes to switching and the energy market*

3.19. It is clear that motivations and influences vary across consumers. Generally, price remains the biggest motivator for consumers to switch, choose a tariff/supplier, or compare tariffs, with 91% of consumers who switched or compared reporting that they did so to save money. The next most common aim was to “get better customer service” (12%, which is an increase of three percentage points on 2014). The least engaged segment are less likely to select price as a key factor in their ‘choice’ of tariff, partly reflecting the fact that they are less likely to have made an active choice at all. More disengaged consumers tend to report either needing a greater sum of money to motivate them to switch or say “it’s not about the money”. This presents a challenge to motivate the most disengaged groups.

3.20. For some consumers, engagement in the energy market may reflect their wider consumer behaviour and attitudes. The most engaged are more likely to have switched in other circumstances, such as a mobile or broadband provider and to report that they always look for ways to save money. For the more disengaged it is clear that perceived barriers exist, and many are sceptical about getting a better deal, energy suppliers, and the market. For example, 41% of ‘Unplugged’ consumers agree with the statement “there are no real differences between suppliers in the prices they charge”, compared to 27% of the ‘Switched on’ group. The more disengaged consumers are also more likely to perceive switching to be a hassle (55% of the ‘Unplugged’ segment compared to just 26% of ‘Switched on’).

3.21. Levels of confidence and trust in the retail energy markets remain lower than in many other comparable industries (except insurance) but we have seen a small increase in consumers trusting their energy supplier to treat them fairly in their dealings with them and to charge a fair price.

#### *Access to the relevant information*

3.22. Internet access has become an increasingly important facilitator as it gives consumers access to tools such as price comparison websites (PCWs) and online accounts, which facilitate actions such as switching supplier or changing tariff. The number of consumers on online tariffs rose by around 6 percentage points (40%, up from 34% in 2014) and the highest rates of switching are still among those who access the internet every day.

3.23. Use of price comparison services has increased substantially in the past year. The 2016 consumer survey showed that 51% of those who had switched supplier, changed tariff, or compared tariffs in the last 12 months used an online price comparison website to find out about deals offered (an increase from 46% in 2015 and 40% in 2014). This follows a general trend observed in other sectors. A 2016

survey by Firebrand<sup>31</sup> showed that 33% of consumers reported using price comparison tables and websites more than the previous year (when thinking generally about all types of products and services) and 63% of consumers think PCWs have an influence on their purchasing decisions. The 2016 consumer survey shows that almost half (47%) of those who switched in the last 12 months used an online price comparison service to switch (an increase of three percentage points since 2014). Switching by contacting the new supplier by phone remains the second most common method of switching (22%). Those who do not access the internet regularly are more likely to having switched via a salesperson at the door, on the phone or in the street.

#### *Ability to assess the required information*

3.24. Consumers should have clear and understandable information about their current tariff and consumption so that they can effectively compare tariffs and engage with the market. Although the proportion who recall receiving one or more communications from their energy supplier over the past 12 months has remained stable, there are some small signs that access to 'clearer information' has helped consumers better understand the energy market. In particular, there have been some continued, albeit slight, improvements in how clear consumers find routine communications (up three percentage points since 2014). Overall, those consumers who at least skim-read a routine communication generally found them to be clear.

3.25. Consumers who switched or compared tariffs in the last 12 months are also more likely to seek out information about their current tariff or energy use when comparing different offers, and tend to find this information easy to access when they do (69% looked for more information about their tariff or energy use, up from 67% in 2015 and 60% in 2014).

3.26. We observe a general trend in consumers finding it easier to compare tariffs (43% find it easy compared to 37% in 2014) and perceptions continue to be the most positive among younger consumers. Consumers who believe it is easy to compare are increasingly likely to credit this to information on price comparison websites (69% compared with 65% in 2014), reflecting the increasing role of PCWs in the energy market. When it comes to level of choice, 48% of consumers say there is about the right amount of choice in the range of tariffs available (up from 44% last year) while 29% think that they have too much choice, and 10% think they have too little. This represents a small decrease from 2014 in the proportions who think there is either too little or too much choice, while there are more consumers who report that they do not know whether the amount of choice is right.

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<sup>31</sup> 'Customers in Britain 2016', Firebrand Insight, May 2016. Based on an online survey of 1,000 adults.

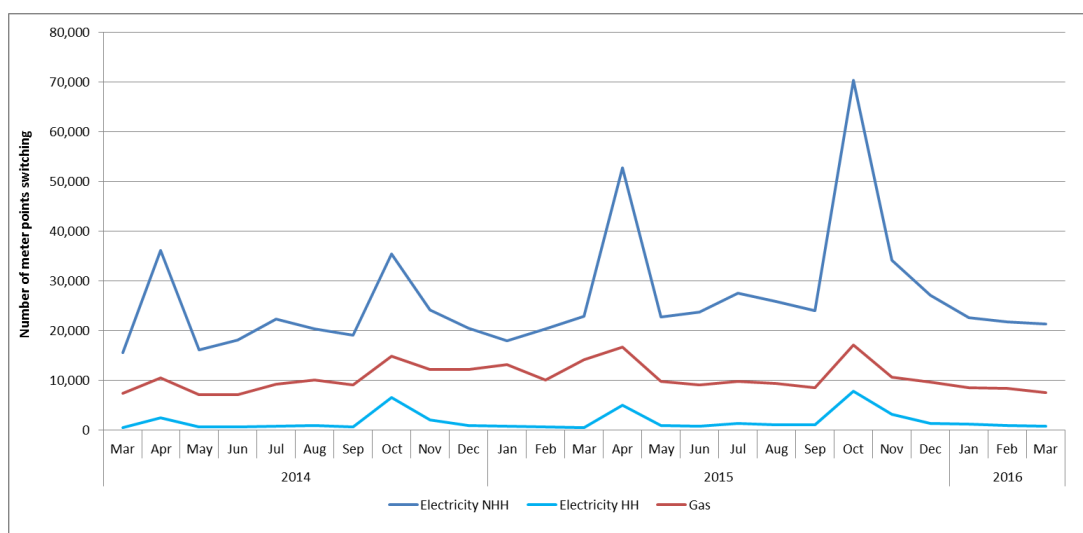
## Business consumer engagement

3.27. Smaller businesses may face many of the same difficulties that restrict engagement among domestic customers. They can also face additional barriers, such as higher search costs because of the lack of published prices for fixed-term contracts. This is less of a problem for larger businesses, which tend to be better able to negotiate contracts directly with suppliers or use intermediaries.

### Switching trends

3.28. Figure 3.5 shows an upward trend in non-domestic switching for electricity and a more stable pattern for gas. The big spikes in April and October coincide with the typical renewal periods for business contracts. Approximately 374,000 non-domestic non-half hourly (nHH) electricity meter points and 25,000 half-hourly (HH) electricity meter points switched supplier between April 2015 and March 2016, and 125,000 switched gas supplier. This represents an annual switching rate of 16% for nHH electricity and 18% for HH electricity, respectively four and five percentage points higher than the same period last year. By contrast, the annual switching rate for gas over the same period was one percentage point lower, at 16%.

FIGURE 3.5: **Non-domestic meter points switching by month**



Source: Ofgem analysis of data provided by Xoserve, DNOs and iDNOs.

3.29. The proportion of nHH electricity meter points that did not switch supplier between the removal of price controls in 2002 and 2015 was 27%, down by two percentage points relative to 2014<sup>32</sup>. For the largest business users with HH metering, the proportion that had not switched in the period was below 26%, while 30% of HH meter points switched over four times in the period.

<sup>32</sup> Ofgem's analysis of meter point data provided by DNOs and iDNOs.

## **Overall levels of engagement**

3.30. Levels of engagement in the non-domestic sector tend to be higher than the domestic sector. A far greater proportion of businesses are on fixed-term contracts and rates of switching supplier tend to be higher. Encouragingly, there has been a shift away from extending/rolling-over contracts towards negotiating new contracts with existing suppliers this year, suggesting more are making an active choice at the end of a fixed-term contract. The propensity to negotiate a new contract with an existing supplier is particularly evident among businesses with higher than average energy expenditure. However, there remains a substantial proportion of small business consumers who do not engage. Survey data<sup>33</sup> showed that 33% of this group have not switched in the last five years (down from 36% in 2014) and nearly half of these businesses (44%; 16% of all micro and small businesses) have never considered switching.

## **Smaller businesses' understanding of contract terms**

3.31. Most businesses (82%) said they review their energy supply arrangements when their contract comes up for renewal. This is a higher proportion than in 2014 (73%) and suggests that information regarding renewal dates is becoming increasingly important as a trigger for contract review and pursuing better deals.

3.32. More than three quarters of businesses (77%) have read their current contract document in detail or at least glanced through it and the majority are satisfied with various elements of it. Just under half of businesses (48%) recalled receiving a contract renewal letter in the last 12 months. The majority of these businesses (88%) have at least glanced at it or skim read it.

3.33. Eighty-two percent of respondents with a fixed-term contract knew at least approximately their contract end date (84% in 2014). Three fifths of businesses with fixed-term contracts (62%) knew when they were able to start renegotiating or giving notice of termination (16% exactly and 46% approximately), a decline from 73% in 2014<sup>34</sup>. Of those businesses that have noticed contract end dates and shopped around in the last 12 months (17% of all businesses), more than half (54%) said they were prompted to do so by the dates included on the bill. However, this is a lower proportion than in 2014 (64%, when it was based on a similar proportion of all businesses - 16%).

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<sup>33</sup> Unless indicated otherwise, all reported non-domestic survey results are based on ['Micro and small business engagement in the energy market 2016 - quantitative research report'](#), BMG/Ofgem, May 2016

<sup>34</sup> The 2014 survey saw a higher rate of knowledge around when they can start renegotiating or giving notice of termination, however differences in the methodology mean that the findings from 2014 are not directly comparable with subsequent years.

## **Business consumers and intermediaries**

3.34. Many businesses use intermediaries to choose their supplier. Sixty-four per cent of micro and small businesses cited brokers as a source of information when choosing their energy contracts, while 28% mentioned brokers as a main source of information equally as likely as suppliers (this compares with 33% for brokers and 26% for suppliers respectively in 2014). In addition, 10% had mainly used a price comparison website or telephone service.<sup>35</sup>

3.35. There has been little change in satisfaction levels with regard to broker services between 2015 and 2014. The majority of those that have used brokers were satisfied with the service provided (82%). However, perceptions of brokers across all businesses more generally tend towards the negative (46% negative; 19% positive). Those businesses that have used a broker to arrange their current contract have more positive perceptions (29% very/quite negative; 44% very/quite positive).

3.36. Of those businesses that had been approached by a broker in the last 12 months, 69% disagreed that the broker had been upfront about the cost of their services. Even among those that have used a broker as their main source of information, 57% reported that brokers were not upfront about the cost of their services. There is a positive correlation between brokers clearly identifying themselves as such and securing business. Of those businesses that used brokers as their main source, 62% agreed that the broker had clearly identified themselves, compared to 53% of all micro and small businesses.

## **Future outlook**

3.37. With the proposed removal of restrictions on the tariffs offered by suppliers and the 'whole of the market' requirement for accredited PCWs, there is more room for innovative tariffs. The most active consumers are likely to benefit from this trend, but it is unclear whether it will spread to the most inactive before the CMA remedies for engaging disengaged consumers take effect. Moreover, whereas the tariff information label will continue to help consumers to identify and assess key information about their energy tariff, other information tools such as the cheap tariff message may become less effective. Today we are publishing a consultation on removing aspects of the RMR 'clearer' information tools.<sup>36</sup>

3.38. After this interim period, limited consumer engagement among domestic consumers and microbusinesses will be primarily addressed through our implementation of the CMA's remedy package. For both consumer segments we will develop a database of 'sticky customers' for targeting communications that encourage them to participate in the energy market. We will also be taking forward a programme of trialling which will, in part, focus on testing the most effective

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<sup>35</sup> Few intermediaries in the non-domestic segment offer online comparisons. Most comparison services involved a negotiation with a broker on the phone before a contract is agreed.

<sup>36</sup> ['Helping consumers make informed choices – proposed changes to rules around tariff comparability and marketing'](#), August 2016

'prompts to engage' for different consumer groups. It will be important to take into account the motivations and influences of different groups when tailoring the design and testing of these prompts. Experience to date suggests that it will take time for these remedies to affect engagement levels.

3.39. With regards to microbusinesses, the CMA has indicated it will implement remedies by June 2017, including an order on suppliers to disclose their prices publicly and prohibiting restrictive clauses that lock in customers. These are intended to drive microbusiness consumer engagement in the market by improving price transparency and allowing greater flexibility to change supplier at the end of initial fixed term contracts.

3.40. Intermediaries can also encourage greater consumer engagement. The CMA has established remedies aimed at enhancing PCWs' ability to offer attractive and innovative deals, as well execute faster and more reliable switches, and we are publishing a consultation today on changes to the Confidence Code<sup>37</sup> that should help to stimulate competition among PCWs.

3.41. For the longer term, we expect that improved prompts, the increasing role of intermediaries and faster and more reliable switching should all help facilitate engagement. Moreover, recent survey data suggests that smart meters may also have an impact on engagement through improving customer understanding of bills and confidence in choosing the right tariff and supplier.

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<sup>37</sup> [Confidence Code review 2016 consultation](#), August 2016



## 4. Bills

### Chapter Summary

Domestic bills were subject to two opposing forces in 2015. Prices fell, while consumption increased on average as a result of colder weather. The combined effect was a reduction of two per cent in the average dual fuel bill for a domestic customer of the large suppliers between 2014 and 2015.

Consumers have not experienced these price reductions uniformly. On the one hand, significant competition among fixed-term tariffs has continued, with suppliers using different approaches to acquire new customers (including via white labels or collective switches). On the other hand, despite some cuts in early 2015 and 2016, the average standard variable tariff has not fallen as much as the cheapest fixed-term tariffs in the market. The gap between these two groups of tariffs has widened and is currently around £300 per year. Although the proportion of customers on standard variable tariffs has reduced from 69% in March 2015 to 66% in March 2016, this still represents the majority of consumers.

The observed price reductions primarily reflected lower wholesale costs. Suppliers also reported a fall in the costs of government social and environmental programmes. For some suppliers, cost reductions were partly offset by higher operating costs.

Business customers have also seen gas prices come down, again largely driven by falls in wholesale costs. However, electricity prices for all but the smallest business customers have risen, partly as a result of higher charges to suppliers to meet the costs of government programmes intended to reduce the environmental impact of the energy sector.

The outlook for bills is mixed. On the one hand, the steep falls in wholesale energy prices over the previous two years are likely to continue to feed through into costs, given that many suppliers procure a large part of their energy long before delivery. On the other hand, in the first half of 2016 we have seen wholesale prices stabilise and then increase more recently leading to increases in the prices of fixed-term tariffs. Suppliers will also soon start to incur charges related to the Government's Electricity Market Reform programme, as Contracts for Difference and capacity market payments come online. As we take action to implement the CMA's remedies, we hope to see more competition for customers and so lower prices – particularly for those currently on default contracts.

