

# Response to Ofgem consultation on ‘Helping consumers make informed choices – proposed changes to rules around tariff comparability and marketing’

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Response by Moira Nicolson and Michael Fell of UCL Energy Institute

We welcome the opportunity to respond to the Ofgem consultation on ‘Helping consumers make informed choices – proposed changes to rules around tariff comparability and marketing’. Our Institute, based at University College London within the Bartlett School of Environment, Energy & Resources, is one of the UK’s leading centres of research on energy systems and demand.

We have focused in our responses mainly on how the introduction of more complex ‘smart’ tariffs (e.g. time of use tariffs) may be impacted by the proposed changes. While in general the changes remove key restrictions to the introduction of such tariffs, we see several areas where the changes may risk introducing subtle new barriers to suppliers offering such tariffs, and to promoting them effectively to customers.

## Question 1

*(a) Do you agree with the proposed requirement that any calculation by a supplier of the estimated annual cost figure should be internally consistent (ie calculated in the same way by any given supplier for all tariffs and for all customers over time)?*

An important criterion for suppliers’ annual cost calculations is that there should be a reasonable expectation of accuracy across all tariff types, so as to allow useful comparison within a supplier’s offerings.

The current RMR rules restrict suppliers to offering tariffs with a single standing charge and a single unit rate (except in the case of customers with multi-rate meters). For such tariffs we agree that suppliers’ calculations should be internally consistent – and as past behaviour is generally a reasonable predictor of future behaviour a reasonable level of accuracy should be achievable in the projection. However, the proposed rule changes and other reforms will facilitate multi-rate tariffs or more complex time of use tariffs. It is less clear whether a single consistent method would be able to usefully capture the diversity of features such tariffs might offer, and thereby provide a sufficiently accurate projection.

To illustrate this, it is possible to imagine that a supplier could devise a calculation which takes into account customers’ past half-hourly consumption data (whether actual or, more problematically, modelled) to provide a projection. Such a method could legitimately be applied consistently to both flat rate and time of use tariffs (albeit with the half-hourly granularity being effectively redundant for

the flat rate tariff). However, this method does not take account the intention that time of use offerings should prompt changes in the times of electricity consumption.

Using past data to inform a projection of costs on a time of use tariff without accounting for the possibility of the tariff's influence on consumption timing<sup>1</sup> would potentially project a misleading cost. The question then becomes whether a correction factor of some kind should be applied to account for this, perhaps informed by information on (for example) flexible electrical appliance ownership or even consumers' own expression of willingness to be flexible. Again, such an approach could be legitimately applied to both flat rate and time of use tariffs. However, the calculation would necessarily be expanded to include information and variables which are redundant for flat rate tariff projections. We also note that half-hourly consumption data will only be recorded and therefore available for creating tariff projections if a consumer actively opts-in to have half-hourly data recorded (given that consumers tend to 'go with the flow' of pre-set options, this could mean that the data required to provide an accurate projection for a time of use tariff is unavailable for the majority of customers, which could also introduce a barrier to the uptake of time of use tariffs.

The requirement to devise such catch-all calculations, and to collect and process such information, could act as a barrier to suppliers introducing innovative tariffs. The requirement to provide this information could also set up a barrier to some consumers from engaging in the switching process at all. The use of modelled half-hourly consumption data would also present a serious risk of giving a misleading or inaccurate projection. It is also more difficult to validate calculations for time of use tariffs using just past data because, again, unlike flat tariffs, they would be expected to promote a change in consumption patterns. Pragmatically, there may therefore be some justification for treating more complex tariffs differently from simple flat rate tariffs for the purposes of projections.

Either way, if it is agreed that the most important feature of the estimated annual cost figure is that it should provide consumers with as realistic an approximation as possible about their likely energy costs, then we suggest the best next step would be for: (1) Ofgem to analyse the extent to which the rules after the proposed changes would incentivize energy suppliers to provide a realistic cost estimate to consumers; (2) Ofgem to require suppliers and price comparison sites to test methods of estimating the estimated annual cost figure by comparing different estimates to the actual end energy consumption on their existing consumer base. The latter is required because, although we might expect flexible appliance ownership or intention to change consumption patterns to predict annual costs on a time of use tariff, there is still a lack of empirical evidence as to how well these variables are likely to predict costs on a time of use tariff in reality.

