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Flexible And Responsive Energy Retail Markets - July 2019 consultation
Citizens Advice Response

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Citizens Advice welcomes the opportunity to respond to the joint BEIS and Ofgem consultation on Flexible And Responsive Energy Retail Markets. This submission is entirely non-confidential and may be published on your website.

As recognised by the review, we are quickly moving towards a smarter, more decentralised energy future. As many people as possible must be able to benefit by being able to access the new ways of buying energy that are already emerging.

Decarbonisation, and particularly the recent adoption of a net zero emissions target, has added fresh impetus to ensuring the energy retail market functions for all consumers. Attractive retail propositions that inspire consumer confidence will be vital to enabling take up of electric vehicles, low-carbon heating and efficiency measures by households.

There is a real risk that those that struggle to engage with the future retail energy market will face paying a disproportionately high burden of decarbonisation costs. Without a retail market that works for everyone - with smart consumer protections at its heart - it won't be possible to have a just low-carbon transition.

We commissioned research to understand the barriers and risks consumers might face to accessing future energy supply models, held workshops with consumers to understand their perceptions, and have put forward a series of recommendations in our recent report Future for All.

We think this review captures well the issues at play and brings forward some fresh approaches that could deliver a better energy future for consumers. We

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recognise that much of the thinking is at a developmental point, with more definitive proposals forthcoming in the latter stages.

Finally, we are encouraged by the wide range of engagement that has been pursued by BEIS and Ofgem in the early stages of the review, and look forward to continuing to contribute. If you would like to discuss anything in this response, we would be keen to do so.

Yours sincerely,

Tom Crisp

Senior Policy Researcher

1. Do you agree with our vision for the future of the energy retail market, the outcomes we are seeking to achieve and our characterisation of the key challenges we need to overcome?

We are in broad agreement with the objectives of the review as a whole. The five outcomes are in close alignment with principles we have established[1] that we would judge the success of a future retail energy market by, namely:

- Enable all consumers to choose from a good range of supply models
- Make information about products and services transparent and accessible
- Protect vulnerable consumers and ensure people are not penalised for loyalty
- Put consumers in control of their energy outcomes

We are particularly supportive of the explicit recognition of the review of the need to guarantee that people in vulnerable circumstances receive the services they need. With a transition to a future retail energy market, the opportunity for consumers who have previously struggled to access the market to receive more tailored services that deliver better outcomes is substantial. However, our research has shown there are significant risks that large groups of future consumers could be excluded from such services and their benefits. This includes some existing vulnerable groups, but also some consumers we might not have traditionally considered to be at risk in the energy market.

In order for some vulnerable consumers to get the services they need, there needs to be a focus on providing affordable energy - not just energy at a competitive price. This will require an ongoing role for social policies - like Warm Home Discount - alongside reforms to ensure the retail market delivers the best outcomes for these consumers.

While the benefits of regulatory simplicity - such as lower costs and difficulty ensuring compliance - are well worth pursuing, we would state at the outset that delivering regulatory simplicity should not be conflated with unleashing innovation by removing established consumer protections. Approaches like Ofgem's licence guides and transition to principles-based regulation where appropriate have already made the rules more accessible and flexible without diluting required outcomes. The digitalisation of rule books will increasingly enable market participants to view only the rules relevant to them in a simple format, even if there are still multiple, complex rule books that sit behind this.

Finally, while there is recognition in the challenges set out that decarbonisation will require change for consumers, if anything the urgency of this is understated

[1] Citizens Advice (2019) Future for All

in the review objectives. To meet the net zero target will require a speed and scale of change that is unachievable unless consumer confidence and support is maintained, especially as transport and (to some extent) heat are electrified. In the context of rising projected electricity prices[2] throughout the 2020s it is vital that the retail market functions to help consumers minimise these costs as much as possible.

We think there has to be a strong focus on the fairest way to pay for the energy transition, recently calling for an independent commission to be set up to explore these options.[3]

2. Are there examples of new products, services and business models that would benefit current and future consumers, but are blocked by the current regulatory framework?

We would characterise the current regulatory framework not necessarily as blocking new products, services and business models, but as presenting in some instances high hurdles to their introduction and/or widespread adoption.

For example, dynamic time-of-use tariffs, domestic demand-side response aggregation and bundling of battery storage, solar and autoswitching are all established in the market, albeit at a limited level. However, we recognise the upfront investment and complexity of bringing such offers to market can be prohibitive, and are in favour of lowering barriers to innovation, with the proviso that risks to consumers are minimised and protections maintained.

We would also echo industry that in the short/medium term many of these barriers lie not necessarily in retail market regulation, but elsewhere in industry regulation, systems and processes. For example, better data is required to make many new business models practical. But the smart meter roll-out and midata programme both remain in a state of delay, with a roll-out monitoring framework now being consulted on going out to 2024.[4] Likewise revenue streams such as flexibility markets and the Capacity Market remain difficult to access for smaller participants, and technical and revenue-stacking challenges also remain[5]. We recognise that energy codes are a significantly complex part of the regulatory framework that can block innovation. We welcome the steps taken through the development of the Retail Energy Code and the Codes Review

[2] CCC (2017) Energy Prices and Bills
[3] Citizens Advice (2019) The costs of decarbonisation must not hit those who can least afford it
[4] Citizens Advice (2019) Smart meter rollout must be extended says Citizens Advice
[5] National Grid ESO (2019) Power Responsive Annual Report 2018

to create a new approach to codes which have innovation and consumer outcomes at their centre.