4.1. Energy bills are a key area of concern for consumers. Suppliers typically charge their customers a combination of a price per kWh of gas or electricity (which may vary for different consumption levels) and a standing charge (which the customer must pay irrespective of how much energy they use). The bill size will depend both on the level of these charges and the customer usage. In this Chapter we focus on prices and the underlying cost components, while Chapter 7 looks at consumption trends.

4.2. While many of the costs which drive the rates set by energy suppliers are determined elsewhere in the supply chain, the retail markets also have an important influence on prices. For example, effective competition drives suppliers to keep their margins low and to reduce their costs – fearing that if they don’t, they will lose business to their rivals.

## Domestic bills

### Components of a customer’s bill

4.3. Suppliers incur different types of costs in delivering energy to their customers. The largest part of costs is associated with buying energy from electricity generators and gas producers: equal to £281 per domestic gas customer of the six large suppliers on average in 2015, and £225 per domestic electricity customer.<sup>38</sup> We estimate that these costs made up around 43% of a dual fuel bill in 2015.

4.4. The second largest component of costs is the charges to suppliers for the costs of building, maintaining and operating the energy network and system infrastructure. On average the network charges paid by suppliers accounted for about £138 per domestic gas customer in 2015 and £141 per domestic electricity customer.<sup>39</sup> These costs accounted for about a quarter of a dual fuel bill in 2015.<sup>40</sup>

4.5. Suppliers also incur costs relating to government environmental and social programmes. These charges fund policies to support renewable generation and fund the installation of energy efficiency measures, among other policy objectives. In total, we estimate that the direct charges to suppliers associated with these programmes amounted to £86 per dual fuel customer in 2015, or 7% of a bill.<sup>41</sup> Table 4.1 summarises the main programmes that made up these costs in 2015.

4.6. Finally, suppliers incur costs in relation to their own retail businesses, including the costs associated with billing, metering and bad debt. They also earn a margin on their sales of energy. In total, we estimate that suppliers’ operating costs (including costs associated with depreciation and amortisation) were around £184 per dual fuel customer in 2015, or 16% of a dual fuel bill. As described in Chapter 2, margins in 2015 were equal to around 4% of a bill, or an average of £47 per dual fuel customer.

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<sup>38</sup> Based on CSS data for financial year 2015. Note that for SSE, the information relates to the period April 2015 to March 2016.

<sup>39</sup> Note that these charges are driven by the consumption patterns of the gas and electricity customers of the large suppliers. In contrast, the estimates provided in Table 4.2 are based on an estimate of the consumption of a typical customer with an unrestricted electricity meter.

<sup>40</sup> Note that this does not include the effect of charges to electricity generators and gas shippers for using the transmission networks, which will also add to bills via their impact on wholesale prices.

<sup>41</sup> Note that government programmes will have an impact on customers’ bills beyond these direct charges to suppliers. For example programmes to incentivise renewable generation are likely to affect wholesale electricity prices, and energy efficiency measures will reduce consumption.

**TABLE 4.1: The main environmental and social obligations affecting suppliers' costs in 2015**

Programme	Description
Renewables obligation	The renewables obligation requires suppliers to source a specified proportion of their electricity from eligible renewable sources or pay a penalty. Averaging across five large suppliers, the costs associated with fulfilling the obligation were around £45 per domestic electricity customer in 2015.
Energy Company Obligation (ECO)	The ECO requires larger suppliers to deliver energy efficiency measures to domestic premises. The size of a supplier's obligation depends on its share of domestic customers. Averaging across five large suppliers, the costs associated with delivering the scheme were approximately £10 per electricity customer and £12 per gas customer in 2015.
Feed-in tariffs	Suppliers are required to make payments under the feed-in tariff scheme to compensate owners of small-scale renewable and low carbon electricity generation for the energy that they generate. Suppliers' payments are calculated according to their share of the electricity supply market. Averaging across five large suppliers, the costs associated with these payments totalled approximately £16 per electricity customer in 2015.

*Source: Estimates of average obligation cost per customer are based on CSS.*

### **Types of tariffs available to domestic customers in 2016**

4.7. The amount that a domestic customer pays for a given volume of gas or electricity may vary greatly from one customer to another, depending on what kind of tariff they are on. A key distinction is between tariffs with a variable price – which suppliers are free to vary at any time subject to giving notice – and those with a price that is contractually fixed for a set period.

4.8. Over the past three years suppliers have faced restrictions on the number and structure of tariffs they could offer, which the CMA recommended to remove. The tariff landscape, as described below, was largely affected by these rules.

4.9. Most customers are still on a 'standard' variable tariff (SVT), ie 66% of domestic gas and electricity customers in March 2016, down from 69% in March 2015. These are the default tariffs offered by suppliers, in the sense that customers will be on a SVT if they have not actively chosen another tariff (eg where their previous contract has come to an end).

4.10. A small number of suppliers also offer other types of variable tariffs, such as capped tariffs (with prices which are guaranteed not to rise for a given period, but which could fall). However almost all customers that are not on an SVT are on a fixed-term tariff (33% of all domestic customers in March 2016, compared to 29% in March 2015). Most commonly the fixed-term tariffs launched by suppliers in 2015 and early 2016 offered a rate fixed for a period of a year up to 18 months – however many suppliers also offered longer-term tariffs (extending up to three years). Some, but not all, of these tariffs include fees if the customer chooses to exit the contract early. It is these fixed-term tariffs which have become the focal point of competition in the domestic retail markets, with suppliers competing to undercut each other by offering cheaper fixed rates.

4.11. Suppliers seek to differentiate their tariffs in a number of ways, including by offering discounts for online account management and rewards such as gift cards. Historically, suppliers have often offered discounts where customers purchase from them both gas and electricity (typically of between £10 and £20 per year), although this has become less common over time.

4.12. A key development in 2015 and 2016 has been the increasing prevalence of tariffs offered exclusively to customers participating in a collective switch, whereby a third party interacts with multiple suppliers in order to negotiate a deal for a group of consumers. In the past, these schemes have typically required customers to register in advance – once the deal was secured with a supplier, only registered customers had the option of switching to the new tariff. However, increasingly over the last year we have seen schemes, particularly offered by price comparison websites, where customers have been allowed to register after the deal has been secured.

4.13. The amount a customer pays for their energy also varies significantly depending on where they live, predominantly as a result of suppliers reflecting local variation in network charges in their prices. With the growth of municipal energy supply businesses there has been an increase in the number tariffs available only in a given geographic area. An example is given by the tariffs offered by Peterborough Energy and Southend Energy via a white label partnership with OVO Energy, as well as some tariffs offered by Robin Hood Energy in and around Nottingham.

4.14. Finally, tariff types also reflect the kind of meter and payment method customers have. For example, paying by direct debit involves a discount compared to a prepayment meter, and also access to a much greater range of tariffs. Some customers also pay less if they are eligible for the Warm Home Discount. Some of these differences are discussed in more detail in Chapter 6.

### **Trend in customers' bills**

4.15. Domestic bills were subject to two opposing forces in 2015: prices fell significantly, while consumption increased on average as a result of colder weather compared to 2014. The financial statements of the six large suppliers show that the combined impact of these two effects was a decrease in the average (ie mean) dual fuel bill for a domestic customer of the largest suppliers of 2% per cent between 2014 and 2015, from £1,190 to £1,165. The average price of a unit of gas supplied by these suppliers also fell between 2014 and 2015 – from 4.69 pence/kWh to 4.44 pence/kWh for gas, and from 14.35 pence/kWh to 14.26 pence/kWh for electricity.<sup>42</sup>

4.16. A reduction in prices was observed across all tariff types, although as Figure 4.1 shows, the scale of the reductions varied. All six of the large suppliers reduced their gas SVTs in early 2015, further cuts were made by British Gas in summer 2015, and then by all other large suppliers in the first quarter of 2016. Taking the average price across the large suppliers, the SVT for a dual fuel customer with typical

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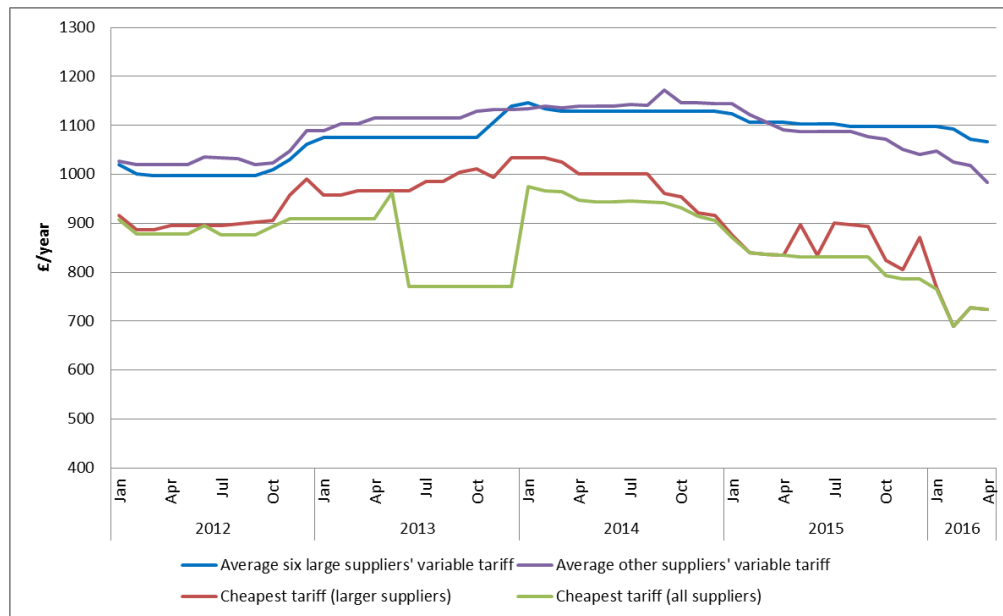
<sup>42</sup> Calculated as total domestic supply revenues summed across the six large suppliers, divided by total volumes of gas and electricity supplied.

consumption fell by around 5% in total between the start of 2015 and the end of April 2016. Other suppliers' SVTs followed a similar trend.

4.17. At the same time, suppliers launched a large number of successively cheaper fixed-term tariffs during 2015 and into 2016. A consistent pattern across the period has been for fixed-term tariffs to be offered for a few weeks or months at a time, before being withdrawn and replaced with a cheaper rate. For a typical customer paying by direct debit, the annual price of the cheapest tariff on the market fell from around £900 at the beginning of 2015 to less than £750 in the first quarter of 2016. As a result, the size of the difference between the cheapest fixed-term tariffs and SVTs increased. As of 28 April 2016 the average SVT annual bill for the six large suppliers was over £300 higher than that of the cheapest fixed tariff available in the market, for a customer paying by direct debit and with typical consumption. The equivalent differential for the other suppliers was around £260.

4.18. The prices set by different suppliers have varied significantly over the period. Looking across 2015 and early 2016, there has been vigorous competition between a number of the smaller suppliers as they have sought to offer the cheapest rates – typically via one-year fixed-term contracts. Of the largest suppliers, ScottishPower, npower and EDF have all also made significant reductions to the prices of their fixed tariffs during the period, and have offered tariffs with prices close to the cheapest available on the market. In contrast, the cheapest deals offered for general sale by SSE, British Gas and E.ON have tended to be more expensive for most of the period – although at times these suppliers have also offered market-leading tariffs, either via white label partners, via collective switching schemes, or by launching cheap tariffs into the market which had limited availability.

FIGURE 4.1: **Cheapest tariffs vs average SVTs**



Source: Ofgem analysis of Energylinx data. Prices shown are GB average prices for a dual fuel, direct debit customer on the 28<sup>th</sup> day of each month, and based on TDCVs of 12,500kWh for gas and 3,100kWh for electricity. Note: cheapest tariff includes collective switching tariffs and tariffs offered by white label suppliers.

## Drivers of trend in prices

4.19. The main factor behind suppliers' price cuts in 2015 and 2016 has been the significant reductions in the price of wholesale gas and electricity, as described in our report on the 'Wholesale energy markets in 2016'. Because suppliers typically buy much of their energy requirement for customers on SVTs long before delivery (sometimes years ahead), these reductions feed through into suppliers' costs with a lag. Fixed-term tariffs are typically hedged over a much shorter horizon – as a result, falls in wholesale prices have passed through to the costs of serving customers on these contracts more rapidly.

4.20. The financial statements of the six large suppliers show a reduction in their overall weighted average cost of gas from 70.4 pence per therm to 63.1 pence per therm between 2014 and 2015 (a decline of 10%), while the weighted average cost of electricity fell from 6.1 pence per kWh to 6.0 pence per kWh (a decline of 1%). As a result, the total cost of supplying a dual fuel customer in 2015 – £506 was down from £532 in 2014 despite the increase in gas consumption per customer.

4.21. Suppliers also reported an overall reduction in the costs per household associated with government environmental and social programmes between 2014 and 2015. This fall is likely to be primarily due to year-on-year reductions in costs of the ECO scheme, partly offset by increases in costs associated with the renewables obligation and payments due under the Feed-in Tariff scheme.

4.22. Total network charges remained fairly stable in 2015-16 relative to 2014-15, while there has been an increase for 2016-17. Table 4.2 shows estimates of the annual network charges to a domestic consumer with 'typical' annual consumption and a standard unrestricted electricity meter, averaging charges across regions, for different charging years. The majority of network charges paid by suppliers are for use of the gas and electricity distribution networks. However, the rise in network charges for 2016-17 mainly reflects higher charges for use of the electricity transmission network. Balancing charges are calculated as costs that are incurred by the System Operator and so the 2016-17 charges are estimates.<sup>43</sup>

**TABLE 4.2: Network charges per dual fuel customer – typical consumption, averaging across regions**

Annual charge per domestic customer, £		2014-15	2015-16	2016-17
<b>Electricity</b>	Transmission	28	32	39
	Distribution	94	87	92
	Balancing	6	6	6*

<sup>43</sup> Balancing charges here refer to the Balancing System Use of Service charge (BSUoS) which National Grid charges suppliers. Generators are also charged BSUoS, which will be reflected in the wholesale price component.

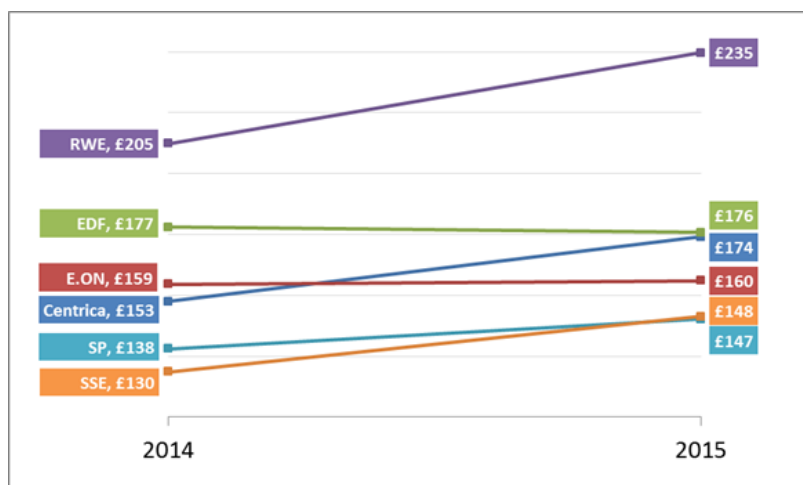
Annual charge per domestic customer, £		2014-15	2015-16	2016-17
<b>Gas</b>	Transmission	10	9	9
	Distribution	115	119	120
<b>Total</b>		<b>252</b>	<b>254</b>	<b>265</b>

Source: Ofgem calculations, based on a combination of network companies' charging statements and published load factors, Elexon data on peak electricity consumption, National Grid monthly balancing services summary and National Grid transmission losses report. Calculations based on fixed annual consumption of 3,100kWh for electricity and 12,500kWh for gas (medium Typical Domestic Consumption Values). Electricity charges given apply to unrestricted domestic meters only.