*(b) Are there any circumstances in which suppliers should have the flexibility to provide an estimated annual cost figure to customers based on different assumptions or methodologies? Please explain your answer.*

For the reasons given above, we believe suppliers probably should have flexibility in how to provide their own estimates for any tariff types which are not simple flat-rate tariffs. For example, there may be more of a role here for customers to give their own input to the calculation, such as their own readiness to be flexible in their consumption times (if this is shown to be helpful – see below, this answer). However, to facilitate comparison between these types of tariffs, price comparison

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<sup>1</sup> This influence has been demonstrated in time of use trials such as the Low-Carbon Network Fund projects 'Low Carbon London' and 'Customer-Led Network Revolution'.

websites could in parallel be encouraged to create more standardised methods for providing consumers with comparable estimates of their annual costs on different ‘smart’ tariffs.

As noted above, we recommend that suppliers and price comparison sites be encouraged to research different methods of providing accurate forecasts of energy bills under different ‘smart’ tariffs. This is important because there is a lack of evidence as to what consumer characteristics are related to load shifting behaviour on ‘smart’ tariffs – currently, suppliers provide estimates based on house size or type however this is unlikely to be sufficient for time of use tariffs. Characteristics which are strong determinants of load shifting behaviour should be included in the methods used to provide estimates. We also note that these characteristics could vary depending the tariff type and structure e.g. static time of use vs dynamic time of use.

## **Question 2**

*Do you support our proposal to require that, in the absence of a prescribed methodology, the estimated annual cost must be personalised, transparent, fair and as accurate as possible, based on reasonable assumptions and all available data?*

We support this proposal, and would encourage Ofgem to require suppliers to justify their choice of methodology against the criteria mentioned (personalized, transparent, etc.). Such justification should include evidence to show that the criteria are being met. For example, suppliers could undertake consumer research to show that their customers view the process as transparent, or create retrospective projections for customers (at least for flat rate tariffs) that could then be checked against their subsequent expenditure to demonstrate accuracy.

By cross-comparing the calculations and justifications provided across suppliers, it should be clear if certain suppliers are falling significantly below the standard of the others in meeting the criteria (requiring action), or are performing exceptionally well (in which case this best practice could be encouraged more broadly).

## **Question 3**

*Do you support our suggestion that, at the end of a fixed-term contract, consumers could be rolled onto another fixed-term (rather than evergreen) tariff, if the consumer were able to exit this tariff with no penalty and at any time?*

We agree with this suggestion, but wish to highlight some possible complications associated with ‘smart’ tariffs and make a more general point in relation to prompts around switching.

Firstly, defaulting people onto the cheapest available<sup>2</sup> tariff could become problematic where suppliers also offer ‘smart’ tariffs and in cases where these could be the cheapest tariff (depending on how the supplier calculates the estimated annual cost). Although Ofgem notes that, “In doing so, we would expect suppliers to consider carefully how they would communicate the change to their customers and avoid confusion (eg about similar tariffs with exit fees)” (p13), research from Consumer Focus<sup>3</sup> casts doubt on the extent to which people will pay attention to or read such

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<sup>2</sup> In the consultation document Ofgem makes it clear that consumers should only be defaulted onto another fixed-term [non evergreen] tariff in the event that “it was a cheaper option” (p13).

<sup>3</sup> Hannah Mummery and Gillian Cooper, Missing the mark: Consumers, energy bills, annual

notifications<sup>4</sup>, meaning that people could be switched onto a tariff without their knowledge but which may require some active effort on their part to obtain the full benefits from e.g. as with time of use tariffs.

One way of avoiding this could be to exclude 'smart' time-varying tariffs from the list of possible tariffs to which suppliers could automatically roll people. However, this would present a specific barrier to uptake of such tariffs, which are important for reducing peak electricity demand and for the integration of intermittent renewables. Therefore, if Ofgem does decide that it will permit suppliers to automatically roll consumers onto the cheapest flat rate fixed-term contract tariff [we agree that this is better than them being automatically switched to an evergreen tariff], research should be conducted into how best to prompt consumers to make an active switching decision which includes the option of smart tariffs where available.

Related to this is the question of what happens when customers reach the end of a fixed term contract involving a time-varying tariff. If they are rolled onto a flat rate tariff (as suggested above) and do not realize it, they risk incurring high costs if they continue to use a lot of electricity at what they wrongly believe to be off-peak times. Again, in such cases, it will be very important to ensure that the tariff transition is flagged as clearly as possible to customers, and ideally to promote active switching decisions where possible.

