

# The Retail Market Review – Draft Impact Assessment for the updated domestic proposals

## Consultation

**Reference:** 135b/12  
**Publication date:** 26 October 2012  
**Response deadline:** 21 December 2012

**Contact:** David Hunt, Head of Retail Markets  
**Team:** Retail Markets  
**Tel:** 020 7901 7000  
**Email:** [rmr@ofgem.gov.uk](mailto:rmr@ofgem.gov.uk)

### Overview:

The aim of the Retail Market Review (RMR) is to encourage and equip consumers to get the best deal from the energy market. We are looking to rebuild trust and confidence in the market so that more people are inclined to engage, and to put in place measures so that consumers are better able to choose the deal that suits them. A combination of the competitive pressure this creates and additional consumer protection we introduce should mean that the market better serves the interests of consumers.

This document sets out our updated RMR proposals for the domestic market, following our consultation in December 2011. Our proposals for the non-domestic sector are set out in a separate document we have published today.

We have looked to make best use of our statutory powers to address the concerns we have about the domestic market. If, following consultation, we consider that our proposals do not have a realistic chance of addressing the concerns identified due to industry opposition or otherwise, we retain the option that we have flagged in our previous consultations of referring the market to the Competition Commission for a Market Investigation Reference.

These proposals represent an important development in the functioning of the retail market and it is important to allow stakeholders adequate time to present their views. Our deadline for responses to this consultation is 21 December 2012.

## Context

---

Ofgem’s principal objective is to protect the interests of both existing and future energy consumers. The RMR aims to make the market better at serving the interests of consumers and enable individuals to get a better deal from energy companies.

This document presents our draft assessment of the impacts of the updated RMR proposals for domestic consumers.

This draft impact assessment consultation is a supplementary document to the RMR updated domestic proposals consultation document, which presents our proposals on seven policy areas, as well as a number of interrelated issues. Proposals for the non-domestic market are published in a separate consultation document.

In conjunction with the consultation on our proposals and the draft impact assessment, we also publish the draft legal text for new and amended licence conditions. We have also published our latest consumer research undertaken to inform our findings.

The RMR has links with our Consumer Vulnerability Strategy,<sup>[1]</sup> Smarter Markets Strategy,<sup>[2]</sup> and our work on liquidity.<sup>[3]</sup> We are working to ensure our RMR proposals work in a complementary manner to these initiatives.

Alongside this document we are publishing our decision not to re-insert the undue discrimination licence condition (SLC 25A).<sup>[4]</sup>

## Associated documents

---

All documents are available at [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

- The Retail Market Review – Updated domestic proposals, Reference: 135/12, October 2012.
- Supplementary appendix to: The Retail Market Review – Updated domestic proposals, Reference: 135a/12, October 2012.

---

<sup>[1]</sup> For more information see the following link:

<http://www.ofgem.gov.uk/Sustainability/SocAction/Pages/SocAction.aspx>.

<sup>[2]</sup> For more information see the following link:


<http://www.ofgem.gov.uk/Markets/sm/strategy/Pages/Strategy.aspx>.

<sup>[3]</sup> For more information see the following links:

<http://www.ofgem.gov.uk/Markets/WhlMkts/CompanEff/Pages/CompanEff.aspx> and


<http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>.

<sup>[4]</sup> Our decision letter will be published alongside this document, and will be placed at the following location: <http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Pages/rmr.aspx>.



## The Retail Market Review – Draft Impact Assessment for the updated domestic proposals

- Draft domestic licence conditions for the Retail Market Review proposals, Reference: 135c/12, October 2012.
- Ipsos MORI, Prompting engagement with and retention of written customer communications, Final report prepared for Ofgem, October 2012.
- SPA Future Thinking, Price Increase Notification Letters, Summary Box on Bills, Tariff Information Labels and Annual Statements, Report of consumer testing to support template development, October 2012.
- Ipsos MORI, Consumer views on Tariff Comparison Rates, Findings from the Ofgem Consumer First Panel Year 4 and new participants: Fourth workshops (held in August 2012), October 2012.
- SPA Future Thinking, Options for cheapest tariff messaging on customer communications; Report of qualitative research, September 2012.
- Insight Exchange, Consumer research and collaborative engagement on the proposed Standards of Conduct – Domestic Customers, September 2012.
- Ipsos MORI, Consumers' views of price comparison guides and tariff structures, September 2012.
- Ipsos MORI, Consumer engagement with the energy market, information needs and perceptions of Ofgem, Findings from the Ofgem Consumer First Panel Year 4: second workshops (held in March 2012), October 2012.
- Ipsos MORI, Customer Engagement with the Energy Market - Tracking Survey 2012, April 2012.
- The Standardised Element of Standard Tariffs under the Retail Market Review, February 2012, Reference: 11/12
- Ipsos MORI, Ofgem Consumer First Panel Year 4, Findings from first workshops (held in October and November 2011), January 2012
- The Retail Market Review: Domestic Proposals, December 2011, Reference: 116/11
- The Retail Market Review: Draft Impact Assessment for Domestic Proposals, Supplementary Appendices, December 2011, Reference: 116A/11