\* This is an estimate calculated using the BSUoS forecast published by National Grid in their June 2016 Monthly Balancing Services Summary.

4.23. The large suppliers' financial statements show an overall increase in operating costs (including depreciation and amortisation) between 2014 and 2015. Figure 4.2 shows that there were significant differences between suppliers in these costs – and that the increase between 2014 and 2015 was primarily driven by increases costs for npower, British Gas, SSE and ScottishPower.

**FIGURE 4.2: Indirect costs per customer (including depreciation and amortisation) – combined gas and electricity (2014 vs 2015)**



Source: Ofgem analysis of CSS. Combined indirect costs per customer were obtained by first dividing operating costs (including depreciation and amortisation) by the number of customers for electricity and gas separately, and then summing up the two figures in order to obtain a combined estimate of indirect costs per customer. Note that the estimates may overestimate true operating costs for a dual fuel customer, because the costs and customer numbers used to derive these estimates include customers on both dual-fuel and single-fuel tariffs.

4.24. Finally, as described in Chapter 2, profit margins increased overall for gas, while falling for electricity. The combined gas and electricity profit margin (EBIT) per customer across all six suppliers fell from £51 in 2014 to £47 in 2015.

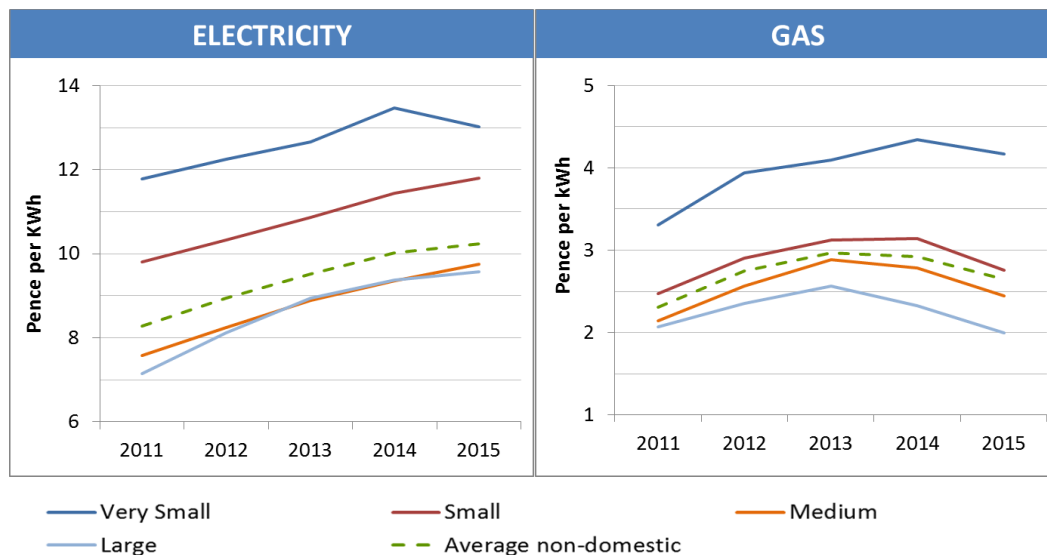
## Prices for business customers

4.25. Energy contracts for business customers are mostly bespoke and prices have rarely been published. Smaller businesses generally have fixed-term, fixed-price contracts with standard terms and conditions. Larger industrial consumers will have more complex requirements such as multiple sites or half-hourly electricity metering and more flexible, bespoke contracts aligned to movements in the wholesale market.

4.26. Figure 4.3 shows that gas prices per kWh fell on average for all size brackets of business customer between 2014 and 2015, reflecting the continued downwards trend in wholesale prices.

4.27. In contrast, electricity prices per kWh rose for all groups except for the smallest business customers. This is likely primarily driven by increases in charges to electricity suppliers to meet the costs of government programmes relating to reducing emissions. In particular, the costs of the renewables obligation and feed-in tariffs (described in Table 4.1 above) have both increased, with business customers bearing these costs in proportion to their share of consumption via charges to suppliers.

**FIGURE 4.3: Average gas and electricity prices for different business customer types**



Source: Ofgem analysis of data from DECC. Note prices exclude VAT and the Climate Change Levy. In electricity very small, small, medium and large customers are defined by DECC as having consumption of 0-20MWh, 20-400 MWh, 2,000-19,999 MWh and 20,000-69,999 MWh respectively. For gas the relevant thresholds are <278MWh, 278-2,777 MWh, 2,778 - 27,777 MWh and 27,778-277,777MWh.

4.28. At the end of a fixed-term contract, a customer can renegotiate their contract with their supplier (moving onto a “retention” contract) or switch to a new supplier (“acquisition”). If they do not contact the supplier, a supplier can extend the fixed-term period without the customer’s assent (a “rollover” contract). If a customer does



not have a fixed-term contract, they are usually supplied on a “deemed” contract classified as out-of-contract; or supplied on a default evergreen contract. Collectively, we consider rollover, deemed, out-of-contract and default evergreen as “default contracts”.

4.29. Analysis by the CMA has found that acquisition and retention contracts are the cheapest tariffs available, followed by rollover and evergreen contracts, with out-of-contract and deemed being the most expensive.<sup>44</sup> According to survey data, 73% of microbusiness consumers identified themselves as being on acquisition or retention contract and a further 24% were on a rollover contract, leaving 3% on other contract types.<sup>45</sup> This is an increase of 6 percentage points in the proportion of consumers on acquisition and retention contracts compared to the previous year.

## Comparison of prices in Great Britain with those in Europe

4.30. As shown in Figure 4.4, estimates of final domestic electricity prices (ie prices inclusive of all taxes) in GB are close to the EU15<sup>46</sup> average, although are higher than many countries in the EU28. Domestic gas prices are below the EU15 average.

4.31. A significant driver of the differences in the final prices paid by domestic consumers across Europe is the different tax rates (including VAT) and levies. Taxes on energy in GB are among the lowest in Europe – while high prices in some countries are often the result of high taxation that is driven by environmental policies. Other factors which contribute to differences between countries include electricity fuel mix; reliance on imports (including LNG); and other aspects of wholesale market conditions.

4.32. Comparing energy prices for industrial customers across Europe is more difficult, as reported prices generally do not reflect the rebates or exemptions that may apply to specific groups of business customers in the different countries. Putting this limitation to one side, industrial gas prices in GB compare relatively favourably to the EU15, while industrial electricity prices were estimated to be the second most expensive in Europe in the same period. The latter is likely a result of the fuel mix in GB and relatively high environmental charges levied on the supply of energy to industrial customers.

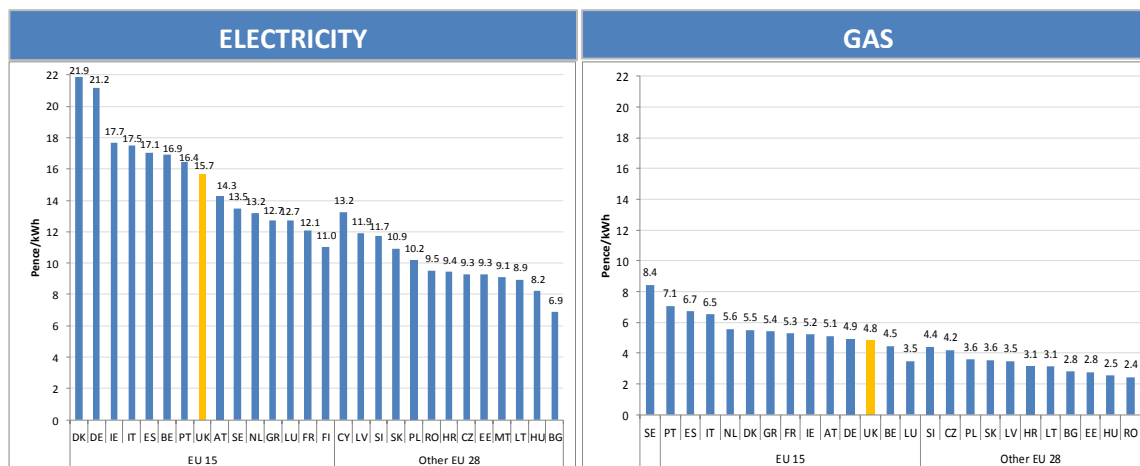
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<sup>44</sup> [Appendix 9.1 Microbusinesses CMA Energy Market Investigation](#), June 2017

<sup>45</sup> [Micro and small business engagement in the energy market 2016 - quantitative research report](#), BMG/Ofgem, May 2016

<sup>46</sup> The term EU15 refers to the 15 Member States of the European Union prior to the accession of ten candidate countries on 1 May 2004. The EU15 comprised the following Member States: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom.

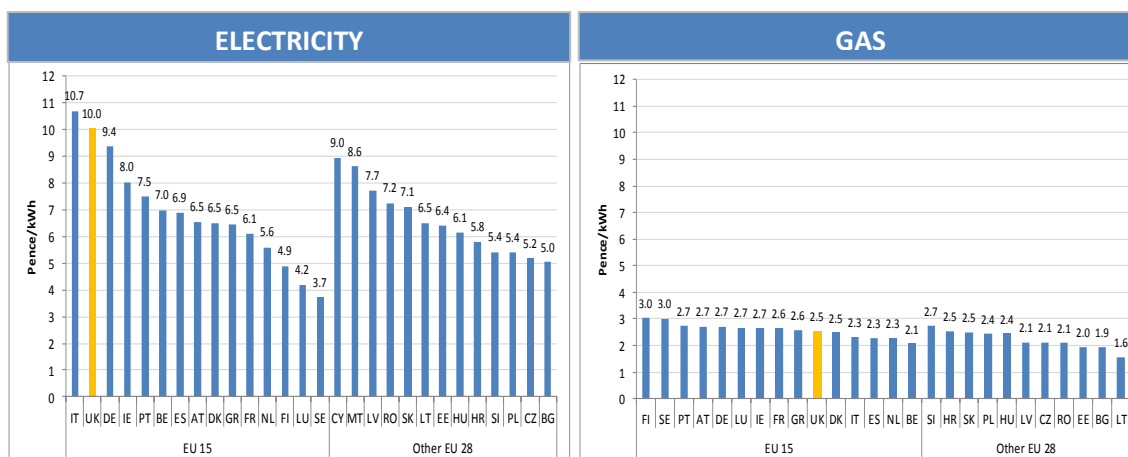
**FIGURE 4.4: Domestic electricity and gas prices, inclusive of all taxes, in EU15/EU28 for the period July 2015 – December 2015 (pence/kWh)**



Source: DEEC 'Domestic electricity/gas prices in the EU', published on 31 March 2016

Notes: The figure is based on data for six months period (July 15 - Dec 15) for electricity and gas households in medium consumption bands of 2,500-5,000 kWh in electricity and 20 GJ - 200 GJ in gas. Malta and Cyprus do not have the retail gas market, while the domestic gas market in Finland is very small and prices are not available.

**FIGURE 4.5: Industrial electricity and gas prices, inclusive of all taxes, in EU15/EU28 for the period July 2015 – December 2015 (pence/kWh)**



Source: DEEC 'Industrial electricity/gas prices in the EU', published on 31 March 2016

Notes: The figure is based on data for six months period (July 15 - Dec 15) for industrial electricity and gas in medium consumption bands of 2,000 - 19,999 MWh in electricity and 2,778 - 27,777 MWh in gas. Malta and Cyprus do not have a retail gas market.

## Future outlook

4.33. The outlook for bills for the remainder of 2016 is mixed. There is likely to be continued downwards pressure on costs for those suppliers that have purchased energy long before delivery (as is common for customers on standard variable

tariffs). In addition, the Government has announced measures to control the costs of certain environmental and social policies.

4.34. However, at the same time, in the first half of 2016 we have seen wholesale prices stabilise and then increase in recent months – leading to some increases in the prices of fixed-term tariffs. Network charges have increased in 2016/17 particularly for electricity transmission and electricity distribution – and there will also be increases in costs as suppliers are required to start making payments for contracts for difference and capacity market contracts (the latter scheme now due to begin in winter 2017). There is also likely to be a re-distributional effect as a result of exemptions for large industrial customers from certain environmental levies, which will reduce prices for these customers, while increasing them for domestic and smaller business consumers.

4.35. In order to provide greater room for innovation in the market, the CMA has recommended that we remove restrictions on what type of tariffs suppliers are permitted to offer, including regulations on tariff structures and the limit of a maximum of four core tariffs. In April 2016, we wrote an open letter to suppliers stating that we do not generally envisage enforcing these restrictions. Today we have launched a statutory consultation<sup>47</sup> on removing these and some related information rules from the supply licence conditions and instead introduce a principle aimed at ensuring tariffs are easily comparable.

4.36. Since our open letter was published, we have seen a number of developments in the types of tariffs on offer, including suppliers launching tariffs offered exclusively via a chosen third party, offering cashback incentives and involving a structure with two-tier consumption and unit rates and no standing charges.

4.37. Another outcome of the CMA's investigation which will directly affect bills is the cap to be placed on prices for prepayment customers, starting in April 2017. More generally, as barriers to competition are reduced with the entry into effect of CMA's remedies and other market developments continue – such as the rollout of smart meters and improvements in the switching process – we would expect increasing competitive pressures on suppliers, helping to keep their costs and prices down.

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<sup>47</sup> [‘Statutory consultations on the removal of certain Retail Market Review Simpler Tariff Choices rules’](#), August 2016

## 5. Quality of service

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### Chapter Summary

We expect competition between suppliers to stimulate improvements in quality of service over time, not just put pressure on prices. The picture over the last year was mixed. On the positive side, the total number of complaints by domestic consumers fell, as reported by suppliers, the Energy Ombudsman and Citizens Advice. This was mainly because a few suppliers resolved problems with their billing systems, which brought the number of complaints back to earlier levels. Customers are slightly more satisfied overall with domestic and non-domestic suppliers, with customers of smaller suppliers generally even more satisfied, with a few exceptions.

Less positively, in the context of fewer complaints overall, most suppliers are taking longer to resolve them. Evidence suggests more serious complaints have grown in volume for some medium-sized suppliers. Customers are also more dissatisfied with how suppliers are handling complaints, particularly microbusiness customers. In other areas, including speed and reliability of switching, suppliers have made limited progress.