Turning to a more general point about switching prompts, remedy (a) in the Competition and Market Authority's "Summary of Provisional Decision on Remedies" was "the establishment by Ofgem of a programme to provide customers – directly or through their own suppliers – with information to prompt them to engage"<sup>5</sup>. We welcome this recommendation but note that suppliers may not always be the best candidates to prompt people to switch and therefore suggest that this research include prompts delivered by other parties.

Consumer Focus found that the vast majority (81%) of consumers do not pay attention to any other information in their bills except the amount they owe, suggesting that they may ignore Cheapest Tariff Message prompts that are included on bills from their supplier.<sup>3</sup> Further, there is a significant portion (20%) of consumers who do not read communications from their supplier, particularly those sent by email (40%).<sup>3</sup> Moreover, whilst the termination of a consumer's tariff may seem like an ideal time to prompt people to switch, other research suggests that people are more likely to break old habits (e.g. a habit of not switching tariff) when they have recently undergone some other life change such as moving house,<sup>6</sup> particularly when they are personalised to the recipient.<sup>7</sup>

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statements and behaviour change (London: Consumer Focus, 2011): 9-10.

<sup>4</sup> Consumer Focus' nationally representative survey of 2,000 energy bill payers in 2011 found that although 77% of people who receive paper bill report that they always read them as soon as they arrive, this falls to just over half (57%) for those who are billed online. The vast majority (81%) of consumers, however, only look at their bill to see how much they owe, ignoring the rest of the information provided.

<sup>5</sup> Competition and Markets Authority. Energy Market Investigation: Summary of Provisional Decision on Remedies. 2016.

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/506949/Energy\\_PDR\\_Summary\\_March\\_2016.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/506949/Energy_PDR_Summary_March_2016.pdf).

<sup>6</sup> A good review can be found in Thompson, S., Michaelson, S., Abdallah, S., Johnson, V., Morris, D., Riley, K., Sims, A. (2011). "'Moments of change' as opportunities for influencing behaviour. A research report completed for the Department for Environment, Food and Environment". nef (new economics foundation). Defra, London.

<sup>7</sup> For a concise review of this literature, see "The Behavioural Insights Team Update report 2013-2015", p1-24. <http://www.behaviouralinsights.co.uk/publications/the-behavioural-insights-team-update-report-2013-2015/>

As an example of our work which illustrates this, we partnered with the Office of Low Emission Vehicles and the Energy Saving Trust to test the effectiveness of prompting electric vehicle owners to consider switching their electricity tariff shortly after they purchased a brand new electric vehicle, a point at which they would be more likely to be thinking about the costs of running their new car. In August 2016, we emailed 8,000 private electric vehicle owners to prompt them to switch electricity tariff and to provide further information on how to find the cheapest tariff, hosted on the Energy Saving Trust website.

We found that over 40% of recipients opened the email and a further 12% went on to click-through to the Energy Saving Trust website (with over 1,000 visitors downloading our digital tips leaflets in the first week). This compares to an average open rate and click-through rate of 22% and 3% respectively for email communications, suggesting that the Office for Low Emission Vehicles is a viable candidate for prompting electric vehicle owners to switch tariff, particularly to tariffs which incentivise off-peak charging. Tailoring the email specifically to EV owners (“switch to cut your home charging costs by £300”) increased the open rate by 24% and the click-through rate by nearly 80% compared to a generic appeal (“switch to save £300 on your energy bills”), as is usually used by government and price comparison sites to promote switching. This research has just been conducted but a report is forthcoming in September/October 2016 – we would be happy to present the results in more detail if Ofgem is interested.

Ofgem notes on p2 that “The CMA also recommended that we carry out a programme of trials to find out what prompts work in practice to encourage consumers to engage in the market. These may, for example, include a prompt based on the cheapest tariff available in the market.” – we suggest that such trials could also trial prompts from different organisations, sent at different moments in time and segmented by consumer groups, thinking ahead to new types of energy consumers such as electric vehicle owners and those with new electric heating systems (e.g. heat pumps).

#### **Question 4**

*Do you agree with our overall approach to managing the consequential impacts on the Clearer Information tools arising from the removal of the relevant Simpler Tariff Choices rules?*

Yes, insofar as the removal of the Tariff Comparison Rate but retention of the Tariff Information Label would accommodate the introduction of more complex tariffs. However, the Cheapest Tariff Message (CTM) is more problematic for reasons described above. As we currently do not have good evidence on how to provide useful projections and comparisons for more complex smart tariffs, it will be important to keep under review (and research) how projections and comparisons for such tariffs can most accurately and usefully be made. This is especially important in the context of the CTM since whether or not smart tariffs appear in this message (and the appropriateness of their appearance there) is likely to have important ramifications for this uptake.

