



SLC 32A: Power to direct suppliers to test consumer engagement measures

OVO Energy's response to Ofgem's consultation

18 November 2016

1. Introduction

1.1. OVO welcomes the opportunity to respond to Ofgem's recent publications in relation to mandatory supplier testing of measures to promote domestic consumer engagement. In this response we are responding to the following:

- (a) Statutory consultation on the introduction of SLC 32A: Power to direct suppliers to test consumer engagement measures published 19 October 2016 (**Statutory Consultation**); and
- (b) Open letter on the proposed selection criteria for mandatory supplier testing of measures to promote domestic consumer engagement published 19 October 2016 (**Open Letter**).

1.2. OVO supports the introduction of measures which are designed to address one of the key problems the CMA has identified as existing in the retail energy market - **consumer disengagement**.¹ OVO also generally supports cooperation between suppliers and Ofgem to test measures to improve consumer engagement and looks forward to working with Ofgem to find innovative and effective ways to do this.

1.3. However, OVO is concerned that Ofgem's proposal to introduce a licence condition which allows Ofgem to **direct** suppliers to conduct such tests and trials is a step backwards to RMR-style prescriptive regulation and unilateral direction, and away from open engagement with suppliers. OVO believes that this SLC is not reflective of the change which Ofgem has acknowledged needs to be made to the way suppliers and Ofgem interact. Specifically, Ofgem noted in its "Working paper on broad principles" published 18 August 2016 that "a central objective of our new regulatory approach is getting suppliers to firmly own the responsibility for achieving good consumer outcomes". Introducing an additional SLC which allows Ofgem to **direct** suppliers to take action to test engagement measures does not shift the responsibility to suppliers for achieving good consumer outcomes but instead requires Ofgem to mandate measures to achieve this.

¹ The CMA's findings in its Final Report confirmed that a large number of energy customers lack understanding of, and engagement in, the market: Paragraph 8.104 of the CMA's Final Report in the Energy Market Investigation, dated 24 June 2016.

1.4. Additionally, OVO is concerned that:

- (a) There is no explicit requirement for Ofgem to **consult or engage** with a supplier prior to issuing a **direction** under the proposed SLC, despite the fact that a supplier will be in the best position to determine whether such measures are feasible, efficient or likely to be effective.
- (b) The information gathering powers are **unnecessarily broad**, and allow Ofgem to share with any other third party the information it collects. In the context of engagement measures which may have been successful, OVO is concerned that this could extend to Ofgem sharing commercially sensitive information with other suppliers.
- (c) It is not clear from the Open Letter whether the selection criteria for suppliers to participate in trials will be issued before or after suppliers are selected to participate in trials, and consequently whether there is a right for a supplier to **challenge** its selection under the **selection criteria** - e.g. particularly in relation to capabilities of a supplier to undertake a trial or the anticipated burden of the trial on that supplier.
- (d) Suppliers with specific customer bases (e.g. suppliers with large numbers of prepayment customers) may be specifically targeted and therefore incur greater costs and operational burden than other suppliers. Independent and smaller suppliers are likely to be most impacted by this as they do not have the same economies of scale as the Big Six to absorb the costs associated with meeting Ofgem's requests, or may be less operationally mature requiring broadscale changes to processes or expertise.

1.5. OVO recognises that the Statutory Consultation largely mirrors the CMA's recommendation in its Final Report,² however, OVO believes Ofgem still has the opportunity to ensure its implementation of the CMA's remedies reflects Ofgem's intention for the future of retail regulation. In this context, OVO would urge Ofgem to consider whether the introduction of SLC 32A is appropriate at all, or whether a move towards principles which encourage suppliers to act in a way to achieve

² Paragraph 20.24(a)-(b), CMA's Final Report in the Energy Market Investigation, dated 24 June 2016.

better consumer outcomes would be a more appropriate way to achieve Ofgem's aims and to meet the CMA's recommendations.

1.6. Despite the above, if Ofgem is minded to continue with the introduction of SLC 32A, in order to address the above concerns listed in paragraph 1.4 OVO has the following recommendations:

- (a) SLC 32A should allow Ofgem to issue a **request** to a supplier **to engage** in a test or trial of measures to improve consumer engagement, giving the supplier the ability to decline the request if it has **reasonable** grounds to do so.
- (b) There should be an obligation on Ofgem to **engage** and **consult** with a selected supplier prior to issuing any request for a supplier to engage in a test or trial.
- (c) The information gathering power should be more explicitly limited to information necessary for Ofgem to make a decision in relation to a matter under the proposed SLC or to analyse the effectiveness of a trial. It should also allow for a supplier to specify that certain information provided is commercial-in-confidence and therefore cannot be shared with a third party other than Ofgem without the supplier's permission.
- (d) The selection criteria should be published before suppliers are specifically requested to engage in trials, allowing suppliers an opportunity to feed back on the proposed criteria.
- (e) There should be a mechanism for cost-sharing between both suppliers and Ofgem, particularly where a particular supplier is conducting a trial or test which has an industry wide application and which therefore would also benefit other suppliers.