We introduced new Guaranteed Standards of Performance for suppliers, with effect from January 2016. Results for the first quarter indicate that suppliers breached these standards in 5-6% of cases and most breaches related to missed appointments. We will continue to monitor this indicator of quality of service and update on its development in future reports.

Several important initiatives are under way to improve the quality of service provided to customers. The switching programme will radically improve the speed and reliability of the switching process. In the meantime, suppliers have this year launched the Energy Switch Guarantee, an industry-led initiative to address consumer concerns with the switching process. Smart metering should also make bills, including final bills, accurate and more timely.

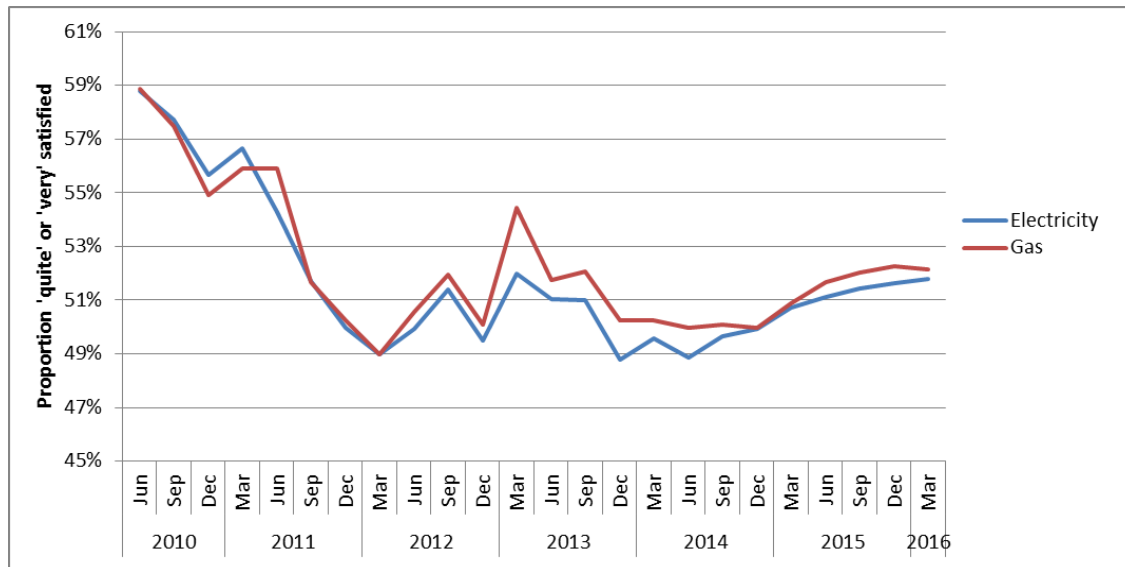
5.1. In this chapter, we present a number of indicators showing recent trends in the quality of service provided by suppliers. Most of these indicators have appeared in our previous reports (for example those on overall customer satisfaction, complaint levels and speed of switching supplier). This year, for the first time, we also provide information on how suppliers have performed in relation to keeping appointments, replacing meters and reconnecting supplies.

## Customer satisfaction

### Domestic consumers

5.2. Figure 5.1 shows the trend in overall levels of satisfaction with the service received from their supplier among domestic customers. From the low point in 2014 (especially for electricity customers) there has been a slight increase in the number of customers quite or very satisfied through 2015 and into early 2016.

FIGURE 5.1: **Overall satisfaction with current supplier, 2010 to 2016**



Source: Ofgem analysis of data from GfK Energy Research Panel. The table illustrates the proportion of customers reporting being 'very satisfied' or 'quite satisfied' when asked "How satisfied are you with the service that you get from your current gas / electricity supplier?"

5.3. Our [website indicators](#) show material differences in customer satisfaction across suppliers. E.ON has the highest overall satisfaction among the six large suppliers at 57% in electricity and 62% in gas, whereas npower has the lowest at 44% in electricity and 47% in gas. Taken together, most small and medium sized suppliers tend to have relatively high reported satisfaction<sup>48</sup>.

5.4. There is also evidence that customers' satisfaction with their energy providers is still below their satisfaction with other services, such as banks and postal services, but in relation to other utilities there are not significant differences.<sup>49</sup>

<sup>48</sup> 'GfK Energy Research Panel', quarter 1 2016.

<sup>49</sup> 'Customers in Britain 2016', Firebrand Insight, Apr 2016. This research is based on an online survey of 1,000 adults, who provided a customer service rating from 1 to 10 for their 'main service provider' in a number of categories. In 2016, the average rating for energy providers was 6.86, compared to 6.97 for banks and 6.98 for postal services. Whilst mean scores were 6.87 for mobile providers, 6.78 for broadband providers, and 6.74 for water suppliers.

## Business consumers

5.5. In 2015, overall satisfaction was stable for suppliers in the non-domestic segment compared to 2014. Survey data shows that over two thirds (67%) of small and microbusinesses reported they were satisfied with their current supplier's overall service in 2015 (66% in 2014). There was also a slight increase in a few other measures, eg 72% were satisfied with the degree to which their supplier met their needs (69% in 2014).<sup>50</sup>

5.6. Despite generally high levels of satisfaction, only 19% of smaller businesses in the 2016 survey would recommend their energy supplier to others. The Net Promoter Score<sup>51</sup> (NPS) for suppliers has improved slightly since 2014 moving from -39% to -34%. There is a lower NPS among those without fixed term contracts (-47%); and those that have used brokers to arrange their current contract (-41%). We also saw a decrease in NPS as expenditure increases.

## Complaints

5.7. Complaints are, by definition, an expression of consumer dissatisfaction. Data on complaints are regularly published by us, Citizens Advice and the Energy Ombudsman and reflect suppliers' performance at different stages of the complaint journey.

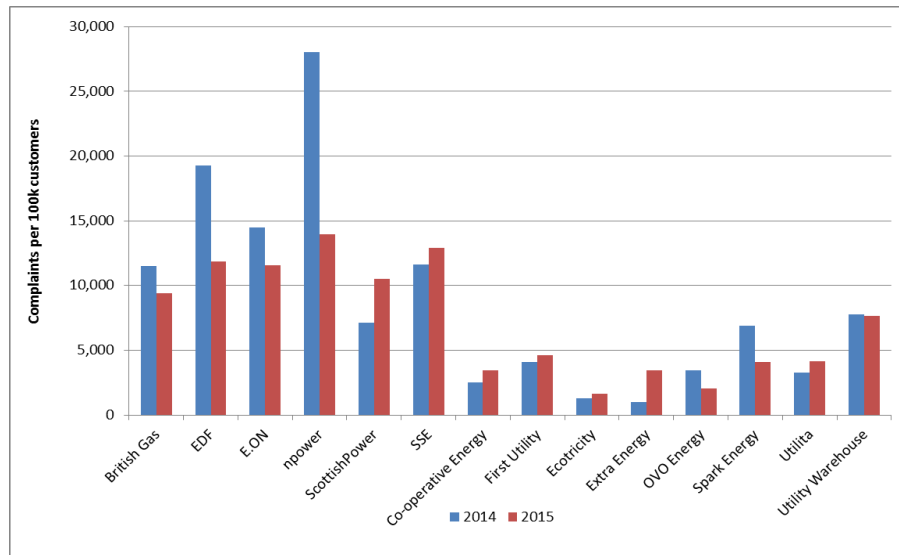
5.8. The information we publish refers to the first stage of the complaint process, ie the complaints consumers submit directly to suppliers.<sup>52</sup> The total number of domestic complaints received by the 14 largest suppliers fell by 44% in the first quarter of 2016 relative to the same period last year. This resulted mainly from a few of the large suppliers resolving problems with their billing systems, which brought the number of complaints back to earlier levels. Small and medium-sized suppliers generally performed better than the large suppliers in terms of complaint numbers.

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<sup>50</sup> ['Micro and small business engagement in the energy market 2016 - quantitative research report'](#), BMG/Ofgem, May 2016.

<sup>51</sup> NPS is calculated by subtracting the proportion that are detractors (those actively discouraging usage) from the proportion that are promoters (actively encouraging usage). 'Promoters' are scored 9 or 10 out of 10 by consumers, 'Neutral' scores 7 or 8 and 'Detractors' score 0-6. The possible range of the NPS is -100% (completely negative) to +100% (completely positive).

<sup>52</sup> ['Supplier performance on consumer complaints'](#)

FIGURE 5.2. **Number of complaints per year and per 100k customers**

Source: Ofgem analysis of suppliers' data.

5.9. We also monitor the speed of resolution of complaints. In the first quarter of 2015 the six large suppliers resolved on average 77% of complaints within one working day and the other suppliers resolved on average 67%. This figure fell to 60% for the six large suppliers and to 58% for the other suppliers in the first quarter of 2016. This may imply that although the overall number of complaints has fallen, the number of complaints most difficult to resolve has not fallen in line with this. All suppliers resolved at least 80% of complaints within eight weeks.

5.10. The Energy Ombudsman publishes information<sup>53</sup> on complaints it receives after either the supplier has been unable to resolve them to the customer's satisfaction within eight weeks or the complaints have reached a 'deadlock situation'. The total number of cases accepted by the Ombudsman in the first quarter of 2016 fell by 31% compared to the same period in 2015. A reduction was generally observed across all suppliers, with a few exceptions (and an increase for E.ON, npower and Co-operative Energy). The three main complaint areas identified by the Ombudsman were billing (around 80% of the cases), transfers and sales. In turn, the top three billing complaints were for late billing, inaccurate invoices, and disputed charges.

5.11. Finally, Citizens Advice publishes a complaint performance table covering all domestic energy suppliers with more than 50,000 customers. The data is based on contacts received from consumers seeking independent advice from the Citizens Advice helpline and from their Extra Help unit (the latter has a special focus on consumers in vulnerable situations). Contacts are weighted to reflect the seriousness of the complaints and the time and effort spent by consumers to get their issues resolved.

<sup>53</sup> [Energy Ombudsman website'](#)

5.12. As a result, the ranking of suppliers according to this performance table is likely to differ from that based on the number of complaints suppliers directly receive from consumers. The latest ranking published by Citizens Advice for the first quarter of 2016 showed a mixed picture regarding the position of large, medium sized and small suppliers.<sup>54</sup>

5.13. There is evidence suggesting suppliers have often failed to handle complaints well and have got worse in recent years. Between April 2015 and March 2016 we closed four investigations involving, among others, complaint handling issues, compared to one over the same period in 2014-15. Our forthcoming 2016 complaint handling survey<sup>55</sup> shows that 60% of domestic and 68% of microbusiness customers were dissatisfied with the way their complaint was handled, in 2015, which is higher than in 2014 (57% and 52% respectively).

## Switching process

5.14. Switching is an important element in any competitive market. However, the switching process in the gas and electricity markets is complex, prone to delays and errors, and is consequently a significant source of customer complaints and a barrier to engagement.<sup>56</sup>

### Consumers' views on switching

5.15. Many consumers still have negative views of the switching process, although perceptions among those who have never switched seem to have stabilised, halting a previous trend where non-switchers were increasingly negative.<sup>57</sup> The proportion of all domestic customers (ie including both those who have and haven't switched) who agree that switching is a hassle was 46% in 2016, while 36% of customers agreed that they worry that if they switch, something will go wrong.<sup>58</sup> Both proportions represent small decreases from a year earlier.

5.16. Among business consumers, views of the switching process tended to be positive where businesses had switched in the last 12 months. Most agreed that comparing prices and switching supplier was easy (48% and 61% respectively). Only 37% felt that the process took too long. There is an equal split between those who think that expected savings materialise and those that don't (38% and 38%).<sup>59</sup>

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<sup>54</sup> '[Energy supplier performance](#)', Citizens Advice.

<sup>55</sup> See our forthcoming 2016 complaint handling survey, which we'll publish by the end of September.

<sup>56</sup> '[Moving to reliable next-day switching - consultation](#)', June 2014.

<sup>57</sup> '[Customer Engagement with the Energy Market: Tracking Survey 2015](#)', Ipsos Mori/Ofgem, Sep 2015.

<sup>58</sup> '[Consumer engagement in the energy market since the Retail Market Review: 2016 survey findings](#)', August 2016

<sup>59</sup> '[Micro and small business engagement in the energy market 2016 - quantitative research report](#)', BMG/Ofgem, May 2016

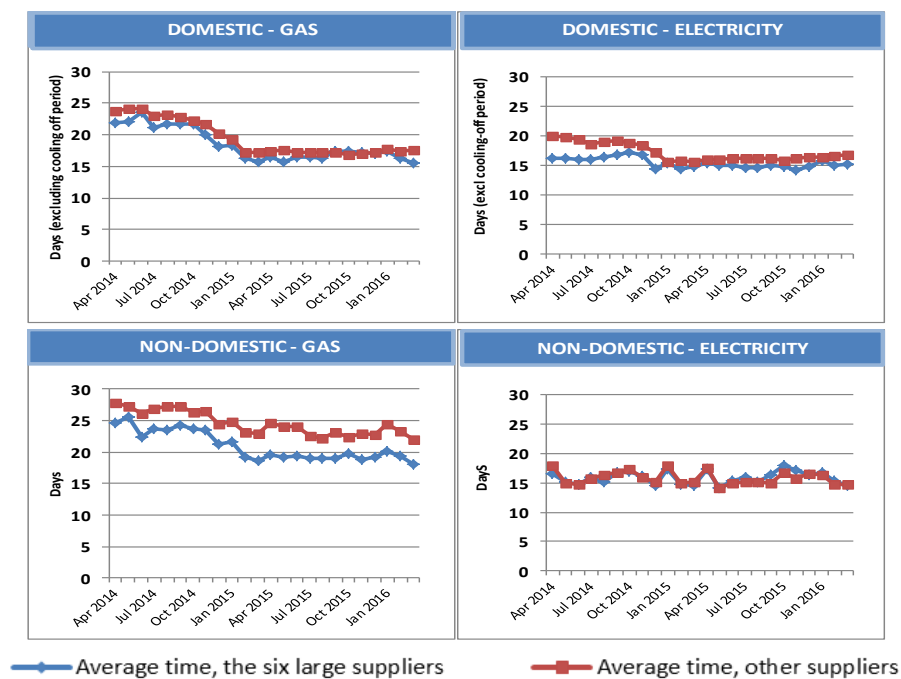


## Switching times

5.17. Figure 5.3 shows that average switching times for domestic gas and electricity consumers remained almost unchanged compared to last year and converged for the six large suppliers and other suppliers that entered the market after liberalization.<sup>60</sup> On average, from a system perspective, it took 15 days for a domestic electricity switch to be completed by the six large suppliers in March 2016 and 16 days for a domestic gas switch. This is unchanged from March 2015. For other suppliers it took on average a day longer to complete a switch in March 2016 compared to one year earlier (up from 16 to 17 days for electricity and from 17 to 18 days for gas).

5.18. Non-domestic switches were more likely to take longer than domestic switches. However, in most cases suppliers reported that the longer timescales were because customers on fixed-term contracts had requested that their transfer be completed at a later date when their contract ended. Figure 5.3 shows that average switching times in the non-domestic electricity market remained quite stable over the last year. As with domestic customers, average switching times are higher in gas.