## The Retail Market Review – Draft Impact Assessment for the updated domestic proposals

- The Retail Market Review – Non Domestic Proposals, November 2011, Reference: 157/11
- The Retail Market Review – Draft Impact Assessment for Non Domestic Proposals, November 2011, Reference: 157A/11
- Retail Market Review: Energy bills, annual statements and price rise notifications; advice on the use of layout and language. A Research Report For Ofgem, Lawes Consulting and Lawes Gadsby Semiotics, November 2011
- Creative Research, Tariff Comparability Models, Volume 1 and 2 - Consumer qualitative research findings, October 2011
- Ipsos MORI, Consumer reactions to varying tariff comparability models, Quantitative Research conducted for Ofgem, 18 October 2011
- Ofgem’s Retail Market Review – update and next steps (non-liquidity proposals), June 2011
- Ofgem’s Retail Market Review – update and next steps (liquidity proposals), June 2011
- The Retail Market Review – Findings and Initial Proposals, March 2011, Reference: 34/11
- Ofgem Consumer First Panel, Year 3 2010/11, Findings From The Second Set Of Workshops, Opinion Leader, March 2011
- Ipsos MORI, Customer Engagement with the Energy Market – Tracking Survey, March 2011
- FDS International, Vulnerable Customer Research, March 2011
- Energy Supply Probe - Proposed Retail Market Remedies, August 2009, Reference: 99/09
- Ipsos MORI, Report on the 2009 Consumer Conditions Survey Market research survey conducted for Consumer Focus, March/April 2009
- Ofgem Consumer First Panel, Research Findings from the Second Events – Billing Information and Price Metrics, March 2009
- Ofgem Consumer First Panel, Research findings from first event, January 2009
- Energy Supply Probe - Initial Findings Report, October 2008, Reference: 140/08

# Contents

---

<b>1. Introduction</b>	<b>7</b>
Barriers to consumer engagement and effective competition	7
Our proposal	9
Summary of impacts	10
<b>2. Objectives and approach</b>	<b>13</b>
Objectives for the RMR proposal for domestic consumers	13
Approach to the IA	14
Structure of the document	15
<b>3. Impacts on consumers</b>	<b>16</b>
Tariff complexity	16
Impact of proposals on tariff complexity	18
Poor information	23
Impact of proposals on poor information	24
Lack of consumer trust	30
Impact of proposals on lack of consumer trust	31
Engagement: quantity and quality	33
Impact of proposals on engagement	34
<b>4. Impacts on competition</b>	<b>37</b>
Impacts in terms of supplier rivalry in the market	37
Overall impact across suppliers	37
Differential impacts across suppliers' incentives and ability to compete	40
Impact on barriers to entry and expansion and small suppliers	41
Impacts on innovation	44
Overall impact across suppliers	44
Differential impacts across suppliers	46
Approach to the quantitative assessment of costs	47
December 2011 consultation responses	47
Approach to quantifying costs	48
The proposal and the counterfactual	48
Estimating costs	49
Ongoing costs	50
Questions on implementation costs	51
<b>5. Impacts on sustainable development</b>	<b>53</b>
Protecting vulnerable consumers and eradicating fuel poverty	53
Insight into vulnerable consumers	53
Further measures	55
Impact on fuel poverty	56
Managing the transition to a low-carbon economy	56
Consumer awareness of energy usage	57
Green tariffs, Green Deal and Energy Company Obligation	58
Smart metering	58
<b>6. Impacts on health and safety</b>	<b>62</b>
<b>7. Risks and unintended consequences</b>	<b>63</b>