#### **Question 5**

*Have we identified the right benefits and risks associated with our preferred approach to managing the impacts of removing the relevant Simpler Tariff Choices rules on each of the Clearer Information tools?*

Yes – although we note that the consumers at greater risk are those who have yet to receive smart meters, since suppliers are least likely to hold accurate historical consumption data for these groups, which should be expected to affect the accuracy with which projections can be made.

### **Question 6**

*Are there any potential unintended consequences associated with our proposed approach?*

Here we would simply highlight some of the possible consequences for the introduction of more complex smart tariffs as discussed in previous responses, especially Question 4 with regard to CTM.

### **Question 7**

*Do you agree that our proposed policy objective is the correct one? Please explain your answer.*

We understand that Ofgem’s overall policy objective is to regulate so that “consumers are able to make informed choices by understanding which of a supplier’s tariffs offers the best value to them based on their characteristics and preferences” (p21). We agree that that this is a good objective from the point of view of promoting energy affordability and delivering good outcomes for consumers.

However, there are other policy objectives – namely to promote energy security and mitigate the environmental impact of energy use – which, following the smart meter roll-out, will also be affected by consumer decisions over tariffs. For example, the extent to which consumers are willing to switch to static time of use tariffs, or agree to sign up to tariffs which involve a third party controlling their home heating to balance energy demand with renewable energy sources, will affect energy security and the UK’s ability to meet climate emission targets and realise the wider benefits of the smart meter roll-out. Ofgem may also wish to incorporate these objectives into its overall policy objectives. This would be in alignment with all four of Ofgem’s major themes: promoting value for money, promoting security of supply, promoting sustainability, delivering government programmes.<sup>8</sup>

### **Question 8**

*Do you consider that the proposed principles are a sensible way of achieving our policy objective? Please explain your answer.*

Yes, we do. However, if Ofgem also wanted to further other policy objectives such as facilitating choices which promote energy security and sustainability (both of which are in the long-term interest of consumers) then Principle 3 could pose a barrier, particularly if Ofgem follows the CMA suggestion to “require suppliers to have regard in the design of their tariffs to the ease with which customers can compare ‘value for money’ with other tariffs they offer”<sup>9</sup>. This could have the unintended consequence of dis-incentivizing suppliers from offering more complex tariffs like time

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<sup>8</sup> <https://www.ofgem.gov.uk/about-us/how-we-work>.

<sup>9</sup> Competition and Markets Authority. Energy Market Investigation: Summary of Provisional Decision on Remedies. 2016, p24.

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/506949/Energy\\_PDR\\_Summary\\_March\\_2016.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/506949/Energy_PDR_Summary_March_2016.pdf).

of use tariffs which are naturally much harder to compare (or will at least require more development effort to provide an easy method of comparison) than flat-rate tariffs.

Principle 6 may need to be adapted or caveated. Principle 6 states that “The licensee must only recommend, and must ensure that its Representatives only recommend, to a Domestic Customer products or services which are appropriate to that Domestic Customer’s needs or preferences”. As noted by Ofgem in its section on ‘Characteristics’, “Consumption profiles over the day will also become increasingly relevant for consumers if suppliers offer more time-of-use products with different rates at different times of the day” (22). We note that, the consumer’s existing or historical consumption profile may not be an accurate or most appropriate to use in predicting a consumer’s ability to benefit from a time of use tariff.

With the exception of those on ‘legacy’ Economy 7 style tariffs, the majority (80-90%) of energy bill payers in the UK are on flat-rate tariffs and therefore, on average, will have a load profile that is currently unreflective of any ‘smart’ tariff structure. Where a supplier lacks the information needed to make an accurate projection of costs on a time-varying tariff (e.g. on past half-hourly usage, appliance ownership or willingness to shift load) they may be unable to meet Principle 6 with confidence, resulting in a further barrier to the promotion of smart tariffs.

Therefore, when creating a Personal Projection for a time of use tariff, it may be necessary for suppliers to provide consumers with different estimates depending on how much load shifting there are willing or able to do (ability can also be assessed based on other important characteristics as noted in our responses to other questions). For a crude example of this, see the information that was provided to electric vehicle owners in a trial that we ran with the Office for Low Emission Vehicles and the Energy Saving Trust (attached with this response – see p3). As noted elsewhere, we recommend that these methods of providing a Personal Projection are rigorously tested by suppliers in advance to ensure that they are easy to understand and that they provide an accurate projection. However, as noted above, half-hourly consumption data will only be recorded and therefore available for creating tariff projections if a consumer actively opts-in to have half-hourly data recorded, which many consumers may not do.