FIGURE 5.3: **Average switching times**



Source: Ofgem analysis of data provided by DNOs, iDNOs and Xoserve. Note: switching times reflect the time between a supplier switching request and the transfer taking place, and include all switches, including those with a legitimate cause for delay. There is no cooling-off period requirement for business contracts.

<sup>60</sup> This data is sourced from network operators. Hence, it does not measure the full switching time from when a customer enters into a contract, but rather the time from when the switching request is submitted by the supplier to the system. More specifically, it does not incorporate any time in advance a supplier may take to process the contract or as part of the cooling-off period. It also includes all types of delays, including those for legitimate reasons.

## Reliability of switching

5.19. A customer's perception of the switching process will be significantly influenced by whether the transfer is completed without a hitch.<sup>61</sup> Our evidence generally suggests that switching reliability remains an area of concern, although we have observed a few improvements over the last year. Below we review several aspects of reliability, including erroneous transfers, objections sent by the old suppliers to block a switch and delays in sending the final bills after a transfer has been completed.

### *Erroneous transfers*

5.20. In September 2014 we introduced new requirements for suppliers to take all reasonable steps to prevent erroneous transfers and we have been monitoring their performance closely. The number of erroneous transfers for the six large suppliers fell from 2,228 in October 2014 to 2,100 in March 2016, ie from 0.8% to 0.5% relative to the total number of switches for these suppliers. This was mainly because ScottishPower resolved an earlier IT system problem.

### *Supplier objections*

5.21. As part of the switching process, suppliers are ordinarily prohibited from objecting to a customer transfer, but may object in specific circumstances<sup>62</sup>. This is usually for debt in the domestic market and for contractual breaches in the non-domestic market<sup>63</sup>. Objections may lengthen the time for a switch to complete or prevent the switch if the objection is not resolved. The overall market objection rate indicates the extent to which suppliers use the objection tool. In the domestic market, the overall rate of objections relative to the total number of transfers remained relatively stable, as indicated by data provided by network operators<sup>64</sup>. As of March 2016, the objection rate was 6% for electricity and 5% for gas (in each case 1% down on March 2015).

5.22. Our recent review of objections<sup>65</sup> in the non-domestic market shows markedly higher objection rates than in the domestic market. This is due to the fact that the license condition circumstances under which the supplier may object to a customer switch are more limited in the domestic than in the non-domestic market. The industry average for gas and electricity microbusinesses in 2015 was around 30% and 12% for large industrial customers<sup>66</sup>. Compared with 2014 and 2013, the trend

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<sup>61</sup> For example, in the [Consumer First panel research](#) (published in August 2013) conducted to inform our review of the change of supplier process, many participants cited ensuring reliability and accuracy during the change of supplier transfer as the most important issue.

<sup>62</sup> Standard condition 14 of the gas and electricity supply licences.

<sup>63</sup> The most common contractual terms relied upon by non-domestic suppliers when objecting are those that prevent a switch during a fixed term period or when a customer is in debt.

<sup>64</sup> The domestic objection data from network operators includes multiple objections raised by the same supplier, as well as multiple switching requests for the same site.

<sup>65</sup> '[Decision on review of non-domestic objections](#)', August 2016

<sup>66</sup> The non-domestic objection data gathered as part of our recent review excludes multiple objections raised by the same supplier.

was broadly stable for microbusinesses and decreasing for large industrial customers.

### *Sending final bills*

5.23. We require suppliers to send a final bill no later than six weeks after the relationship with a customer is terminated, including where the customer switches to another supplier.<sup>67</sup> Data submitted by the six large suppliers shows that, as of the first quarter of 2016, they complied with this requirement 95% of the time in gas and 93% of the time in electricity. This is an increase of three and five percentage points in gas and electricity respectively from the same period in 2015. Moreover, the average time taken for sending the final bill was 27 days in electricity and 25 in gas, down by seven and four days respectively.

### **Guaranteed Standards of Performance**

5.24. The Guaranteed Standards of Performance were designed by Ofgem and introduced in July 2015<sup>68</sup> and took effect on suppliers in January 2016. They set the levels of service for electricity and gas suppliers to achieve when making and keeping appointments, replacing domestic credit and prepayment meters (faulty or otherwise) and, where necessary, reconnecting supplies.

5.25. Most guaranteed standards apply only to domestic customers. Only the Guaranteed Standard on making and keeping appointments applies to both domestic and microbusiness customers. Every time a supplier fails to meet a guaranteed standard it must pay a compensation of £30 to the affected customer within 10 working days (or face an additional £30 payment to that customer). Table 5.1 shows the number of breaches of guaranteed standards related to domestic customers and microbusinesses and the payments due to these customers in the first quarter of 2016.

**TABLE 5.1: Guaranteed Standards of Performance – Q1 2016**

	<b>Customer category</b>	<b>Number of cases where regulation applied</b>	<b>Number of breaches</b>	<b>Payments due to customers</b>
<b>Gas</b>	Domestic customers	728,110	32,619	£965,650
	Microbusinesses	22,720	1,348	£37,320
	Total	750,830	33,967	£1,004,970
<b>Electricity</b>	Domestic customers	828,403	52,391	£1,560,240
	Microbusinesses	96,748	6,588	£126,150
	Total	925,151	58,979	£1,686,390

*Source: Ofgem's analysis of data provided by electricity and gas suppliers*

5.26. Breaches represented around 5% of cases in gas and 6% in electricity. Of all the payments to domestic customers, most related to making and keeping

<sup>67</sup> Standard condition 27(17) of the gas and electricity supply licences.

<sup>68</sup> [The Electricity and Gas \(Standards of Performance\) \(Suppliers\) Regulations 2015](#)

appointments (75% in gas and 81% in electricity). Suppliers' performance across the various standards, expressed as a percentage of breaches of all cases, is to a great extent homogenous across different suppliers.

## Future outlook

5.27. Several important initiatives are underway to improve the quality of service provided to customers. Ofgem's switching programme will make the switching process radically faster and more reliable. Smart metering should also make customer billing, including final bills, accurate and more timely.

5.28. This year, suppliers launched the Energy Switch Guarantee (the Guarantee), an industry-led initiative to address consumer concerns with the switching process. At the time of publication, nine suppliers have signed up to the Guarantee, covering 64% and 69% of the domestic electricity and gas markets respectively, and more are expected to follow. Under the Guarantee, suppliers have committed to completing switches in no more than 21 days after they have received the completed switch application.<sup>69</sup> The Guarantee should help to provide consumers with the confidence they need to engage in the market and switch. To maximise the impact of the Guarantee we encourage all suppliers to meet its standards, join and publicise it.

5.29. Following our review of supplier objections<sup>70</sup> we intend to step up our monitoring of suppliers' objections practices. We want suppliers to manage the process fairly, efficiently and in accordance with their licence obligations.

5.30. We will also continue to publicise suppliers' compliance of the Guaranteed Standards of Performance and, in the interests of transparency, we will continue to encourage all suppliers to do likewise.

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<sup>69</sup> Suppliers typically receive the application the day after the consumer submits the request to switch. Therefore suppliers who sign up to the Switch Guarantee commit to switching consumers in no more than 3 working days plus the 14 calendar days of the cooling-off period.

<sup>70</sup> [Review of domestic and non-domestic objections](#), July 2016

## 6. Benefits for society

### Chapter Summary

Consumers in vulnerable situations continue to experience worse outcomes than other consumers. Our analysis focuses on three key groups where there is ongoing evidence of detriment: consumers with prepayment meters (PPMs), consumers in debt with their supplier and electric heating customers on certain types of restricted meters. For various reasons, as highlighted in the CMA's final report, these customers' choice of tariffs is still very limited and they face barriers to switching supplier, tariff, payment method and meter. In particular, the best offers in the market, most often fixed-term tariffs, are generally not available to these consumers, and they tend to be on more expensive standard variable tariffs.

Some positive developments should be noted. For example, the number of customer accounts in debt has continued to fall, including the proportion of PPM customers in debt, and switching has become easier for them. Suppliers have started offering a number of innovative and cheaper 'smart' prepayment tariffs. Suppliers have also identified and recorded more customers on the Priority Service Register and more people took up these services.

Looking forward, the CMA's remedies on tariff pages, as well as our work to provide more information to prepayment customers and reduce PPM removal costs, should help remove some important barriers to switching faced by this group. At the same time, the transitional PPM price cap from April 2017 is expected to lead to reductions in bills for many PPM customers. The CMA's remedies for customers on restricted meters other than Economy 7 should also increase tariff choice, information and advice for these customers. In the longer term, the roll-out of smart meters by 2020 has the potential to address most of the prepayment and restricted meter issues identified here.

6.1. As energy is an essential service, the retail market should work to the benefit of all customers, and no one group should face disproportionate barriers to interacting with it. Regulation should ensure that consumers in vulnerable situations<sup>71</sup> receive the necessary protections and can engage in the market.

6.2. There are many reasons why one consumer may be less able than another to protect or represent their own interests, and reasons often overlap. In Chapter 3 we described how consumers who are most disengaged from the market are also more likely to be in vulnerable situations because of their socio-economic group, age, status as tenants or lack of regular internet use. In this chapter we focus on three key groups of consumers: (i) those with PPMs, (ii) consumers in debt to their supplier and (iii) electric heating customers on certain types of restricted meter. For each group we look at changes in the past year in the proportions of consumers affected (by region if possible) and the barriers they face. We then consider the kinds of support available for consumers in vulnerable situations and how they help

<sup>71</sup> '[Consumer vulnerability strategy](#)', July 2013

to reduce levels of disadvantage. Finally, we look at the future prospects for these consumers.

6.3. In September 2016 we will publish our annual Social Obligations Report. This will provide a detailed update of how suppliers complied with their obligations towards consumers in vulnerable circumstances in 2015.

### **Consumers with prepayment meters**

6.4. Prepayment meters (PPMs) can help customers to budget and can be a way to pay off debts if the key or meter is programmed to pay off debt. However, customers usually do not choose to install this type of meter. Instead, PPMs are generally installed when a customer has had a poor payment history or in certain types of accommodation such as short-term rented accommodation.

6.5. According to our consumer engagement survey<sup>72</sup>, 80% of respondents with a PPM lived in rented accommodation, compared to only 17% who owned their home or had a mortgage. Although not all PPM customers are financially vulnerable, they are more likely to be on low incomes and to face other conditions associated with vulnerability. For example, 46% of PPM customers were from the lowest social grades, compared to only 17% of direct debit (DD) customers, and 43% of PPM customers reported an annual income below £16,000, compared to 22% in the DD segment.

6.6. As of December 2015, there were 4.5 million PPM electricity accounts and 3.5 million PPM gas accounts<sup>73</sup>, representing 17% of all domestic electricity accounts and 15% of all domestic gas accounts. Although there was a steep increase in PPM customer accounts from 2012 to 2014, it's since plateaued. There are differences in the proportion of PPM accounts across GB, with a higher proportion of electricity PPM customers in Scotland (21%) and Wales (20%) than in England (16%). The proportions are similar for gas.<sup>74</sup>

6.7. In 2015, approximately 360,000 PPM meters were installed for electricity customers, with 41% of these being installed for debt. This represents a decrease of 15% relative to the number of PPMs that were installed for debt in 2014. The number of PPMs installed for debt under warrant<sup>75</sup> has also been falling, although not as much as the overall proportion of PPMs installed for debt.

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<sup>72</sup> [Consumer engagement in the energy market since the Retail Market Review: 2016 survey findings](#), August 2016

<sup>73</sup> Social Obligations Reporting data for 2015. Under their standard licence conditions, suppliers are obliged to provide us with data on payment methods, debt, disconnection, and Priority Services Registers (PSRs). We refer to this as the Social Obligations Reporting.

<sup>74</sup> In 2015, the proportion of PPM customer accounts in the gas segment was 14.9% in England, 16.9% in Scotland and 19.1% in Wales.

<sup>75</sup> This is where the supplier applied for a court warrant to gain permission to enter the property to install the PPM meter.

6.8. Overall, although PPM customers tend to have higher switching rates (around 15% compared to the average of 13% for all customers in 2015), they tend to be more disengaged than DD customers. Based on the data collected from our consumer engagement survey, only 72% of PPM customers recognized all of the key actions they could take to engage with the market (such as switching supplier), compared to 83% of DD customers. Furthermore, of all PPM customers, only 15% are reported having compared tariffs from other suppliers, compared to 31% of DD customers.

### *Barriers*

6.9. PPM customers typically have less choice in the market. There have consistently been fewer PPM tariffs compared to those available for DD customers.<sup>76</sup> Moreover, the cheapest fixed tariff deals in the market are not available for PPM. In its investigation, the CMA established that technical restrictions in the existing PPM infrastructure negatively impact on competition as they limit the number of tariffs that can be offered, so that it is not possible for any supplier to reproduce the same number and variety of tariffs available for DD customers.<sup>77</sup>

6.10. The average differential between the six large suppliers' SVTs for customers paying via standard credit and prepayment, and those paying via direct debit, has remained constant over the past year, at around £75.<sup>78</sup> The six large suppliers' SVT price cuts in early 2016 benefited both DD and PPM customers equally. However, there is a growing gap between the better offers available for PPM and DD customers, due to the latter falling at a faster rate. As an indication of this trend, Figure 6.2 shows that in March 2016 the price differential between the cheapest PPM and DD tariffs available nationwide was £324, an increase of £44 compared to March 2015. Moreover, the CMA estimated that the detriment experienced by these consumers amounted to 15% of the dual fuel bill, up from 10% in 2014.

6.11. During 2015 and the first quarter of 2016, there has been some improvement in market conditions for prepayment customers. There are more tariff offers for PPM customers, from 18 in March 2015 to 30 in March 2016, although still well below 96 in the DD segment. There are also more innovative PPM deals available. The main medium-sized suppliers driving the growth were Utilita and OVO Energy, who have continued to expand their prepayment customer base by offering smart prepayment tariffs, and a small supplier, Economy Energy, which started offering PPM tariffs in 2015.

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<sup>76</sup> Standard licence condition 27.2 establishes that only suppliers with more than 50,000 customers have an obligation to offer a choice of payment methods to customers.

<sup>77</sup> In order for a PPM to record the customer's balance correctly, the meter needs to be programmed with the customer's tariff details. The details of all PPM tariffs offered by each supplier are stored in the prepayment infrastructure, with each tariff allocated a 'tariff code'. In gas, tariff codes are grouped into pages that are mostly concentrated with the six large suppliers and the availability for the other suppliers is very limited. The number and allocation of codes is constrained also in electricity, but each supplier receives the same number of codes.

<sup>78</sup> Note that Standard license condition 27.2A states that any difference in terms and conditions as between payment methods for paying charges for the supply of gas or electricity shall reflect the costs to the supplier of the different payment methods.

These tariffs are offered at a price that undercuts most other suppliers in the prepayment market, and are approximately in line with the average price of the large six SVTs for direct debit customers. Among the six large suppliers British Gas and E.ON are the only ones at present offering smart pay-as-you go deals, and E.ON smart prepayment options are available for all their tariffs.