Risks	63
Regulatory risk for suppliers	63
Risk of continuing consumer disengagement	64
Risk of consumer frustration	65
Risk of consumer detriment	66
Possible unintended consequences due to suppliers’ responses	67
Frustrate strategies	67
Non-compliance	71
<b>8. Assessment of alternative options</b>	<b>72</b>
Supplier’s cheapest deal	72
Developments since December 2011 proposals	72
Options considered	73
Tariff Comparison Rate	76
Developments since December 2011 proposals	76
Options on the methodology for TCRs and personal projections	76
Tariff simplification	86
Developments since December 2011 proposals	86
Options considered	88
Clearer and simpler information	91
Developments since December 2011 proposals	91
Standards of Conduct	98
Developments since December 2011 proposals	98
Options Considered	99
Protecting Consumers on Fixed Term Offers	104
<b>Appendices</b>	<b>111</b>
<b>Appendix 1 - Consultation questions</b>	<b>112</b>
<b>Appendix 2 – Evidence on barriers</b>	<b>113</b>
Tariff complexity	113
Evidence of tariff complexity	113
Causes of tariff complexity	114
Poor information	116
Evidence of poor information	117
Causes of poor information	119
Lack of consumer trust	120
Evidence of lack of consumer trust	120
Causes of lack of consumer trust	122
Switching and engagement: quantity and quality	124
Hassle of switching: cause and evidence	124
Lack of switching: evidence and cause	124
Costs of switching: evidence and cause	125
<b>Appendix 3 - Bibliography</b>	<b>126</b>

# 1. Introduction

---

## Chapter Summary

In this chapter we describe the purpose of this document. We outline the key barriers to consumer engagement and effective competition in the energy retail markets for domestic consumers that are the basis of our proposal. We also summarise our proposed package of measures, and set out the summary of the key impacts.

1.1. This document supports our accompanying consultation document on our proposal to empower consumers and improve consumers' trust in the gas and electricity retail market. It sets out our draft Impact Assessment (IA) of our proposed package of measures to enhance effective domestic consumer engagement, and also to increase effective competition in the retail energy markets in Great Britain (GB).

1.2. The purpose of this IA is to explain our draft proposal to introduce a package of measures covering the supplier cheapest deal, a Tariff Comparison Rate (TCR), tariff simplification, clearer and simpler information, the Standards of Conduct (SOC) and protection of consumers on fixed term offers. Our preliminary qualitative analysis indicates that our proposed package of measures is likely to provide a net benefit to consumers.

## Barriers to consumer engagement and effective competition

1.3. In the March and December 2011 Retail Market Review (RMR) consultations, we set out our concerns in relation to the number of consumers currently disengaged from the energy market.<sup>1</sup> Lack of appropriate information and growing complexity of pricing information is making engagement increasingly difficult. This has resulted in a large number of sticky consumers.<sup>2</sup>

1.4. Through our research and consultation process, we have identified a number of barriers that inhibit effective consumer engagement. Many consumers feel frustrated with the energy markets,<sup>3</sup> have difficulty in identifying the best alternative for their circumstances, and find it difficult to make well-informed decisions.

---

<sup>1</sup> In our latest tracking survey approximately 64% of consumers report never having switched supplier for gas or electricity - Ipsos MORI, (April 2012), 'Customer Engagement with the Energy Market Tracking Survey 2012'. This figure should be approached with some caution because it is reliant on respondents' ability to recall their past behaviours, and our analysis of trends over time suggests the tendency to under report previous switching behaviour is increasing. Nevertheless, it does suggest that a majority of consumers perceive themselves to have been largely inactive in the market.

<sup>2</sup> Sticky consumers are those that choose not to switch, cannot switch due to their circumstances, or are put off switching due to other features of the market such as tariff complexity.

<sup>3</sup> This is the case especially in the face of rising prices.