#### **Question 9**

*Are there any benefits, risks or potential unintended consequences associated with the proposed principles which we have omitted? If so, what are they and how could they be mitigated?*

Please see response to previous for examples of possible risks and unintended consequences.

#### **Question 10**

*Are these principles likely to result in differential impacts across different types of suppliers (eg large vs. small or medium suppliers)? Please explain your answer.*

Because of the relative challenges in making the comparison of complex tariffs easy, Principle 3 may disadvantage suppliers who only offer complex tariff structures. Such suppliers may be expected to be important trailblazers in the introduction of such tariffs. As such, there should be appropriate leeway in the interpretation of this principle to allow for the additional challenges such suppliers may face.

## Questions 11-14 – no response

### Question 15

*Do you agree with our proposal to remove the prescription from SLC 25? Are there any other areas where you think prescription still needs to be retained to maintain consumer protection?*

We have a point to make here specifically in relation to the provision of bundled products, which Ofgem is proposing to remove restrictions on. We also made these points in a response to the recent consultation on the removal of specific rules.

Firstly, there is a risk that bundling will take place which is not fully and clearly understood by the customer. For example, dynamic switching of appliances could be offered as an additional service as part of new 'smart tariffs'. It is important to consider how such a service is presented since it introduces elements of external control into the home which customers may not previously have experienced, and which may have ramifications for comfort, privacy, etc. Moreover, the ways in which the service is presented could affect the extent to which customers are aware that they are signing up not just to a tariff but also to some additional service. It is not clear that the newly proposed Principle 1 ('The licensee must ensure that the terms and conditions of its Tariffs (including their structure) are clear and easily understandable') would necessarily apply to bundled services or, if it does, what level of detail on the potential impacts of such services would be considered appropriate.

There is no reason to assume that SLC 25 would protect consumers from unknowingly consenting to such services given that consumers who are inattentive to default options may be just as likely not to read a list of information provided at the point the contract is signed. There is insufficient evidence on how suppliers are likely to obtain consent for such services (if they choose to offer them) or how consumers are likely to respond to different methods of obtaining such consent. Therefore, we cannot recommend what prescriptions should be put in place.

We are currently undertaking work in this area, specifically to test two different methods of obtaining informed consent for direct load control of home heating and of electric vehicle home charging. The first method is to embed direct load control within a supplier's general terms and conditions, which consumers are able to read and must agree to prior to switching. The alternative method is to require potential customers to make an active choice as to whether they would like to be delivered with these additional services in the form of a prompt delivered after the consumer has switched to a 'smart' time of use tariff. The objective is to determine whether consumers may sign up to direct load control programmes without reading the terms and conditions (thus without knowing that they have signed up to direct load control) and whether prompting an active choice affects enrolments in direct load control programmes. The results of this project are expected to become available in Spring 2017.

Our second point is that it is likely that bundled services will be offered to make certain tariffs more attractive both to switch to and to remain on. This is not a problem in itself. However, it is possible that certain bundled services could lead to a level of lock-in to certain suppliers or tariffs that would be undesirable from the point of view of encouraging switching. For example, a tariff offering smart heating controls (or other appliance control systems) that are not compatible with other suppliers'

load control programmes could present a barrier to switching away from that supplier because it might mean losing capabilities that the customer has come to rely on.

We are aware that additional services could increase the potential consumer benefits of smart tariffs and, in some cases, may even be necessary for realising them (e.g. dynamic tariffs). We also note that the points made above are possible concerns, both of which we believe could be addressed in a manner consistent with Ofgem's 'principles' approach if preliminary consumer research indicates that these concerns are likely to occur in practice. However, we recommend that these issues are kept under review.

## Questions 16-20 – no response

### Question 21

*Are there any other sources of information we could use to provide us with an early indication of potential issues with sales and marketing activities?*

If Ofgem does not already have this in place, then monitoring of social media discourse may help provide useful early insights into the sales and marketing issues as they arise.

### Contact

This response was written by Moira Nicolson and Michael Fell. It does not claim to represent the views of UCL Energy Institute. Please do not hesitate to get in touch if you would like to discuss any of the points raised in our response:

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