**FIGURE 6.1: The cheapest tariffs offered on the market, by payment method**



Source: Ofgem analysis of Energylinx data. Prices shown are for a dual fuel customer and based on TDCVs of 12,500kWh for gas and 3,100kWh for electricity

6.12. PPM customers face additional barriers that restrict them from engaging in the market and from benefiting from better deals. In particular, we see low switching rates from PPM to credit, although they have increased. In 2015, nearly 165,000 electricity and 130,000 gas PPM customers switched to a credit meter (a 27% and 26% increase respectively compared to 2014). Some consumers may need to pay a security deposit if they fail a credit check. We have worked with suppliers to largely remove fees for the installation or removal of a PPM, but a few may still face these charges.

### Consumers in debt to their energy supplier

6.13. Being in debt to an energy supplier can prevent a consumer from engaging in the market and accessing the cheapest deals. At the end of 2015, approximately 1.3 million domestic electricity accounts (4.0%) and 1.1 million domestic gas accounts (4.8%) in GB were in debt to their energy supplier.<sup>79</sup> The number of

<sup>79</sup> Social Obligations Reporting data for 2015.



customer accounts in debt has been falling since 2013. Compared to 2014 it has decreased by 7.8% for electricity and 8.8% for gas. Around 60% of accounts in debt for both fuels had a repayment plan arranged to pay off the debt (a slight decrease compared to 2014).

6.14. On the other hand, the average amount of debt owed by customers has increased. At the end of 2015, customers on a repayment plan had an average outstanding debt of £401 for electricity accounts and £443 for gas: an increase of 13% and 16% respectively compared to 2014.<sup>80</sup> Customers in debt without a repayment set up also saw an increase in the average debt amount: this rose by 11% for electricity and 10% for gas, reaching £566 and £529 respectively at the end of 2015.

### *Barriers*

6.15. Customers with a history of debt may be much less able to engage in the market, and may face disconnection and barriers to switching tariff or supplier. Disconnection should be used as a last resort,<sup>81</sup> and there are strict rules about who can be disconnected from gas or electricity supply for non-payment of debt. Instead, PPMs may be installed by suppliers to limit customer debt and/or oblige customers to repay past debt. This allows continuity of supply, but opens up the possibility of “self-disconnection” by consumers themselves, as well as the barriers discussed above.

6.16. In 2015 the number of electricity and gas disconnections for debt continued a long-term falling trend. There were 204 electricity customers and 49 gas customers disconnected for debt, compared to 261 and 88 respectively in 2014. Three suppliers made up 94% of the disconnections of both electricity and gas.

6.17. In 2015 the proportion of PPM customers in debt was 6% for electricity and 8% for gas, down from 7% and 10% respectively in 2014. The Debt Assignment Protocol (DAP) sets out rules that govern whether prepayment customers in debt are able to switch suppliers. The losing supplier can only block a transfer on grounds of debt when this is above a threshold defined in the standard licence conditions. In July 2015 we formally increased this threshold from £200 per fuel to £500 per fuel.<sup>82</sup> In addition, a voluntary process change was introduced by the ten main PPM suppliers in the third quarter of 2015 making it easier for PPM customers with a debt to switch. This was followed by an upturn in switching among indebted PPM

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<sup>80</sup> Based on snapshot debt, which is the average amount of debt that remains outstanding on formal repayment arrangements at the end of the reporting period.

<sup>81</sup> Suppliers are required not to disconnect customers in debt unless they have taken all reasonable steps to recover debt by offering the consumer a range of repayment options. They are also prohibited from knowingly disconnecting consumers of pensionable age (where they live alone, with other pensioners or with children) during winter months, and to take all reasonable steps during winter to avoid disconnecting premises where the occupants include a person who has a disability, a chronic sickness or is of pensionable age.

<sup>82</sup> See [this](#) decision.

customers, which is an indication of progress, although the proportion of successful indebted PPM switches remains low.

## Consumers off the gas grid and on restricted meters

6.18. There are 1.8 million households in GB (8%) which use electricity as their main source of heating, particularly concentrated in Scotland (13% of households). These households tend to have lower income and, as electrical heating (particular direct-acting heating) is generally more expensive<sup>83</sup>, there are higher rates of fuel poverty among them.

6.19. Within the group of customers who use electric heating, we estimate from supplier data that in 2015 there were roughly 700,000 customers on restricted meters other than Economy 7, such as Economy 10 and Dynamically Teleswitched (DTS) meters that are currently mainly located in Scotland. This number has been declining, which may be due to the extension of the gas network and a trend away from electric heating systems. On the other hand, during 2015 only a very small proportion (around 1%) of these meters was replaced by smart meters<sup>84</sup>.

### *Barriers*

6.20. Research findings<sup>85</sup>, including most recently as part of the CMA's investigation, show that consumers with electric heating who are on a restricted meter other than Economy 7 face particular barriers to engagement in the market, as they have a narrower range of suppliers and tariffs to choose from. These customers are typically on tariffs that are bespoke to their heating systems, with different rates at different times of the day (which can vary daily for DTS meters) or for different electricity uses (ie heating versus other uses). Across GB the historical incumbent suppliers' share of supply in restricted meters is 79%, and for certain types of restricted meter such as DTS it is above 90%. Competing suppliers do not generally offer tariffs that mirror the existing complex bespoke arrangements. Also, restricted meter tariffs are not available on price comparison services or actively advertised by suppliers. Often, when these customers attempt to switch supplier they are offered simpler tariffs (single rate or Economy 7) conditional on a costly meter replacement.

6.21. Our past consumer research<sup>86</sup> had shown that these consumers have very low levels of awareness of their complex heating, tariff and metering arrangements and are most likely to be in vulnerable situations. They also have trouble accessing and understanding relevant information. Examples of key issues emerging from research, as well as complaint cases, include the lack of knowledge of the times when cheap

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<sup>83</sup> Heating costs will depend on a range of factors such as size and insulation of property, type of energy tariff, heating needs and ability to shift and manage energy use.

<sup>84</sup> Information provided to Ofgem by suppliers

<sup>85</sup> '[Insights paper on households with electric and other non-gas heating](#)', December 2015, '[The state of the market for customers with dynamically teleswitched meters](#)', July 2013

<sup>86</sup> '[Understanding the consumer experience of Dynamically Teleswitched \(DTS\) meters and tariffs](#)', Big Sofa research report prepared for Ofgem, November 2014.

electricity is available, the working of storage heaters (especially in the remote control cases such as DTS), or the concern around meters not working correctly (eg registering peak and off-peak at the wrong times).

6.22. The CMA found that 67% of standard credit and direct debit customers with non-Economy 7 restricted meters would have saved 17% of their bill in the second quarter of 2015, if they had switched to the cheapest single-rate tariff available (up from 40% in the first quarter of 2015 and an equivalent saving of 14%).

## **Support for consumers in vulnerable situations**

6.23. We expect suppliers to identify consumers who are vulnerable and support them by meeting a number of obligations, including providing special services and financial support schemes. At the same time, we support programmes led by Citizens Advice to improve engagement and awareness among vulnerable consumers.

### *Priority Service Register*

6.24. Suppliers and network operators<sup>87</sup> are required to keep a register of customers of pensionable age, or who are disabled and chronically sick, known as the Priority Service Register (PSR). We require energy companies to provide certain non-financial services<sup>88</sup> related to safety, access and communication needs free of charge to these customers.

6.25. For the fifth consecutive year the number of customers on the PSR has increased, reaching 3.6 million electricity customers and 3 million gas customers (a 23% and 30% increase respectively from 2014) and over 13% of all domestic customers. There are now more PSR customers taking up services. Electricity customers accessed 719,000 services in 2015 and gas customers accessed 567,000 services (a 31% and 24% increase respectively from 2014). The most commonly used PSR service is quarterly meter readings, which allows for more accurate billing. However, take-up of services remains relatively low compared to the number of eligible customers.

### *Energy efficiency measures*

6.26. Under the relevant licence conditions<sup>89</sup>, suppliers must help customers finding it difficult to pay by giving them information on using energy more efficiently. In 2015, suppliers provided approximately 10 million consumers with information on consuming less energy: this is 5.9% less than in 2014. The number of consumers who called a specialised energy efficiency supplier helpline to request energy efficiency advice also fell to 135,000, of whom 24,000 were in debt: a decrease of 15.8% compared to 2014. Direct support to vulnerable customers is provided under the Energy Company Obligation (ECO) and Green Deal (GD) programmes. These are

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<sup>87</sup> Electricity distribution network operators are required to hold registers, while gas distribution networks record details outside of formal registration arrangements.

<sup>88</sup> PSR services include the provision of bills in alternative formats; doorstep password schemes and a meter reading service.

<sup>89</sup> Under Standard licence condition 27.6B.

Government energy efficiency schemes that tackle fuel poverty by making buildings more energy efficient. We discuss the recent developments of these schemes in Chapter 7.

### *Warm Home Discount*

6.27. The Warm Home Discount (WHD) scheme, launched in April 2011, requires domestic electricity suppliers to provide support to consumers who are in or at risk of fuel poverty, including a £140 rebate on their bills. The scheme is set out in legislation and requires suppliers with over 250,000 domestic customer accounts to participate. In March 2015 the scheme reached the end of its original four-year period, during which participants met the overall scheme spending obligations, by providing more than £1.14 billion of support and reaching nearly 2.2 million vulnerable consumers each year.<sup>90</sup>

### *Energy Best Deal*

6.28. There are also programmes to support vulnerable consumers to engage with energy markets and get better deals, such as the Energy Best Deal (EBD) and Energy Best Deal Extra (EBDx) schemes run by Citizens Advice. These give low-income consumers, and frontline workers who support them, face-to-face coaching, help with switching and other services such as advice on debt and energy efficiency. Over 400,000 consumers have benefited from EBD since 2008, and in winter 2014/15, 1,370 EBD group sessions were delivered (a 9% reduction on 2013/14), reaching 9,070 consumers and 4,910 frontline workers. The Citizens Advice Service also delivered one-to-one EBDx advice appointments to 6,050 clients in 2014/15 (a 40% increase on 2013/14).<sup>91</sup>

## **Future outlook**

6.29. Over the coming year, a number of positive developments specifically aimed at PPM customers, customers in debt and customers on restricted meters are expected to kick-off as a result of the CMA's remedies and our policy work.

6.30. Active PPM customers should benefit from the CMA remedy on tariff pages<sup>92</sup>, which will free-up more capacity on both gas and electricity PPM infrastructure and allow the creation of more PPM tariffs. Additionally, the CMA has recommended that we take appropriate steps to ensure that planned changes to the DAP be implemented by the end of 2016. This should make switching easier for PPM customers in debt. Our work on PPM warrant costs is intended to reduce or remove costs for consumers in vulnerable situations who may go through the process of PPM installation under warrant. Our consultation in December 2015 outlined proposals that included improved identification of vulnerable consumers, and removal and/or capping of charges. Final proposals are currently being developed for publication in September.

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<sup>90</sup> ['WHD Annual Report'](#), November 2015

<sup>91</sup> ['Energy Best Deal 2015-16 evaluation report'](#), Citizen's Advice

<sup>92</sup> See footnote 77.

6.31. From April 2017 customers on restricted meters other than Economy 7 should also see improved switching options, as the CMA's proposed order will oblige suppliers with more than 50,000 customers to make all their single-rate tariffs available to these customers and prohibit such suppliers from making this conditional upon the replacement of their existing meter. Additionally, restricted meter customers will be able to access improved information and advice from Citizens Advice. These remedies will only apply during the period before the completion of the roll-out of smart meters.

6.32. From April 2017 the CMA will introduce a transitional price cap for PPM customers (excluding those with SMETS2 smart meters). This will offer additional protection to these customers to reflect the additional barriers to engaging in the market that they face and is likely to lead to significant reductions in bills. A risk associated with the cap is that it reduces the incentive for prepayment customers to engage in the market or that it distorts competition in some other way. The CMA has sought to minimise this risk in how it has designed the cap and has set an end date for 2020: it is anticipated that by this date the engagement remedies will have taken hold, alongside the smart meter roll-out, meaning that the cap on prices will no longer be required.

6.33. In the longer term, smart meters can potentially address many of the PPM and restricted meter issues by allowing consumers to engage more effectively with information on their consumption. For instance, smart meters can make peak and off-peak consumption more transparent through in-home displays and can allow consumers to better manage their energy use and identify suitable tariffs. In turn, this can enhance the role that customers with electric storage heaters can play in smoothing demand and providing demand flexibility.

6.34. Policies supporting consumers in vulnerable situations will continue to be reviewed and improved. For example, the Government has announced that the WHD scheme will continue to 2020/21 following consultation on changes to the scheme<sup>93</sup>. Moreover, following a review in 2014 and further consultations in December 2015 and June 2016, we are reforming PSR arrangements to ensure that companies apply a broader definition of vulnerability when identifying eligibility, and offer outcomes-focused rather than prescriptive services. Suppliers will also be responsible for identifying customers who are likely to benefit from PSR services. We intend to introduce licence changes in the autumn to implement these reforms.

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<sup>93</sup> ['Warm Home Discount scheme consultation 2016-17'](#)

## 7. Environmental impact

### Chapter Summary

Over the last decade, consumption and energy intensity have followed a downward trend. Weather-adjusted domestic consumption fell in 2015 relative to 2014, by 0.9% in gas and 1.3% in electricity.

Retail market arrangements can facilitate consumers' access to information on their consumption (eg through smart meters with in-home displays) and send price signals that promote efficient and sustainable energy use.

Many developments are still in their infancy, but there has been a lot of progress in consumers generating their own energy and offering flexibility to the system. For example, the contribution of (mostly domestic) consumers self-generating electricity under the Feed-in Tariff scheme expanded by 28% in 2015 and reached around 15% of total renewable capacity installed in the UK. At the same time, there are more opportunities for the largest business consumers to offer flexibility services to the market, including balancing services and participation in capacity market auctions.

The main installation phase of the smart roll-out is due to start shortly and is due to be completed in 2020. We will continue to monitor suppliers' progress towards their targets and start reporting in early 2017. We are also supporting this transformation of the energy system through our work, including the Future Retail Regulation project, the flexibility strategy and the introduction of half-hourly settlement.

7.1. In this chapter we consider the retail markets' influence on the environmental impact of the energy sector. To set the context, we start by looking at trends in consumption and other sustainability indicators<sup>94</sup>. We then describe recent developments in how retail markets have contributed to date to the provision of smart and sustainability tools.

7.2. A full review of energy environmental issues is beyond the scope of this report. As described in our Forward Work Programme, we have various ongoing projects which cover many of the relevant issues in greater detail beyond the boundaries of the retail market.<sup>95</sup>

### Sustainability trends

7.3. Consumption and energy intensity are both declining, mainly because people are more energy efficient or are changing fuel source. Final energy consumption in

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<sup>94</sup> Further information about these trends can be found in our [Sustainable Development Indicators](#).