We would end on a note of optimism that our workshops with energy consumer has identified some appetite for innovative new ways of delivering energy services. Consumers are keen to find out more about the energy market, including the current energy supply model and implications of changes in the energy system.[6]

3. Are there current or emerging harms to energy consumers which are currently out of scope of the regulatory framework? Do these differ for domestic and non-domestic consumers?

In terms of current harms, we have identified some detriment to consumers from third-party intermediaries (TPIs). This represents a protection gap and is likely to be a growing risk as the market develops.

We support the role of TPIs in facilitating greater engagement with the market; our most recent joint survey with Ofgem revealed over two-thirds (68%) of respondents would use a price comparison site to compare suppliers.[7] However, there exists a mismatch between how much protection consumers believe exists, and reality, as identified by research for the CMA's 2017 *Digital Comparison Tools* study[8]. This found six in ten consumers (59%) who have used a comparison site thought or assumed that comparison sites are checked and approved before they can operate.

Since TPIs are regulated by Ofgem's voluntary Confidence Code or generic consumer law rather than direct sectoral regulation, consumers may be exposed to higher risks than if they bought from, or interacted with, a supplier directly.

Our monitoring of complaints to the Citizens Advice Consumer Service shows while the level of cases raised in relation to TPIs is relatively low, consistent themes emerge, such as accuracy of information and being unable to resolve complaints.[9] As a minimum, we would like to see all TPI users able to consistently access alternative dispute resolution.

New third-party services offer greater scope for better outcomes for consumers through personalisation of offers and a greater degree of automation. However, there are also associated risks. New developments such as the increased

[6] Impact (2019) Future Energy Models
[7] Accent (2019) Household Consumer Perceptions of the energy market Wave 3
[8] CMA (2017) Digital comparison tools market study
[9] Citizens Advice summary of Consumer Service cases

prominence of "auto-switcher" services may give these issues increased urgency in coming years.

Delivering a lower price for consumers without the risk of roll-on to a default tariff at the end of a contract is a good outcome. There are also positive examples of support being offered to consumers through these services. However, suppliers have expressed concern about being unable to discharge key functions, given that in some examples of the auto-switch model they are no longer the key consumer interface in some functions. In the interim, a supplier-side principles-based approach may be the most appropriate. We note that Ofgem has recently set out that where these services create substantial risk of erroneous transfer, suppliers may be required to refuse the switch to avoid breaching the supply licence condition that requires them to treat customers fairly.[10]

This demonstrates the risk that in the longer term, without appropriate regulation around third party intermediary services, they may not develop to their full potential. There are also examples of customers being switched through these services without regard to the level of customer service capable of being provided. Emerging risks can also be seen in next generation business models where a third party could be taking import/export decisions over assets such as battery storage, electric vehicles and smart appliances, which as yet are hard to fully anticipate or design protections for, especially as the householder will act as both consumer and producer of energy services. In this environment it will be critical that consumers are able to have clear expectations of what a service will provide, be able to compare likely outcomes, and then be able to audit outcomes when a service is installed and running. Where promised outcomes are persistently not achieved, people need to be able to exit contracts. Similar provisions exist in relation to other core markets, such as around broadband speed.

As the statutory advocate for microbusiness consumers, we note that the risks from TPIs in this market are already higher, with identified trends of aggressive sales, lack of transparency, misrepresentation and mis-selling.[11] Concurrently as the risks increase, the protections diminish in the non-domestic space, with even sole traders unable to rely on the same basic protections in their business premises as they can in their homes.

We would also note that over many years, this issue has been focused on several times by government and regulator. For example, the *Energy Act 2013* allows the Secretary of State to extend the licence regime governed by the Authority to

[10] Ofgem (2019) Switching Compensation Presentation
[11] Citizens Advice (2018) When Brokers go Rogue

TPIs. The CMA in its 2017 *Digital Comparison Tools* study said the regulatory framework in energy looked "less effective" and called for an activities-based form of regulation.[12] As recently as 2018 Ofgem acknowledged that in relation to TPIs "protections need to evolve so that risks to consumers can be managed in an effective and proportionate way".[13] Given the speed with which the market is moving, the time for action is now to explicitly bring TPIs within the sectoral remit of Ofgem.

We are commissioning research into the legal protections afforded to consumers using TPIs and consumer expectations on protections, and look forward to sharing the results of this with the review team in the coming months.

While not an explicit area of focus of the review, we would add the issue of harms to heat network customers is a current and emergent trend. Research undertaken by Citizens Advice has shown that heat network consumers in vulnerable circumstances believe they are getting a worse deal and, due to the natural monopoly nature of heat networks, these consumers are unable to do anything to get a better deal. We've called for proposals by the end of 2019 for extension of Ofgem's powers to regulate heat networks and establish an independent consumer advocate for heat networks.[14]

Finally, other potential harms emerge around the issue of bundling. It is widely expected that in the long term energy offers will be integrated with other products and services. In a collaboration with the Energy Systems Catapult,[15] Citizens Advice recently considered the customer journey as people buy, use and experience problems with smart energy technologies. Three main themes emerging from the work - control, understanding and support when things go wrong. This also highlighted that it may naturally prove impossible to pre-empt and prevent all problems before they happen, so issues must be fixed fast.

4. Would it be beneficial to allow suppliers to specialise and provide products and services to targeted groups of customers? If so, how can this be delivered while balancing the need for universal service?

The policy objective behind the Duty to Supply - that suppliers cannot "cherry pick" desirable customers, leaving others unable to secure a good deal or supply contract - remains, in our view, an essential outcome in the supply market.