1.7. In the following sections of our response, we will elaborate on the concerns outlined above, and also expand on our recommendations about how OVO considers this mechanism can be most effectively implemented to overcome these concerns, if Ofgem decides to proceed with the introduction of SLC 32A.

2. Power to engage, not direct

- 2.1. Prescriptive direction might be the regulation of today's retail energy market, but if Ofgem is committed to reforming retail regulation, it needs to start reflecting in the regulatory framework principles of supplier engagement. OVO's view is that the proposed SLC 32A is reflective of the former and current approach to regulatory intervention in the retail energy market, and not the intended **future** approach to regulatory intervention envisaged as part of Ofgem's future retail regulation work.
- 2.2. SLC 32A focuses on Ofgem dictating to suppliers how they should act, rather than allowing suppliers to make decisions based on **achieving better customer outcomes**. OVO believes that any licence condition introduced during the transition from current to future retail regulation needs to instead reflect the principle that suppliers should and are in the best position to deliver improved customer outcomes.

Suppliers best placed to drive trials

- 2.3. OVO believes suppliers are best placed to determine if and how to implement consumer engagement measures, and therefore should have primary control over when and how trials and tests are run. This would shift the responsibility to suppliers for driving changes and delivering better customer outcomes.
- 2.4. OVO notes the point made by both the CMA and Ofgem that suppliers are likely to face limited incentives to engage their customers through regular communications and that such regulatory interventions are unlikely to be aligned with suppliers' commercial interests,³ and therefore, the SLC needs to allow Ofgem to direct suppliers to participate. However, we are of the view that this assumes a "worst case" supplier, one that is not willing to actively seek to achieve better consumer outcomes. It also assumes a stagnant market where there is little innovation or competition, where suppliers are able to rely on retaining a high number of disengaged customers. Our view is that this is unrealistic, as the market is going to continue to evolve, particularly as the regulatory framework is transformed, and the

³ Page 2 and 6 of the Statutory Consultation.

ability for customers to engage and to switch through technology and other measures will increase. We therefore anticipate there will be a natural shift where suppliers will have greater incentives to engage consumers.

- 2.5. Additionally, OVO's view is that suppliers are in the best position to identify, test and trial engagement measures which are proportionate, efficient and appropriate both from a consumer benefit perspective and from a cost perspective. It is highly likely that a number of suppliers have already conducted their own internal testing on messaging and communications, and so will already have an evidence base from which to work in determining how best to test future measures. It will also be simple for suppliers to identify options which are "quick wins", e.g., options which are able to be rapidly implemented with low cost and/or resource. Likewise, in circumstances where a supplier may not be able to engage in a trial for legitimate commercial reasons, the supplier is in the best position to make this assessment.

Consultation before engagement

- 2.6. Additionally, whilst OVO appreciates that Ofgem operates within a regulatory framework which requires it to act proportionally, OVO is also concerned that there may not be adequate consultation between Ofgem and suppliers for Ofgem to be able to understand any operational constraints which may prevent a supplier from being able to engage in a trial. In this context, and under the proposed SLC, Ofgem may still proceed with issuing a direction where the supplier has no ability or capacity to meet this obligation.
- 2.7. In light of this, OVO's recommendation is that SLC 32A should:
- (a) allow Ofgem to issue a **request** to a supplier to engage in a test or trial of measures to improve consumer engagement, giving the supplier the ability to **decline the request** if it has reasonable grounds to do so; and
 - (b) require Ofgem to **engage** and **consult** directly with a selected supplier prior to issuing any request for a supplier to engage in a test or trial in accordance with (a).

- 2.8. This would ensure a more open dialogue between Ofgem and the supplier in relation to tests or trials, and would also allow suppliers to raise any concerns or provide evidence which Ofgem may not otherwise have considered in deciding whether to request a supplier to proceed with a test or trial. This could include the supplier providing Ofgem with insight into the likely timescales for implementing any proposed tests or trials, which would allow Ofgem to frame the timeframe for compliance with a request in the most reasonable way. It would also give a supplier the opportunity to decline the request if there are compelling and reasonable operational or other reasons to justify doing so.

3. Information gathering powers to be proportionate

- 3.1. In addition to our concern regarding the power of direction, OVO's view is also that the information gathering powers set out in the proposed SLC 32A are unnecessarily broad, and could result in potential detriment to a supplier's commercial interests.

Powers to be specific but flexible

- 3.2. The information gathering powers allow Ofgem to request any information it reasonably considers could be relevant to a decision under SLC 32A. Our view is this power should be limited to allowing Ofgem to request **specific** information and results it wants to see (i.e., Ofgem wants supplier X to measure the following quantitative and qualitative factors in comms A, B and C for a specified period and provide the results of that measurement to it).
- 3.3. However, there must be **flexibility** in how the results are able to be presented by a supplier, as it will depend on suppliers' own internal systems and processes. It is important in OVO's view that the information gathering powers under SLC 32A do not place increased burden on suppliers who may already be tasked with implementing new processes or system upgrades to meet Ofgem requests under this SLC.