<sup>95</sup> [Forward work programme 2016-17](#), March 2016

the UK has been decreasing since 2005 and is back to similar levels observed in the mid-1980s.<sup>96</sup> Over this period, energy intensity also fell significantly in the industrial, service and domestic market segments of the economy. The drop in the domestic sector was dominated by weather-related factors and by the impact of energy efficiency improvements to the housing stock, especially since 2004.<sup>97</sup>

7.4. Final consumption of electricity rose slightly by 0.2 per cent in 2015, to 304 TWh, mainly due to an increase in commercial and other uses, while industrial and domestic uses fell slightly. Final gas consumption was up 2.4 per cent, to 494 TWh in 2015 with some important sectoral differences. Gas demand for electricity generation was down 3.5 per cent but for domestic supply and other final uses was up nearly six per cent, reflecting colder weather at the start of the year.<sup>98</sup> Nevertheless, after taking into account weather and seasonal demand adjustments, the result was an overall fall in total consumption by 0.5%, and a 0.9% drop for gas and 1.3% for electricity for the domestic sector.<sup>99</sup> We will continue to capture consumption trends through our periodic Typical Domestic Consumption Value (TDCV) reviews, the next being due in early 2017.

7.5. Another important sustainability development is less reliance on fossil fuels. In 2015 the annual fossil fuel dependency, as measured by DECC, was at a record low of 82%, down 2 percentage points from 2014.<sup>100</sup> At the same time, the share of generation from renewables rose from 19% in 2014 to a record 25% per cent in 2015, as a result of more wind, solar and bioenergy generation capacity.

## Smart and sustainability tools

### Smart meter roll-out

7.6. Traditional meters are a barrier to the accurate provision of consumption information: it is difficult for customers with these meters to monitor how much energy they have used and because meter readings need to be taken locally, consumption information can only be provided to customers infrequently and is often based on estimates. Advanced and smart meters should give consumers much easier access to information about their energy use on a near real-time basis, although installation of smart meters is unlikely to guarantee by itself that consumers receive regular and accurate bills.

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<sup>96</sup> '[UK Energy statistics](#)', DECC, March 2016.

<sup>97</sup> This coincides with the end of the first Energy Efficiency Commitment (EEC1) in 2005 and the introduction of EEC2 as part of the Climate Change Programme requiring energy suppliers to save 62 TWh of energy through energy efficiency measures.

<sup>98</sup> In 2015, temperatures were on average 0.6 degrees cooler than in 2014. '[Energy Trends: Gas](#)', DECC, June 2016.

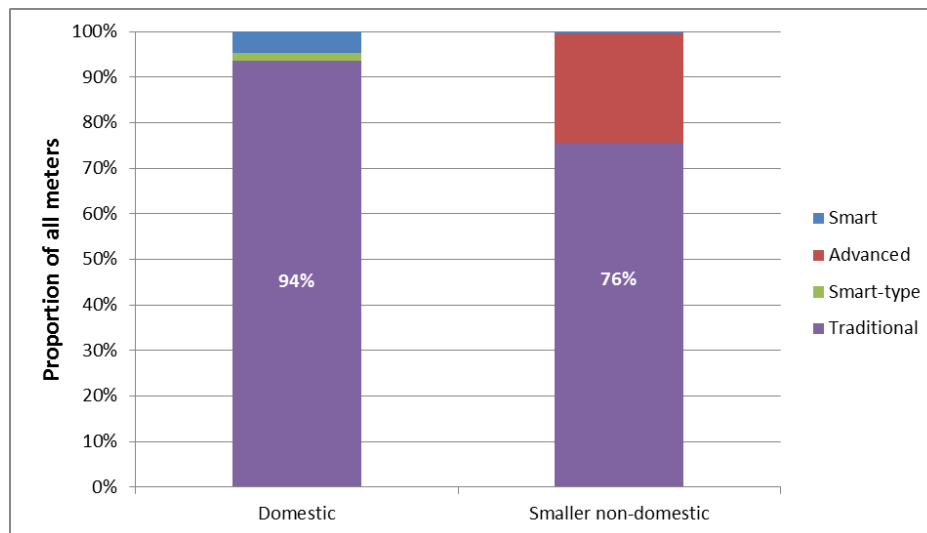
<sup>99</sup> '[Energy Trends: total energy](#)', DECC, March 2016

<sup>100</sup> '[Energy Trends: total energy](#)', DECC, March 2016



7.7. As of December 2015, smart meters made up around 4.3% of all domestic electricity meters and 3.6% of all domestic gas meters for the larger energy suppliers<sup>101</sup>, a two percentage points increase relative to the previous year.<sup>102</sup> A further 1.3% of gas meters and 1.9% of electricity meters were 'smart-type'.<sup>103</sup> There have been substantial differences in the number of installations made by different suppliers, as well as in the proportions of smart meters that are SMETS-compliant<sup>104</sup> and operating in smart mode.

FIGURE 7.1: **Domestic and smaller non-domestic meters, quarter 4 2015**



Source: Ofgem analysis of DECC data taken from [Statistical release and data: Smart Meters, Great Britain, quarter 4 2015](#). Figures shown are for 'larger energy suppliers' as defined by DECC – those with a customer base of more than 250,000 domestic gas or 250,000 domestic electricity customers. For smart meters, the proportion shown is for the number of smart meters defined by DECC as operating in smart mode, aggregated across for gas and electricity.

7.8. Through 2015 we scrutinised suppliers' plans to roll-out smart meters by 2020, an obligation set by Government. This was a 'dry-run' exercise where we wanted to see that suppliers had robust plans to meet their annual milestone targets. In February 2016 we received suppliers' final rollout plans, which included formal, binding targets. We have been engaging with suppliers on their plans, pushing for changes where they are not good enough. We have also been regulating how

<sup>101</sup> This refers to the definition of larger suppliers used by DECC as including all suppliers with more than 250,000 domestic electricity or gas customers.

<sup>102</sup> This relates to the number of smart meters defined by DECC as operating in smart mode. A smart meter may have been installed but not be operating in smart mode due to various technical constraints. Around 1% of installed smart meters were not operating in smart mode in December 2015 ('[Smart Meters, Great Britain, Quarterly report](#)' (p11), DECC, Mar 2015).

<sup>103</sup> Smart-type meters offer some, but not all, of the same functionality as smart meters. They have allowed suppliers to learn from installing and operating these types of meters.

<sup>104</sup> SMETS compliant is defined as: A meter that is – or will be – compliant with SMETS specifications.



suppliers deliver arrangements to engage consumers during the rollout. These include the delivery of Smart Energy GB and the Smart Metering Installation Code of Practice obligations set out in licence conditions.

7.9. In December 2015 smart or advanced meters continued to make up a larger proportion of all smaller non-domestic gas and electricity meters<sup>105</sup> in operation, as compared to domestic. They made up approximately a fifth overall: a one percentage point increase on the previous year. Considerably fewer next-generation gas meters have been installed than electricity meters.

7.10. Suppliers were required to take all reasonable steps to roll out advanced meters to all business customers with annual gas consumption of greater than 732MWh or falling in profile classes 5 to 8 for electricity by April 2014. At that stage, the roll-out was only partially completed (75% in electricity and 86% in gas)<sup>106</sup> leading us to launch investigations into several suppliers over their roll out performance. In December 2015 we found E.ON to have breached its licence obligations.<sup>107</sup> It agreed to pay £7 million to the Carbon Trust which will be used to help SMEs across GB save energy.

7.11. The introduction of a requirement by government for suppliers to print machine-readable images (also known as Quick Response (QR) labels) onto domestic consumers' bills should help consumers to access accurate information about their consumption and assist consumers in making energy price comparisons.

## **Energy efficiency measures**

7.12. There are various Government-led programmes to deliver energy efficiency measures. Possibly the most prominent is the Energy Company Obligation (ECO), which requires energy suppliers with more than 250,000 customers (currently 12) to deliver energy efficiency measures to domestic premises in GB, with a particular focus on low income and vulnerable households. As of the end of March 2016, there have been nearly 1.8million installations under the scheme with around 384,000 of these being installed since April 2015 when the second stage of ECO began.

7.13. Regarding efficiency measures for industrial consumers, the latest performance reports submitted under the Climate Change Levy (CCL), covering 2013-14 showed that around 50% of installations had hit their targets or over performed to improve energy efficiency and reduce emissions.<sup>108</sup> This equates to a total reduction of 5.6 million tonnes of carbon dioxide (adjusted). The buyout option

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<sup>105</sup> The definition of smaller businesses used here includes those business or public sector customers falling within profile classes 1 to 4 of electricity, or using less than 732MWh of gas per year.

<sup>106</sup> '[Suppliers' advanced meter roll-out performance](#)', August 2014.

<sup>107</sup> E.ON will also pay a further £7 million if it fails to achieve its installation target for its outstanding meter points by November 2016. See the financial penalty notice [here](#).

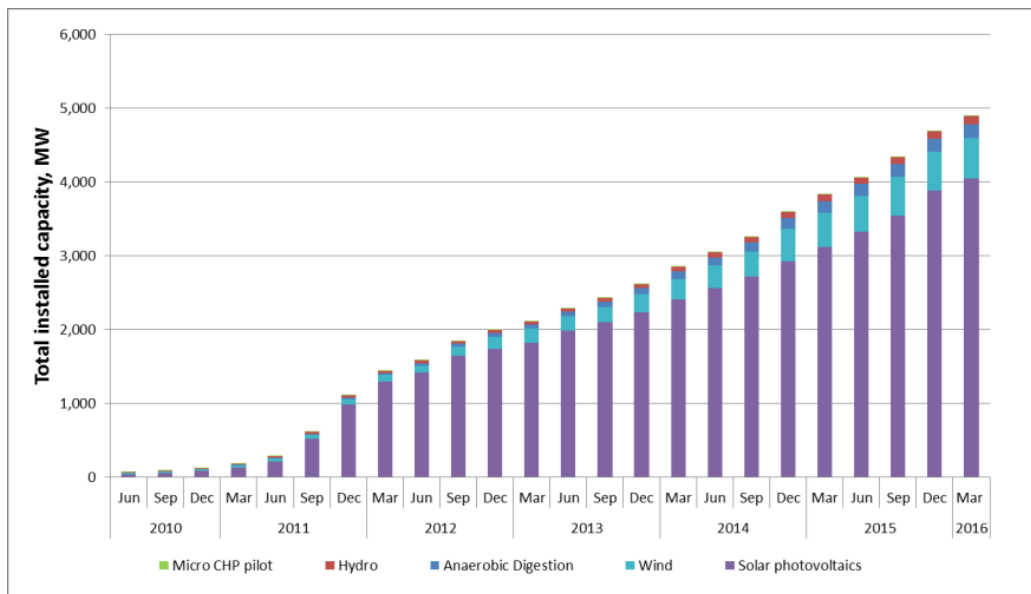
<sup>108</sup> '[Climate Change Agreements biennial progress report](#)', October 2015

at £12 per tonne carbon was taken up by the large majority of the industry who missed the target to reduce their emissions.

### Renewable incentives

7.14. Consumers are also playing a role in reducing the environmental impact of the energy sector by generating renewable electricity themselves. We have seen small-scale renewable generation capacity expand recently, particularly solar photovoltaic panels. Under the Feed-in Tariff (FiT) scheme (administered by Ofgem E-serve), owners of small-scale renewable and low-carbon electricity generation technologies can be paid for the energy they generate and the electricity that they export back to the grid. These customers may include individuals, businesses, communities or organisations.

**FIGURE 7.2: Total capacity installed on the central Feed-in Tariff register**



Source: Ofgem analysis of data from DECC ['Monthly feed-in tariff commissioned installations by Month'](#), April 2016

7.15. As shown in Figure 7.2, there has been a significant expansion in installed capacity under the FiT scheme in recent years, with solar (and particularly the smallest installations) making up the largest part. From March 2015 to March 2016 the installed capacity expanded by 28%. Installations under the FiT scheme represented 0.6% of electricity meter points in GB. More than half of the capacity and 95% of installations in March 2016 were domestic and from solar photovoltaic panels. On the other hand, the majority of the non-domestic commercial installation was made up of micro Combined Heat and Power (CHP).

7.16. Consumers can also influence the demand for renewables through their choice of tariff. As of March 2016 the availability of green tariffs was still somewhat limited

in number but showing signs of growth. Green tariffs are predominantly offered by medium-sized and small suppliers, including those with an explicitly green business model, offering green tariffs to domestic customers. In some cases, green products may also be available to business customers, who may have a further incentive (eg reputational) to source their electricity from renewables. For example, Good Energy offers businesses zero carbon footprint electricity tariffs backed by 100% renewable power. Among the six large suppliers, EDF offers its 'Blue' tariffs backed by low-carbon nuclear power. Moreover, collective switches offered by PCWs have recently incentivised switching to greener tariffs.

### **Demand-side response<sup>109</sup>**

7.17. Demand-side flexibility can be defined as the ability of consumers to change their usage pattern (eg by reducing consumption at peaks and increasing it at off-peak periods) in response to market signals. These include price signals from suppliers or acceptance of a bid to sell demand reduction or increase demand at a price in the market.<sup>110</sup> The former is often referred to as implicit demand-side response (DSR), while the latter is referred to as explicit DSR.

7.18. Large business customers that are half-hourly settled can already offer explicit DSR services and receive a market-based compensation, either directly or through aggregators<sup>111</sup>. This is typically done for system balancing. A wide range of opportunities have become available recently, including the provision of frequency response and reserve services to National Grid, as well as participation in several capacity market auctions.<sup>112</sup>

7.19. Domestic and smaller businesses that are not half-hourly settled can't yet provide explicit DSR through aggregators. Implicit DSR already exist, but it is limited. Business customers often have time of use (ToU) tariffs, in some cases linked to the wholesale price, and may therefore face some incentives to change their electricity demand. As to domestic consumers, around 17% are on electricity meters<sup>113</sup> that allow for implicit DSR, responding to price signals, generally through static ToU tariffs (mainly associated with Economy 7, Economy 10 and DTS

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<sup>109</sup> '[Making the electricity system more flexible and delivering the benefits for consumers](#)', September 2015.

<sup>110</sup> '[Scoping of flexible response](#)', CEER discussion paper, May 2016.

<sup>111</sup> Aggregators are third party intermediaries specialising in coordinating or aggregating demand response from individual consumers, to better meet the needs of agents that are procuring flexibility for the electricity system. The system operator is currently the greatest user of flexibility, which is provided through balancing services for reserve and frequency management purposes, as well as for system security. It is expected that in the future DNOs, generators and suppliers could also become important users of flexibility.

<sup>112</sup> There are transitional arrangement auctions for small amounts of capacity, specifically put in place to help demand side providers enter the capacity market. They work in the same way as the main capacity market auction, but for a much shorter term. The first transitional arrangement auction ran in January 2016, for delivery in winter 2016/2017. See '[Profiting from Demand Side Response](#)' National Grid, 2016

<sup>113</sup> No time of use equivalent is currently available for gas.

meters<sup>114</sup>, with the capability to record consumption separately for different times and allow for cheaper rates at certain off-peak times).

7.20. As smart meters aren't yet widespread, smart tariffs are currently also limited but growing. A recent example is the British Gas offer of free electricity for one day per weekend (between 9am – 5pm) for smart meter users on their Free Time tariff. Nevertheless, smart technologies can also be used by suppliers to offer value added services such as smart thermostats and home batteries that do not necessarily require a smart meter and may only require a meter recording consumption separately for peak and off-peak periods.