[12] CMA (2017) Digital comparison tools market study
[13] Ofgem (2018) Future supply market arrangements – response to our call for evidence
[14] Citizens Advice (2019) Keeping warm: the future of heat
[15] Energy Systems Catapult (2019) Smarter Protection

We would note that in practice, the current duty to supply does not guarantee that all consumers have equal access to the market. Suppliers can act to exclude certain types of meter/tariff type that are outside their target segment(s) by offering them uncompetitive prices. This is particularly evident for customers using prepayment meters, which have traditionally had a higher cost to serve and been more likely to be used by vulnerable groups.

Similarly - but less frequently - companies specialising in prepayment have priced their credit terms at higher levels. In both cases this strategy has been somewhat constrained by the introduction of price caps. Beyond pricing, suppliers also have a wide discretion to target certain customer types through their marketing and acquisition strategies. And more recently, suppliers have emerged with niche customer service offerings that are unlikely to be appropriate for certain customers.[16]

We recognise that to some extent, future energy models misalign with the duty to supply. Future energy models suggest the potential for specialised energy offerings which might be suitable only for certain groups of people. For example, a supplier focused on electric vehicles might not be well placed to supply customers without these.

In the short term, we think there could be sufficient scope to trial innovative business models through mechanisms such as BEIS-led innovation trials and expanded sandboxes. Current BEIS trials in areas such as smart energy systems are providing funding for a wide range of approaches and we would support continued efforts in this area, extending beyond a technology focus and to how such offerings can cater for consumers with characteristics that might otherwise exclude them. We think this is likely to be sufficient in the short term because it will take some time to resolve the "complex mix of requirements including industry systems, charging arrangements, codes and licences" beyond the retail market rules that are acting to inhibit innovation.

Likewise moves by code administrators to establish sandboxes in a coordinated fashion could also yield the space to trial new energy offerings in a clearly defined environment. The example of the FCA's sandbox has delivered positive moves towards greater competition and innovation by allowing an expanded range of exemptions from conventional regulations.[17]

Longer term, a future-facing modular regulatory approach may well necessitate a re-think in how the USO is delivered, especially as essential functions may, by then, be disaggregated. This would require particular consideration of the customer journey when moving into a new home, at the end of contracts, and

[16] Citizens Advice (2019) Why energy suppliers need to keep their customer phone services
[17] FCA (2017) Regulatory sandbox lessons learned report

when companies failed. However, in the short term we think it is currently unclear whether removing the duty to supply and replacing it with other alternative arrangements would, on aggregate, reduce costs and be a more efficient way of delivering the universal service obligation.

If such a move is, in the longer term, considered, it will need to be accompanied by concrete measures to engage as broad a section of consumers as possible, and guarantees for those that can't engage that they will always be able to access an appropriate energy supply and at a fair price.

5. Are incremental changes to regulation sufficient to support the energy transition and protect consumers? Or does this require a more fundamental reform, such as moving to modular regulation?

As recognised in the consultation document, thus far incremental efforts to reform regulation have delivered, at best, incremental benefits. Moves such as a principles-based approach to supplier communications have offered scope for innovation and better consumer outcomes, but very much within the supplier hub framework.

However, such approaches seem ill-suited to the scale of transition that will be necessary to achieve binding climate goals and ensure consumers are protected through that transition. In the longer-term, we agree with the arguments put forward to favour a modular approach to regulation. This would create a level playing field in which all companies face the same rules and consumers can expect the same outcomes.

This approach could also be more suitable to a future market with more diverse supply models, in which the range of activities companies undertake is much wider, and would be more flexible and future-proofed if these change over time.

We acknowledge the scale of change this would necessitate within the existing regulatory structures, but given the need to arrive on a future-proof solution, the question becomes when that work begins on an enduring regulatory solution, not if it is needed. Other concurrent workstreams such as the code review, delivering a consolidated administrative regime could act as a stepping stone in that direction.

We would welcome greater clarity on whether more than one of the consumer protection options under consideration could be introduced, and what the sequencing of this could be. Given the time necessary to consult on, legislate for, implement and monitor the impact of some options under consideration, such as new licences, such an approach risks being a medium-term answer, when

resources may need to be dedicated to a comprehensive, longer term solution. However, we recognise that should significant consumer harms emerge around certain activities - and these are unable to be ameliorated by other steps - then action may need to be taken more urgently.

We'd also welcome clarity on how proposals to reform the regulatory framework will interact with connected reforms already underway or planned. For example, the recent Smart Data consultation seeks views on introducing a cross-sectoral general authorisation regime for "Third Party Providers" . These are defined as services that use smart data to provide "innovative services for consumers". In response[18] to this we argued there are real advantages to this approach. At a fundamental level, a higher level of protection would be introduced than is currently in place. Such entities would then be brought within scope for compliance and enforcement activities from regulators. The approach would also minimise the risk of a protection gap from taking up bundled services across sectors through a TPP. However, it should also be recognised that there are often sector-specific rules, designed with a bespoke need in mind.

6. Are there any other potential market distortions we should be considering as part of our review?

A distortion that is by now an established part of the current market, that is not explicitly addressed in the review, is the consequences of supplier failure.

This leads to consumers falling out of the protection framework, with debts being in some chased aggressively chased by administrators and no back-bill limit. There are also issues for the wider industry with the socialisation of credit balances, outstanding policy cost and other industry debts leading to a total estimated bill of £172mn up to June 2019.[19] Since publishing our analysis, three more suppliers have failed.

Recent reforms such as requiring a business plan for the initial period and a fit and proper person test are welcome. We also generally support the direction of travel by Ofgem in the second phase of the review, to look at ongoing requirements on supplier and exit processes. But government should also act - particularly by amending the schedule for making Renewable Obligation payments and ensuring all customers are protected from aggressive debt practices if their supplier fails.