1.5. The key barriers that we have identified to effective consumer engagement and to competition in the energy retail market, are:

- **Tariff complexity:** The quality of consumer engagement is contingent on consumers being confident they can navigate through the market, and comfortable that they understand the options available to them. The complexity of tariffs contributes towards the perception of switching as a hassle and means that potential savings are unclear. It also contributes to the lack of consumer trust (see below) as some consumers believe this complexity is a deliberate measure to prevent consumers from finding the best deal for them.
- **Poor information:** Key information is not always provided to them, and the information that is provided is frequently generic or unclear. For example suppliers do not always bring the principal terms of a contract to their customers' attention. While this was a key issue leading to the introduction of some of the Standard Licence Conditions (SLC) following the 2008 Energy Supply Probe (Probe), we have identified only limited improvements in market practices since then.<sup>4</sup> Without the provision of sufficient relevant information, consumers are unable to engage effectively with the market and make well-informed decisions.
- **Lack of consumer trust:** Many consumers do not trust the energy market, and have little confidence in how suppliers behave and treat their customers.<sup>5</sup> Lack of transparency has led these consumers to feel powerless in the face of suppliers' changes to prices and terms of energy contracts. They have a generic negative perception of suppliers and the energy industry, and believe that suppliers are much the same. Many consumers are, for example, sceptical of the benefits of switching, as they believe that the levels of potential savings from switching will be minimal or will not be fully realised over time.<sup>6</sup>

1.6. These barriers prevent consumers from engaging effectively in the gas and electricity markets. They represent a significant barrier to a fully effective competitive energy market. This is also likely to affect market participants, in particular smaller suppliers or potential new entrants, effectively representing a barrier to entry and expansion in the energy market. Appendix 2 sets out in more detail the evidence base and the causes for each of these barriers.

---

<sup>4</sup> This is based on Ofgem's internal evaluation of communications undertaken in 2010 and 2011. For SLC 23 and 31A we gathered evidence from the suppliers of the materials they were using for compliance with the conditions, and assessed them against the requirements of the licence conditions.

<sup>5</sup> Energy suppliers are more likely to be distrusted than trusted - Ipsos MORI (April 2012).

<sup>6</sup> Ipsos MORI (January 2012), 'Ofgem Consumer First Panel, Year 4 Findings from first workshops (held in October and November 2011)'. Ofgem's Consumer First Panel comprises around 100 consumers who are broadly representative of the British population. Panellists generally meet three or four times each year to explore a range of issues regarding Ofgem policy. Panel participants change every year.



## Our proposal

1.7. In the December 2011 consultation we proposed to address these barriers by promoting “at a glance” tariff comparisons across evergreen tariffs.<sup>7</sup> We also proposed a range of improvements to the information suppliers provide to their customers and the introduction of new SOC. There was support for our December 2011 consultation proposals on improvements to information. However, a large number of consultation respondents considered that those proposals could impose significant commercial restrictions on suppliers, could have significant implementation costs, and could lead to important unintended consequences.<sup>8</sup>

1.8. We have reconsidered those proposals in light of these responses, of the additional consumer research we commissioned, and of the additional stakeholder engagement we promoted over the last months. Our present proposed package of measures for tariff simplification, rules on fixed term tariffs, improvements to information, and SOC is designed to avoid the restrictions in choice for consumers without weakening the impact in addressing the barriers to engagement we have identified. We have also developed the TCR, and include in our package proposals for introducing the supplier cheapest deal information.

1.9. Our draft IA indicates that this package of measures can contribute to building effective consumer engagement. Our proposal includes the following elements:<sup>9</sup>

- **Supplier cheapest deal.** Suppliers will provide consumers with information about the cheapest tariff they have on offer for that consumer’s payment method and meter type, their cheapest tariff overall, and the projected amount the consumer would save should they decide to switch.
- **Tariff Comparison Rate.** We propose to introduce the TCR and personal projection as common currencies for comparisons of energy prices. Suppliers will be required to express each tariff they offer as a single number that captures the tariff’s relevant price elements. We also propose to introduce rules governing how suppliers calculate and provide the TCR and personal projections.
- **Tariff simplification.** Suppliers will be required to offer a limited number of tariffs to new customers. The charges and discounts for these tariffs must be simple and understandable. Where appropriate, we also propose that suppliers must close down tariffs not open to new customers where these offer poor value for consumers.
- **Clearer and simpler information.** We propose to prescribe the format and content of certain key pieces of information provided to consumers, for five routine communications: the Bill; the Annual Statement; the Price Increase

<sup>7</sup> An evergreen tariff is any tariff that is for an indefinite length.

<sup>8</sup> Including distributional effects across customer groups and the impact on independent suppliers and competition.

<sup>9</sup> The detail on each of the measures we are proposing is included in chapters 4 to 9 of the consultation document.