Third party disclosure

- 3.4. OVO is also concerned that the information gathering powers allow Ofgem to share with any other third party the information it collects. The effect of this is that Ofgem has the power to share commercially sensitive information with other suppliers - for example, in the context of engagement measures, a supplier may have adopted measures which were successful for that supplier to engage and retain consumers. As this method was extremely effective at engaging customers, Ofgem may share certain commercial information with other suppliers to test that method against a different demographic or customer profile. The supplier who bore the operational burden and (potentially) cost of operating the trial would be in no better position than all other suppliers in the market.
- 3.5. Whilst OVO supports sharing learnings across the industry, there needs to be some limits on this right to request and share information. OVO's recommendation is that there is a right for a supplier to specify that certain information provided to Ofgem is **commercial-in-confidence** and therefore cannot be shared with a third party other than Ofgem without the supplier's permission.

4. Selection criteria to be challenged

- 4.1. Another way in which Ofgem can engage with suppliers and encourage collaboration is to publish its proposed selection criteria prior to Ofgem selecting suppliers whom it considers are appropriate to conduct trials or tests. It is not clear from the Open Letter whether this is Ofgem's intention or not (e.g., whether the selection criteria will be issued before or after suppliers are selected to participate).
- 4.2. OVO's view is that allowing suppliers to have visibility of the selection criteria will allow suppliers to provide insight to Ofgem about why certain criteria may not be appropriate. For example, Ofgem may decide that suppliers with a more engaged customer based should be targeted for a particular test of messaging on bills, as these customers are more likely to take action based on price or switching messages. However, it may be more appropriate for a supplier with a large

percentage of customers on standard variable tariffs to trial varied messaging on bills or other communications, as its more “sticky” base is likely to give more credible insight into whether the varied messages do actually impact on engagement.

- 4.3. Conversely, suppliers may wish to challenge the identification of certain customer demographics in selection criteria for certain measures - particularly if an individual supplier knows it has operational constraints which may prevent it from proceeding with a trial.
- 4.4. Allowing suppliers to provide this sort of feedback prior to Ofgem identifying suppliers who it wishes to engage with will ensure Ofgem is fully informed prior to issuing any requests for suppliers to participate in trials or tests. It will also ensure suppliers can provide valuable insight to Ofgem about the operational constraints involved in testing particular measures.

Proposed selection criteria

- 4.5. In relation to the proposed criteria for trials outlined in the Open Letter, OVO believes that in addition to the assessment of whether the burden of conducting the trial is proportionate to a particular supplier, Ofgem should also consider whether the burden is proportionate to the proposed consumer benefit which may be derived from the trial and/or measure. There may be a lower operational or cost burden on a supplier in testing or measuring certain engagement measures, but equally the expected benefit for that supplier’s customers may be negligible. In these sorts of circumstances, OVO would assume this would be considered as part of Ofgem’s decision on selecting a certain supplier to conduct a test or trial.
- 4.6. OVO notes that Ofgem did note in the Open Letter that this element would be considered, and OVO supports the inclusion of this element in the formal selection criteria when it is finalised.

5. Shared learning and shared costs

- 5.1. One of the key concerns OVO and other suppliers have expressed⁴ in relation to the proposed SLC 32A is the potential financial implications of Ofgem having a power to direct suppliers to test and trial various engagement measures.
- 5.2. The proposed wording of SLC 32A does not provide any guidance on who will bear the costs of compliance with this condition, and in the absence of any process to the contrary, it appears a supplier who is directed under SLC 32A to carry out tests and trials will solely bear those costs.
- 5.3. OVO's view is that SLC 32A needs to include a mechanism for cost-sharing between both suppliers and Ofgem, where a supplier is conducting a trial or test which has an industry wide application and which therefore would benefit other suppliers (and Ofgem) as well.
- 5.4. This would allow suppliers who may not have the current in-house capabilities to acquire those capabilities for the purpose of conducting certain trials, without incurring significant costs - e.g., whether through recruitment of specialist staff, changes or upgrades to systems or through engagement of external assistance. Without this, suppliers who lack those capabilities may incur a potentially significant financial detriment in order to comply with a direction under this SLC 32A. Ultimately, this is a cost which would be passed on to consumers of that supplier.
- 5.5. Another consideration is where a supplier conducts a trial or test which has a negative impact commercially for it (e.g., it encourages customers to actively switch away). In this instance, OVO believes it would be unfair for the supplier to bear both the operational cost of running the trial along with absorbing the potential financial detriment arising from the trial. A cost-sharing mechanism would assist here to compensate the supplier for at least the operational financial impact of the trial.

⁴ Based on feedback from other Big 6 and independent suppliers at Ofgem's workshop on RMR information tools and proposed SLC 32A on 9 November 2016.

5.6. OVO's view is that the following principles should apply to any cost-sharing mechanism included as part of SLC 32A:

- (a) If a trial or test is Ofgem-initiated, Ofgem should contribute a more significant amount than the supplier to the operational costs of running that trial or test; and
- (b) If a trial or test has a wider industry application and will ultimately benefit all suppliers, the industry as a whole (Ofgem and all suppliers) should contribute to the operational costs of running that trial or test, in proportion to their market share.