[18] Citizens Advice (2019) Smart Data Citizens Advice Consultation Response
[19] Citizens Advice (2019) Picking Up the Pieces

However, longer-term, given the increasing range of participants expected to be involved in the future retail market, including non-conventional suppliers, the consequences of this trend merit consideration. The nature of the protections provided under the Supplier of Last Resort process may need to be reviewed, especially as more bundled products and services emerge, or offerings which require large credit balances. This would support the insurance principle set out in then BEIS Secretary Greg Clark's November 2018 "After the Trilemma" speech. [20]

7. Would removing the thresholds for the Energy Company Obligation and Warm Home Discount help remove imbalances in the retail market, and could this be done without significantly increasing barriers to supplier entry or expansion in the retail market?

In our view, thresholds for these obligations distort competition, by increasing the costs of obligated suppliers, thus putting them at a disadvantage compared to newer entrants.

We have already supported lowering the thresholds for these schemes to avoid this distortion[21] and, in the case of the Warm Home Discount, ensure all consumers can access the benefits. It causes significant difficulty in the customer journey advising clients on how to conduct an energy switch, necessitating warning them that they risk losing £140 from the WHD, thus wiping out much of their projected savings or putting them off switching altogether.

We have also seen examples of suppliers opting to stay below these thresholds as a business strategy, allowing them to continue to offer attractive acquisition tariffs.

Thresholds could be reduced incrementally, so as to monitor the impact on the wider market and ensure innovation and new entry is not being unduly inhibited. We have also previously highlighted the need for enhanced monitoring of suppliers about to cross regulatory thresholds in our supplier licencing review response.[22]

We recognise that this would only be achievable alongside action to ease delivery of these policies, such as the ECO buy-out proposal and greater data-matching for WHD.

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[20] BEIS (2018) After the Trilemma
[21] Citizens Advice (2019) Citizens Advice response to Warm Home Discount Scheme 2018/19 consultation
[22] Citizens Advice (2019) Citizens Advice Response to Ofgem's Supplier Licensing Review

8. How could the delivery burden on suppliers from the Energy Company Obligation be reduced, for example through the introduction of a buyout mechanism?

In the short term, a buy-out mechanism offers a credible solution for the issues of ECO delivery for smaller suppliers that have been documented, in either struggling to meet their obligation, or having to pay over the odds to a competitor with established energy efficiency routes to market. Such a solution could support other innovative industry-led mechanisms, for example the proposed ECO Switch pilot programme, which envisages a tripartite bid system.[23]

In the longer term, we have called for the government to move beyond the current supplier-led model once the current ECO period is over in 2022. Energy suppliers by their innate business model are not incentivised to reduce consumption, they also often lack the data to identify suitable households and measures, or deliver them in a holistic way.

Research for Citizens Advice has identified that an effective replacement scheme could be local-authority led with an area-based approach, overseen by a national delivery body and funded through general taxation.[24]

A role could also be found for local distribution system operators, given they have an enduring relationship with customers though for example, priority service registers, and - through mitigating network constraints - have an incentive to aid reduction in usage.

9. What effect does the range of Energy and Climate Change Policy Levies have on the retail market?

The levying of policy costs on consumer bills is generally not a progressive policy. Often fuel poor homes with the worst energy performance certificate ratings will naturally have far higher usage compared to ultra-modern homes with a high energy efficiency.

Therefore levying costs on bills on a usage basis creates unfair outcomes that risk escalating in the future, as homes able to afford battery storage and solar

[23] Pixie Energy (2019) ECO Switch proposal
[24] IPPR (2018) Beyond ECO

will be able to arbitrage and self-consume, lowering their bills - and their policy cost contribution - further.

There is also a broader implication in that current policy cost exemptions distort best buy tables. These are usually topped by new entrant suppliers that benefit from those exemptions. They may therefore be dulling efficiency incentives. This allows some engaged consumers to effectively opt-out of paying policy costs, although this is not commonly understood by consumers. Because the more affluent are more likely to be engaged, this aggravates the existing underlying problem of paying for policies through bills being regressive.

In the short term, the question of substantive removing the cost of bearing such levies for energy-intensive industries to the tune of 85% would seem to violate a "polluter pays" principle of funding the low-carbon transition and it could be explored whether this approach is equitable on an enduring basis. The current exemption regime may create competitive distortions between those firms who are eligible for the existing exemption and those who are not. It also increases costs for non-exempt non-domestic and domestic customers, with a best estimate of £160/ year cost for a small business and a total impact for the domestic market of tens of millions per year.[25] This would also seem contrary to the "no free riding" principle of all participants paying their fair share of system costs set out by then BEIS Secretary Greg Clark in his November 2018 speech.

Levying policy costs as a pass-through cost on suppliers also increases risk in the market when unpredictable policy outcomes occur. For example, the ECJ State Aid-imposed Capacity Market standstill has led to a situation where suppliers are uncertain when they will have to resume payments. This is in addition to the broader forecasting complexity as recognised in the consultation document.

We are looking further into the question of "who pays" in a fair low-carbon transition and will contribute to this debate.

10. What actions could government take to reduce any negative impact of Energy and Climate Change Policy Levies?

In the short term, as we have previously advocated, we would be in favour of increasing payment frequencies for policy levies.

The biggest single socialised cost from recent supplier failures has been the Renewables Obligation, which is paid annually.[26] Increased payment frequencies

[25] BEIS (2016) Widening eligibility for energy intensive industries in the schemes providing relief from the indirect costs of renewable energy policies impact assessment
[26] Citizens Advice (2019) Picking Up the Pieces

would give greater visibility on costs to suppliers and mitigate risks to the wider market. This is especially pertinent as it seems certain mutualisation is again set to be triggered in the next RO compliance period.