7.21. The current main barriers for suppliers in offering dynamic pricing contracts relate to the lack of smart meters (and the associated real-time information) and to the current settlement rules. In the absence of half-hourly settlement, suppliers tend to have limited incentives to offer time-variable prices, as they cannot capture the commercial value of shifting usage away from peak demand periods.

7.22. In October 2014, we approved a modification to the Balancing and Settlement Code known as P272. This change introduced a requirement that consumers in profile classes 5 to 8 (generally medium to large business consumers) should be settled using their actual half hourly consumption data. P272 has an implementation date of 1 April 2017. As of 31 March 2016, around 6% of customers in profile classes 5 to 8 had been migrated to half-hourly settlement.<sup>115</sup> For all domestic and small business customers, settlement is still based on estimated consumption profiles and work is ongoing to identify and overcome barriers to half-hourly settlement<sup>116</sup>.

## Future outlook

7.23. Given the developments in the retail markets – including the roll-out of smart meters and the emergence of new business models – the regulatory framework will need to evolve to support the cost-effective transformation of the energy market into a low-carbon, smart and flexible system. The National Infrastructure Commission has recently estimated that a smart and flexible power system could save consumers up to £8 billion a year by 2030<sup>117</sup>.

7.24. Our programme to help deliver these benefits to consumers spans across several ongoing projects, including in particular the Future Retail Regulation, the flexibility strategy and the introduction of half-hourly settlement.

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<sup>114</sup> This is one of the very few existing examples of dynamic pricing, but not controlled by consumers, see [‘The state of the market for customers with dynamically teleswitched meters’](#), July 2013.

<sup>115</sup> Source: Elexon

<sup>116</sup> [‘Elective half-hourly settlement: conclusions paper’](#), May 2016, [Open letter on mandatory half-hourly settlement: intention to launch a Significant Code Review](#), June 2016.

<sup>117</sup> [‘Smart Power’](#) National Infrastructure Commission, March 2016

7.25. The main installation phase of the smart roll-out is due to start shortly and is due to be completed in 2020. We will continue to monitor suppliers' progress towards their targets and start progress reporting in early 2017. We will also continue to regulate suppliers' delivery of a national campaign for consumer engagement in the smart meter roll-out and their performance against the smart metering installation code of practice.

7.26. Regulated measures for efficiency and small-size renewable plants will continue. Government recently announced that the ECO scheme will be reformed and extended for a further five years. Feed-In Tariff deployment caps were introduced this year<sup>118</sup>, which are expected to reduce the future expansion of Feed-In Tariff capacity. Government intends to develop a system for recycling underspend from this mechanism and has initially suggested that this will be done biannually. Progress on the environmental side may become increasingly market led with the development of peer-to-peer local renewable supply models, as described in Chapter 2. The CMA's decision to eliminate the RMR tariff cap rule could also contribute to these developments by stimulating the offer of innovative green tariffs.

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<sup>118</sup> On 8 February 2016 deployment caps were introduced to the FITs scheme to accept accreditation applications. Different caps for each technology and tariff band were also introduced.

## Appendix 1 – Summary of key data sources used in the report

Chapter	Dataset	Description	Period covered
2	<i>Number of active licensed suppliers</i>	The number of active licensed suppliers is calculated using information that both network operators and suppliers provide to us. White label suppliers are not included in this number.	Snapshot: 2014-2015-2016
2	<i>Electricity market shares</i>	Electricity market shares, both at a GB and regional level, are calculated using meter point data provided by DNOs and iDNOs (for domestic customers and NHH customers profile classes 3 and 4), and volume data provided by Elexon (for NHH customers profile classes 5-8 and HH customers).	Quarterly: June 2005 to March 2016
2	<i>Gas market shares</i>	Gas market shares are calculated using meter point data (for domestic customers and non-domestic customers with annual consumption 0-73.2MWh) and volume data (for non-domestic customers with annual consumption >73.2MWh) provided by Xoserve.	Quarterly: June 2005 to March 2016
2	<i>Suppliers' penetration by segment</i>	Suppliers' relative share among domestic customers by (a) type of tariff, (b) payment types and (c) online/offline are all based on data provided by suppliers on customer accounts by type.	Snapshot: March 2015-2016
2 ; 4	<a href="#">Consolidated segmental statements (CSS)</a>	Data on revenues, profits, costs and volumes are all based on the annual statements that the six large suppliers are required to publish covering each financial year (the CSS). For all of the six large suppliers except SSE, the statements correspond to the calendar year. For SSE, the statements cover the period April to March.	Annually: financial years 2009 - 2015
3 ; 5 ; 6	<a href="#">Consumer engagement in the energy market since the Retail Market Review: 2016 survey findings</a>	This report provides results from the 2016 Ofgem consumer engagement survey. It presents engagement trends between 2014 and 2016 to help understand whether and how consumer behaviours and outcomes have changed over this period since the RMR. Specifically Ofgem commissioned TNS BMRB to conduct three annual nationally representative face to face surveys, one each in 2014, 2015 and 2016. Each survey took place in the spring interviewing over 6,000 energy consumers in Great Britain.	Snapshot: February/March 2016
3	<i>Domestic switching rates</i>	Electricity switching rates are calculated using meter point gains based on data provided by DNOs. For the period up to December 2013, gas switching rates are calculated using data provided by the six large suppliers. For the period from January 2014 they are calculated using information provided by Xoserve.	Monthly: March 2012 to March 2016

Chapter	Dataset	Description	Period covered
3	<i>Domestic 'internal switching'</i>	Internal switching rates are calculated using monthly information provided by the six large suppliers on customer account changes by tariff type, payment method, and account management.	Monthly: November 2014 to March 2016
3 ; 5	<a href="#"><i>Micro and Small Business Engagement in Energy Markets</i></a>	Our evidence on engagement among business consumers is primarily based on a telephone survey of 1,502 micro- and small- business customers carried out for Ofgem by BMG Research in 2014, focusing on how these customers engage in energy markets. Questions included in the survey covered energy usage and expenditure, contracts, the switching experience, use of brokers, contact with suppliers and views on suppliers and the energy market.	Snapshot: September/ November 2014
3	<i>Non-domestic switching rates</i>	Non-domestic switching rates are calculated using information on meter point gains provided by DNOs, iDNOs and Xoserve.	Monthly: March 2014 to March 2016
4	<i>Estimated Network charges per customer – typical consumption, standard unrestricted electricity meter, averaging across regions</i>	Based on a combination of network companies' charging statements and published load factors, Elexon data on peak electricity consumption, National Grid monthly balancing services summary and National Grid transmission losses report. Estimates based on fixed annual consumption of 3,100kWh for electricity and 12,500kWh for gas (medium Typical Domestic Consumption Values).	Annually: 2014, 2015, 2016, 2017
4	<i>Domestic electricity and gas prices, inclusive of all taxes, in EU15/EU28</i>	Based on data for six months period for electricity and gas households in medium consumption bands of 2,500-5,000 kWh in electricity and 20 GJ - 200 GJ in gas. Malta and Cyprus do not have the retail gas market, while the domestic gas market in Finland is very small and prices are not available.	Average over period July 2015 to Dec 2015
4	<i>Industrial electricity and gas prices, inclusive of all taxes, in EU15/EU28</i>	DEEC 'Industrial electricity/gas prices in the EU', published on 31 March 2016. The figure is based on data for six months period for industrial electricity and gas in medium consumption bands of 2,000 - 19,999 MWh in electricity and 2,778 - 27,777 MWh in gas. Malta and Cyprus do not have a retail gas market.	Average over period July 2015 to Dec 2015
5	<i>GfK Energy Research Panel</i>	Satisfaction data is based on a semi-continuous, nationally representative panel of 10,000 GB homes carried out by GfK, which includes questions on consumers' satisfaction with their energy supplier.	Quarterly: June 2010 to March 2016
5	<i>Number of complaints per year and per 100k customers</i>	Ofgem analysis of suppliers data, number of complaints per 100k customers aggregated over 2014 and 2015.	Annually: 2014,2015

Chapter	Dataset	Description	Period covered
5	<i>Average switching times</i>	Average switching times for gas based on Xoserve data - for electricity these are based on data provided by the DNOs.	Monthly: April 2014 to March 2016
5	<i>Objections, erroneous transfers and final bills</i>	Data on objections, erroneous transfers and time to send final bills are calculated using monthly information provided by the six large suppliers.	Monthly: 2014-2016
6	<i>Payment method, debt and disconnections social obligations reporting</i>	Under their standard licence conditions, suppliers are obliged to provide us with data on payment methods, debt, disconnection, and Priority Services Registers (PSRs). This Social Obligations Reporting is our key source on trends in debt and disconnections.	Annually: 2013, 2014, 2015
7	<a href="#"><i>Smart and advanced meters</i></a>	Information on the number of smart and advanced meters is based on information published by DECC.	Snapshot: quarter 4 2015
7	<a href="#"><i>Feed in Tariffs: total installed capacity</i></a>	Total installed Feed-in Tariff capacity is based on data published annually by DECC on feed-in tariff commissioned installations.	Quarterly: 2010 to 2016



## Appendix 2 – Glossary

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### A

#### **Advanced meter**

Defined in the electricity and gas supply licence as a meter that must be capable of recording half-hour consumption data and of providing suppliers with remote access to this data.

### D

#### **Debt Assignment Protocol**

Energy supplier can stop a customer who owes them money from moving to another supplier, this is known as debt blocking. This is applicable on debts outstanding for 28 days or more. Using a process known as the Debt Assignment Protocol (DAP), prepayment meter customers can, however, switch supplier even if they have a debt, by transferring the debt to their new supplier. The maximum level of debt a consumer is allowed to carry over to the new supplier is £500.

#### **Direct debit (DD)**

A method of payment where a fixed or variable amount is taken from a bank account each month, quarter or year.

#### **Distributor Network Operators (DNO)**

DNOs own and operate the distribution network of towers and cables that bring electricity from our national transmission network to homes and businesses. Independent Distribution Network Operators (iDNOs) develop, operate and maintain local electricity distribution networks. iDNO networks are directly connected to the DNO networks or indirectly to the DNO via another iDNO.

#### **Dual fuel**

A type of energy contract where a customer takes gas and electricity from the same supplier.

#### **Dynamically teleswitched (DTS) meter**

A teleswitched meter is a particular type of electricity meter with time of use registers that are switched remotely through messages sent via the Radio Teleswitching Service. Following instructions from suppliers, or distribution companies, messages are sent via the BBC's 198 kHz long wave network to a teleswitch device in the customer's meter to turn the customer's heating on and off. A dynamic teleswitched meter is one where the switching schedule of the heating load may vary from day to day, following the supplier's instructions, most often to take into account prevailing or forecast weather conditions.

## **E**

### **EBIT**

Earnings before interest and tax are deducted.

### **Elxon**

Elxon procures, manages and operates services and systems which enable the balancing and imbalance settlement of the wholesale electricity market.

### **Energy Best Deal/ Energy Best Deal Extra**

Scheme run by Citizens Advice which aims to provide support to vulnerable consumers to engage with energy market and get better deals. These give low-income consumers, and frontline workers who support them, face-to-face coaching and, where needed, help with switching.

## **F**

### **Fixed-term tariffs**

Domestic supply contracts with terms and conditions which apply for a fixed period (for example, a contract offered by a supplier that has a standing and unit price that is fixed for a year).

## **H**

### **Half hourly (HH) meter**

A type of meter which measures and records electricity use on a half-hourly basis. A customer is required to have a HH meter where the average of the maximum monthly electrical demands in the three months of highest demand either over a 12 month period or the period since the most significant change in demand (whichever is shorter) exceeds 100kW. Half hourly meters are typically used by the largest business customers. Nevertheless, smaller businesses (including micro-business) may also qualify for a HH meter.

### **Half hourly (HH) settlement**

As part of the settlement process, the arrangements for using actual HH meter readings to determine how much a supplier's consumers use in each settlement period.

## **I**

### **Intermediary**

A body that is involved in a transaction or interaction between a licensed party and a consumer.

## **M**

### **Microbusiness**

A non-domestic electricity consumer with annual consumption not more than 100,000 kWh or a non-domestic gas consumer with annual consumption not more than 293,000kWh, or a non-domestic consumer with fewer than 10 employees and an annual turnover or annual balance sheet total not exceeding €2 million.

## **N**

### **Non-half hourly (nHH) meter**

A type of meter which measures and records electrical energy flow over longer periods of time (than each half hour). Smaller businesses and domestic customers typically use non-half hourly meters. Nevertheless, larger businesses may also qualify for an nHH meter.

## **P**

### **Prepayment meter**

A prepayment meter is a type of meter that allows consumers to pay as they go for their energy. Consumers pay for their energy using a token, key or card.

### **Priority Service Register (PSR)**

Suppliers and network operators are required to keep a register of customers of pensionable age, disabled and chronically sick known as the Priority Service Register (PSR). The PSR licence provisions place obligations on energy companies to provide certain non-financial services free of charge related to safety, access and communication needs to these specified groups of domestic customers.

### **Profile class**

Consumers that are not settled using actual meter readings for each settlement period are grouped into one of eight Profile Classes. For each Profile Class, a load profile is created that estimates the consumption shape of the average consumer. This load profile (or variations of it) is used to determine the consumption in each half hour for all consumers assigned to the Profile Class.

## **R**

### **Restricted meters**

Meters that can differentiate between peak and off-peak consumption, eg Economy 7.

## **S**

### **Smart meter**

A meter which, in addition to traditional metering functionality (measuring and registering the amount of energy that passes through it), is capable of providing additional functionality, for example two way communication allowing it to transmit meter reads and receive data remotely. It must comply with the technical specification set out by the Government.

### **SMETS 1 meter**

A first generation smart meter, complying with the first version of the Smart Metering Equipment Technical Specifications.

### **SMETS 2 meter**

A second generation smart meter, complying with the second version of the Smart Metering Equipment Technical Specifications.

### **Standard credit (SC)**

A payment method where customers pay on receipt of the bill. This typically covers a wide range of payment mechanisms, including cash, credit card and standing order.

### **Standard variable tariffs (SVTs)**

The standard evergreen supply contract offered by a supplier (ie a contract which is for a period of an indefinite length and which does not contain a fixed term period that applies to any of the terms and conditions). SVT rates can be varied at any time, subject to giving customers advance notice where the change may significantly disadvantage the customer. SVTs do not require online account management.

## **T**

### **Time of (ToU) tariffs**

Energy tariffs that charge different prices at different times of the day, week, month or year.

### **Typical domestic consumption values (TDCVs)**

The TDCVs are the industry standard consumption values, reflecting typical household consumption. They underpin Tariff Comparison Rates (TCRs) as well as being used in other publications and analyses. The TDCVs promote transparency by ensuring that consumers have a common point of comparison when engaging with suppliers and price comparison websites. We regularly review the TDCVs for gas and electricity to keep them up-to-date.

## **X**

### **Xoserve**

Xoserve is the Gas Distribution Networks' Agent and provides centralised information and data services for gas transporters and shippers in Great Britain.