We agree that there are not significant competitive distortions that arise directly from these schemes.

11. Do you agree that now is not the time to make further changes on system and network cost recovery, metering and access to data as part of this retail market review?

We would agree that given the point at which industry programmes are at, the Retail Market Review is not the vehicle through which to make changes.

System and network cost recovery questions are being addressed through the Targeted Charging Review Significant Code Review and the Network Access and Forward-Looking Charges Significant Code Review and we look forward to continuing to engage with those processes.

We have advocated for an extension to the smart meter roll-out to 2023[27] to help ensure that customer experience and quality is incentivised over speed. However, given the continuing roll-out, the complexity of opening questions around meter ownership outweighs potential benefits. In the longer term, if a modular approach to regulation is taken then separating out the metering function is one option that could be considered.

As set out before, access to data is a major issue that must be addressed in order to facilitate innovation and effective consumer participation in new energy products and services. A strong data privacy framework is needed to give consumers transparency and control over how their data is used.

We are concerned at recent Ofgem statements that they are minded to eliminate half-hourly settlement consumer opt-outs for anything aside from direct marketing. Consumers currently have the ability to opt-out of smart meter data collection of any detail greater than a monthly read, so this would represent a significant reduction in consumers' ability to control how much personal data they share. Forthcoming research on consumer attitudes to smart meter data has found that consumers feel reassured by the existence of the opt-outs (89% consider the ability to opt-out important) even where they do not make use of them.[28]

[27] Citizens Advice (2019) Smart meter rollout must be extended says Citizens Advice
[28] Citizens Advice (2019) Citizens Advice response to Ofgem's Decision for access to half-hourly electricity data for settlement purposes

We would also express disappointment that the midata programme has not delivered the promised benefits to planned timescales.

12. What total costs do suppliers face with regards to bad debt and supporting consumers who struggle to pay for their energy?

We do not have access to internal company information to provide quantitative evidence in relation to bad debt and supporting consumers who struggle to pay for their energy.

However, qualitatively, we can offer some thoughts on where costs might arise and how these differ between different types of market participant.

As a broad trend, costs will include the extra costs of identifying and engaging customers in potential payment difficulty, including through a broad range of communications methods. There are also the costs associated with prepayment payment methods, with the higher cost to serve widely recognised, including in price cap calculations. Other costs include accounting for peoples specific circumstances, such as disability and English not being a first language.

We recognise the risk that some incumbent suppliers may have an increasingly high proportion of high cost to serve customers as their customer numbers generally decline (assuming current trends continue). There are also valid reasons to believe that larger legacy suppliers have more vulnerable customers and have had customers for longer - meaning there is logically more time for them to build up debts. Conversely, smaller suppliers are more likely to have poor billing practices that give rise to debts through not correctly billing, or failing to issue bills.

However, while debt services and support add a cost, it is vital that they continue, especially given broader trends of more customers falling into arrears and having issues dealing with debt repayments. Our own data shows local Citizens Advice clients with energy debt issues increased from 33,742 in 2017-18 to 40,957 in 2018-19.[29]

[29] Citizens Advice Energy Data Dashboard

13. How could any potential distortions related to high cost-to-serve customers be addressed, for example by the provision of additional support services for customers struggling to afford their energy?

The most common energy problem that consumers seek help from our local Citizens Advice offices is dealing with debt. Consumers struggling with their energy bills are often struggling to pay bills across multiple utilities and services and can find it difficult to seek help for all their debt problems. Ofgem has reported a rise in the number of consumers in arrears without an arrangement to repay.[30]

As a starting point, we believe there is more that can be done to achieve better outcomes for consumers within the existing framework. Our recent research with consumers in energy arrears showed that they didn't feel valued and respected by their supplier and that suppliers can be inconsistent across their communications with customers in arrears.[31] Suppliers should improve their standard debt communications and ensure these customers are offered a clear package of support. Ofgem should compel suppliers to trial new approaches to debt letters if this cannot be achieved voluntarily.

Regarding independent advice, the research also showed that people who are not engaging are likely to be in very difficult, complex situations. Independent advice could help them but they often have barriers to engagement. Suppliers need to overcome these by reframing independent debt advice and ensuring debt referral pathways work effectively.

Customers also need to be asked to repay debt in a fair and manageable way. We're concerned that Ofgem's Social Obligations Reporting shows large disparities in the amount of debt suppliers are collecting, with small suppliers collecting around three times as much as large suppliers, often through aggressive means. The average weekly repayment amount in 2017 was £14.58 for smaller suppliers and £5.39 for the six largest suppliers.[32]

Given these disparities we think that any competitive distortions related to debt could be lessened to some extent by tackling poor practice by smaller suppliers in this area. We welcome Ofgem's recent consultation on requiring support for PPM customers at risk of self-disconnection and self-rationing, as well as formalising rules that require suppliers to consider a customer's ability to pay when setting debt repayment levels. This should mean that there is a more level

[30] Ofgem (2018) Number of accounts in arrears where there is no arrangement to repay the debt, Vulnerability Report
[31] Citizens Advice (2019) Supply and Final Demand
[32] Citizens Advice (2019) Supply and Final Demand

playing field, as all suppliers are aiming for the same consumer outcomes when dealing with vulnerable people in debt and at risk of disconnection. If this action is taken we would expect to see the high repayment rates used by small and medium suppliers decline.

Another way to tackle this issue would be to make it easier for consumers to move supplier with a debt. The Debt Assignment Protocol (DAP) already enables PPM customers with a debt below £500 to switch. This should reduce a consumer's ongoing costs and make it quicker for them to pay off their debt. But most recent data showed that only 6,000 customer accounts a year used it to switch, and only around 5% of applications are successful.[33] For credit customers repaying a debt there is no facility to switch supplier. Action to improve this situation could include extending the DAP to credit customers, and trialling switching communications to indebted customers as part of the disengaged database trials to see if this had positive outcomes. This would need to be carefully controlled to ensure that customers were fully supported and not switched to companies with poor levels of service that could not support their needs.

The consultation also makes reference to working with industry to explore tools which would facilitate a more equitable distribution of the costs of dealing with the most extreme cases of debt across the market. We believe it is hard to take a firm position on what form this could take without the information on the scale of the issue and the main sources of the costs of dealing with these customers. Any intervention to facilitate this cost sharing would face considerable design challenges to ensure that it did not incentivise poor supplier practices on debt or inefficient costs.

14. Would addressing market distortions (for example size-based obligation thresholds for some policy schemes, supporting those who are struggling to afford their energy bills) help reduce incentives for suppliers to adopt pricing strategies that lead to excessive prices for loyal consumers? If so, to what extent (providing quantitative evidence, where possible)?

We do not have quantitative evidence to share on this issue. However, theoretically, if the need to recover fixed costs against the loyal customer base of incumbent suppliers is reduced, and the potential to offer attractive acquisition tariffs based on policy scheme distortions is diminished this could lead to a reduction in excessive prices for loyal customers.

[33] Ofgem (2018) Vulnerability Report

However, given the fundamental nature of much of the market to pursue and maintain EBIT, there equally remains a risk that even with distortions addressed, segments of the market will continue to pursue profitability through charging the maximum they are able to.

It is apparent from our work across consumer markets that issues around excess prices and loyalty penalties arise even in the absence of account number-based policy obligations on similar lines to the energy sector, with a total cost to the consumer of nearly £1,000 per year across six markets.[34]

15. What are your views on the measures being considered to address loyalty penalties in different markets? What approach or – combination of approaches – would be most effective in the energy retail market?

We have responded to this question through the framework of the options listed in the consultation document; those identified by the CMA as the most appropriate to prevent the emergence of loyalty penalties. We offer our thoughts on each in turn, considering them through a framework of principles we think should be applied to any approach before it is taken forward. In particular:

- what the likely impact of the approach would be on different types of consumers
- whether such an approach has been tried and tested, and
- the practicality of implementation.

Citizens Advice responded recently[35] to Ofgem's consultation on the framework for assessing whether conditions are in place for effective competition in domestic supply contracts. We are broadly supportive of the proposal to conduct a rounded assessment that considers a range of different market indicators and consumer outcomes in order to reach an overall view of whether conditions would allow for the cap to be lifted, rather than setting a prescriptive list of pass/fail tests. We consider however that there is a risk that the conditions against which the continuation of the cap will be decided - structural changes, competitive process and consumer outcomes - may not have been achieved by the end date of the legislation in 2023. We see the last of these in particular as the one on which most emphasis should be given. It is our view that the litmus test for deciding if the cap should be removed is whether most consumers will receive good outcomes on the things they care about: on price; on quality of

[34] Citizens Advice (2018) The Cost of Loyalty
[35] Citizens Advice (2019) Response to Ofgem's consultation on the framework for assessing whether conditions are in place for effective competition in domestic supply contracts

service; and in having a choice of products that meet their needs and preferences.

As we set out below, the cap has achieved significant positive impact, without many of the negative implications that were raised as concerns prior to its implementation. In the scenario in which the conditions for effective competition as set out have still not been achieved by its expiry, an evaluation must be conducted as to whether legislation should be brought forward to extend a broader cap until the conditions for effective competition are in place.

Targeted interventions to cap prices

In terms of impact, our view of the current default energy price cap is that it is performing well in addressing the loyalty penalty in the energy sector. The cap is still in its early days, but Ofgem's analysis suggests that it may benefit consumers by ~£1.2bn per year.[36] Switching remains healthy, with the switching rate for the first seven months of 2019 up 10% year-on-year.[37] Quality of service remains largely unaffected, though this will require monitoring given a focus of cost-cutting and efficiencies for a number of suppliers has been in their customer service divisions.

The minimum expectation we would have is that after the broader price cap ends in its current form, which as outlined in the legislation would be 2023 at the latest, is that enduring price protection will be necessary for people in vulnerable circumstances. As well as encompassing any remaining non-smart prepayment market, this could include Warm Home Discount recipients. This would have the benefit of having been implemented already for a number of years, with practical experience of the current cap in practice to draw on. It is also, in terms of implementation, within Ofgem's existing powers to be able to deploy, as could be seen from the extension of the PPM cap to WHD recipients in January 2018 without the need for additional legislation.

Principles-based approach

A principles-based approach to pricing is the approach that seems most untested and exposes consumers to the greatest risks.

A similar, reputational approach that was previously taken was Ofgem's Supply Market Indicator (SMI), introduced in 2013, which offered a view on recent and possible future cost trends suppliers face and how they change over time, with a

[36] Ofgem (June 2019) Consumer impact report, financial year 2018-19
[37] Energy UK (August 2019) Summer switching on the rise

reputational incentive to price tariffs in relation to this metric. The Supply Market Indicator was subsequently replaced with a Supplier Cost Index in 2017, that provided a backward-facing look at price trends (this measure was suspended in 2018). In 2017, Ofgem widely publicised this data to set an expectation that supplier prices should not rise, and was critical when prices subsequently did.[38][39] We're not aware of any evidence that this approach was successful in affecting pricing decisions taken by suppliers.

Although principles-based rules would be backed by tougher sanctions, we are still concerned that they are unlikely to be effective. Given the resource challenges of estimating a fair cost of supply twice a year across the whole market for the default price cap, it would seem there would be exponentially greater monitoring, compliance and enforcement implications to determining whether each supply offer represents a reasonable and fair pricing approach. There would seem a risk then that only the most clear cut egregious pricing outliers would fall foul of such an approach. There is also the clear risk of detriment that this approach is ex-post, so by its very nature, when regulatory action is taken, consumers will have already suffered harm.

While a principles-based approaches that only looked at relative price spreads and clamped down on outliers may be more applicable to other markets, in energy it would suffer from the same implications as the proposals for a relative price cap, risking suppliers withdrawing their best deals as an unintended consequence.

We think it would also be difficult to trial the approach and test its implications before wider market application.

Collective switching

A data-driven approach of helping consumers get a better deal, such as collective switching, has a growing evidence base of positive consumer impact.

The disengaged database remedy trials run by Ofgem have seen a significant uplift in engagement through mechanisms such as personalised price projections. Engagement and switching levels of participants have been significantly higher than the control groups, and there is no reason to suggest this could not be improved. Also encouraging has been the willingness of consumers in vulnerable circumstances to engage with this method, making up 40% of those that switched in the February-April 2018 trial, with an average

[38] Guardian (2017) Big six energy suppliers warned not to raise prices any time soon
[39] BBC (2017) EDF raises electricity prices for second time this year

saving of £300/ year achieved.[40] There is also evidence that this approach can deliver lasting benefits, with a reswitch rate one year on for participants of 38%, once contacted.

However, we are of a view that such an approach is currently not trialled sufficiently to apply it across the market, although they have been increasing in scale. We are keen to see a wide range of customer types included in these trials, and for follow up research to determine whether they have an enduring impact on behaviour.

There are also broader data privacy implications. Our recent future retail workshops with consumers revealed a broader scepticism about what data was being collected, why, and whether pricing changes might disadvantage them in the future. Consumers will need to trust the messages they receive and the processing of people's data in this way will need to respect data privacy and marketing choices, while not unduly excluding consumers who may benefit from these communications.

The implications are significantly magnified if an opt-out collective switch model is considered. This could deliver greater consumer benefits by securing a broader saving, but violate the principle of consumer choice that people value highly, again revealed by the workshops. There are significant risks, for example that consumers could be switched to an inappropriate tariff or a supplier whose service did not meet their needs. These would need to be considered in the design of any opt-out switching approach, and tested to understand consumer reactions to the process.

Furthermore, on a practical level, faster switching reforms and changes to the switching infrastructure would likely have to be successfully accomplished to accommodate such a volume of switches. There is also the broader question of whether perpetual market churn is the ideal enduring approach, rather than trying to achieve a market where consumers can be content on a long term basis with their provider and their prices.

Bolder enforcement of consumer law

We are strongly supportive of greater application of the broader protections afforded under consumer law to the energy market, particularly entities, such as TPIs, not currently covered by sectoral regulation.

[40] Energyhelpline (2018) Results of disengaged database remedy trials

We particularly note the commitment to empower the CMA to decide itself whether consumer protection law has been broken and then impose fines for wrong doing directly, and look forward to the detail of the proposals in the forthcoming Consumer White Paper.[41] More proactive enforcement of consumer law in the energy sector also seems the remedy most able to be combined and pursued in harmony with other approaches. However, as with principles-based rules, it is likely that only the most egregious practices will be tackled, and only after the fact.

In summary, these approaches will differ in how quickly and effectively they could be implemented. A longer lead-in time offers greater scope to consider and trial more innovative loyalty remedies, a more short term requirement for a solution necessarily means a tried and tested method would need to be adopted.

16. What other approaches could be adopted to ensure loyalty penalties do not reemerge?

Based on our experience in other markets where loyalty penalties exist, we think the retail price cap is likely to be best suited to the energy market, and other approaches may not travel well. Citizens Advice has highlighted the loyalty penalty in other markets, particularly through our September 2018 super-complaint to the Competition and Markets Authority (CMA).[42]

This found that 8 in 10 bill payers are currently charged significantly higher prices for remaining with their existing supplier in at least one essential market. Our 2018 research found that, across non-energy markets, the loyalty penalty costs these consumers more than £4 billion a year. One year on from the submission of the super-complaint, we are waiting to see the full remedies Ofcom and the Financial Conduct Authority (FCA) will introduce to protect consumers in their respective markets.

But we have some initial lessons from these markets. Ofcom has persuaded almost all mobile phone providers to sign up to a voluntary agreement they estimate will tackle 80% of the total consumer harm. However, this was for an estimated consumer harm of £180m a year. It is extremely unlikely that a similar voluntary agreement could be effective in the energy market, where billions of consumers' money is at stake.

[41] BEIS (2019) Letter from Secretary of State Greg Clark to CMA Chief Executive Dr Andrea Coscelli
[42] Citizens Advice (2018) Loyal consumers are being ripped off to the tune of £4.1 billion

We have also proposed or supported supply-side remedies in other markets. For example, we support the FCA introducing a Basic Savings Rate in the cash savings market and have proposed that the FCA consider relative restrictions on prices in the mortgage market.[43] But, given the different competitive dynamics in the energy market, it is unlikely that either of these proposals would work well. Overall, we have not ourselves devised nor seen others propose a better solution to the problem of loyalty penalties in the energy market than the existing retail price cap.

Our submission also highlighted that regulators should work together to develop a common approach to ensuring vulnerable groups do not end up on bad deals across essential markets. Our research found that there are some characteristics which are associated with a greater risk of facing the loyalty penalty. For example, our research found that people with mental health problems are 3 times as likely as people with no mental health problems to think it's too difficult to switch contracts in essential service markets.[44] It is possible to identify these traits and consider whether there are common solutions that are applicable cross-sector.

Recently we published research on the minimum standards of support that people with mental health problems should receive across water, energy, telecoms and financial services.[45] We previously found that, where poor mental health reduces someone's ability to carry out daily activities, this can result in costs of £1,100 - £1,550 each year as a result of a combination of inaccessible services, inadequate regulatory protections and lack of tailored support. We've called on Ofcom, Ofgem, Ofwat and the FCA to introduce minimum standards in four areas, the most pertinent of which to the loyalty penalty is the area of debt management. If a customer with a mental health problem misses 2 consecutive bill payments, providers should proactively ensure they are on the best deal. Providers should contact the customer about this in a way that works for that customer and highlight clearly that the customer could be saving money (for example, sending them an email, or sending a text asking to arrange a telephone call).

[43] Citizens Advice (2018) Improving the Cash Savings Market
[44] Citizens Advice (2018) Excessive prices for disengaged consumers: A super-complaint to the Competition and Markets Authority
[45] Citizens Advice (2019) Counting on it

17. What protections or support may be required to engage consumers in vulnerable situations in the future market?

As the retail market changes it is important that Ofgem and BEIS take action to ensure everyone can access a good range of services and products that meet their needs. In a more complex, specialised market there may be new ways in which consumers are likely to experience vulnerability. We've previously called for Ofgem to work with stakeholders to build an inventory of the emerging ways that future markets and systems might generate unfairness and leave consumers behind in the energy transition.[46]

Some changes in the retail market may have much more significant impacts on how vulnerable consumers need to be protected. This could include "meter splitting", whereby multiple companies provide electricity to a single customer, or "mobile metering" of electric vehicles. If the system did move away from being based around a fixed supply point matched with a single supplier, many of the current protections and processes for vulnerable consumers would need to be reviewed.

The evolution of the future retail market means it is likely that consumers with characteristics not conventionally seen as vulnerable will need assistance in engaging in the market.
We commissioned research[47] to consider the groups that may face particular barriers, as well as consumer perceptions of the type of future supply model like time of use tariffs, peer to peer trading, and energy as a service, that are likely to become common.

The highest barriers to engagement that also affected the greatest number of people were identified as those financially unable to invest in new technology, the digitally disengaged who would be unable to sign up to and manage digital services, and those that had low trust in the market or were not incentivised to engage.

Other characteristics also had a significant bearing though, for example those in the private rented sector who would struggle to convince a landlord to install new equipment, or those nervous about granular energy consumption data being accessed by third parties.

Our research has also shown it is not just a lack of digital skills that prevents unconfident consumers from using digital comparison tools, they also have a

[46] Citizens Advice (2018) A price control for everyone
[47] Citizens Advice (2019) Future for All

general distrust in the market and believe things will go wrong when using these tools.[48]

We have put forward a series of recommendations, with some of the key ones including:

- One in four (26%) UK adults don't have a saving or investment product. Therefore the government should explore provision of grants and low-interest loans for new energy technologies
- 5.3 million UK adults are non-internet users. Energy service providers should offer non-digital ways of signing up, staying in contact and managing services.
- 186,000 energy issues were raised with local Citizens Advice in the last year. Policymakers and regulators should ensure regardless of how people engage with the energy market there is a level playing field in how they are able to access advice and redress.
- 4.5 million households lived in private rented accommodation in GB in 2017. Innovators should consider how incentives for new energy technologies can be split between tenants and landlords, and regulatory barriers to this should be minimised.
- 51% of respondents in upcoming research were not comfortable sharing near real-time energy usage data. Consumers should retain access to and control over their energy usage data by default

A route to market and support for consumers who are digitally disengaged will be needed for the foreseeable future. Ofgem's trials with disengaged customers have demonstrated the success of offline channels with particular vulnerable groups and we support this work being taken forward.

We think consumers should be equally protected no matter where they buy their energy. Non-licensed TPIs are likely to become more important in future considerations of vulnerability, especially where they take on more of the primary customer relationship.[49] For example, some auto-switching services are already taking on a role as the portal through which key communications are relayed. In this context it may be appropriate for TPIs to take steps to identify vulnerability, take steps to help meet the needs of these customers and, subject to data privacy rules, share information on vulnerability with the relevant licensed supplier and network. Otherwise, the current protection framework in which these responsibilities lie only with suppliers and, to a lesser extent, networks, is likely to be undermined.

[48] Citizens Advice (2017) The future of digital comparison tools
[49] Citizens Advice (2019) Future for All

The CMA has recommended that Ofgem become the designated regulator for district heating.[50] The regulatory design for this market will need to include a consideration of vulnerability, the extent to which gas and electricity market protections are applicable, and any specific risks consumers using this technology face which may need additional rules. In our recent report around the future of heat, we have stated the need for a statutory consumer advocate to be established for heat networks, this will help provide dispute resolution and targeted assistance for consumers in vulnerable situations experiencing problems.[51]

Network companies should also take on a growing role in vulnerability as we move to a future retail market. We would like to see energy networks become better at identifying customers in vulnerable circumstances - particularly transient vulnerability. DNOs can and should improve the way they identify customers who should be on the PSR.

"Social obligation" activities have had good intentions, but have often been poorly evaluated or assessed if they are delivering the right support to the right people. We would like to see network companies engaging with consumers in vulnerable situations as part of their ongoing engagement and employing best practice from the charity sector.

[50] CMA (2018) Heat networks market study
[51] Citizens Advice (2019) Keeping warm: the future of heat