Notice; the new Tariff Information Label; and the End of Fixed Term Notice. Additionally, we propose that elements of the language used within these communications be standardised across suppliers.

- **Standards of Conduct.** Suppliers (and their representatives) will be required to meet a prescribed SOC in all of their interactions with domestic consumers. This represents a principles-based approach to regulation, as we are not prescribing the exact actions suppliers should take in relation to the SOC. Rather, it will be suppliers' responsibility to treat consumers fairly and consider how best to meet consumer needs in the context of the SOC.
- **Protecting consumers on fixed term offers.** Automatic contract rollovers to fixed term contracts will be prohibited. In the absence of action on the part of the consumer, the supplier will be required to transfer the consumer to their cheapest evergreen tariff, with no exit fees or notification periods. We are proposing additional rules regarding communication/notification of the end of fixed term contracts. Price increases and other adverse unilateral variations will also be prohibited for fixed term contracts (subject to certain exceptions). We also propose to clarify and tighten some existing rules regarding notification of and consent to mutual variations.

1.10. In addition to these package of measures, we aim to ensure that our package is effective in widening the pool of engaged consumers into those who may have disengaged from the market (as well as providing already engaged consumers with added encouragement to engage and the tools they need to assess alternative offers) through our proposal to trial a scheme to provide a subset of the most sticky and vulnerable consumers with information on the cheapest deal for them across the market. We expect to develop this scheme by trialling it and through our stakeholder engagement, and therefore do not propose to assess any potential related impacts at this stage. We consider however that this scheme is important to mitigate the risk of consumer segmentation in the energy market, and it is a key element of our proposal.

## Summary of impacts

1.11. Our preliminary qualitative analysis indicates that our proposed package of measures is likely to provide a direct net benefit to consumers. We expect that our proposal will have an overall positive effect in improving the ability of consumers to pick the best deal for them in the energy market and in widening the pool of consumers who are active in the market.

1.12. Our proposed measures for the supplier cheapest deal, to require suppliers to include prompts to engage on all regular communications and to introduce the TCR as a common currency for use in all marketing materials are likely to impact positively in raising consumer **awareness** about the alternatives available in the energy market. Consumers are likely to have better **access** to market information as a result of our proposal to facilitate the publication of best buy tables (using the

TCR), introduce the tariff information label, and to publish information on suppliers' comparative performance.

1.13. Consumers are also likely to face **simpler** choices when they are looking for alternative offers, as a consequence of our measures to reduce the number of tariffs and to introduce rules on the tariff and discount structures. Our proposal to require suppliers to provide consumers with **clearer** information, including a personal projection of their annual energy costs on each bill, along with the tariff information label and personalised information on the supplier's cheapest deal will enable consumers to better **assess** the alternative offers available in the market. Finally, our proposals to introduce enforceable SOC and new rules on contract terms are likely to lead consumers experiencing a **fairer** treatment in all their interactions with suppliers. This, along with our tariff simplification proposals and the clear signposting to switching sites on key supplier communications, should mean that some currently disengaged consumers gain the confidence they need to look around for the best deal.

1.14. Our proposed package of measures should mean that individual consumers are able to get a better deal in the market. More effective engagement should also have the effect of increasing competition (see Chapter 4) so that the interests of consumers as a whole are better served by the market. Further, a number of our measures should reduce the scope for **individual harm**. For example, the rules on fixed term contracts will prevent consumers finding themselves on deals they did not sign up to, a range of our proposals should mean there is less scope for consumer harm arising from consumers unknowingly switching to tariffs which are more expensive for them and the standards of conduct should mean there is less individual harm arising from instances of poor supplier conduct.

1.15. We recognise that there is a risk our proposal may also bring some downsides for consumers, but we have looked to mitigate these risks. For example, the gap between engaged and disengaged consumers could widen if our proposed package of measures is not sufficiently robust. To mitigate this risk we have proposed several policies that are targeted at less informed consumers, including providing clear prompts to engagement, the supplier's cheapest deal message on bills, or simplifying and standardising terminology. We are also proposing to trial the market cheapest deal, which is focused on addressing the group of consumers who are least likely to benefit from the other measures in our proposed package. We view the market cheapest deal as a key element to mitigate the risk of continuous consumer segmentation in the energy market.

1.16. We also recognise that the benefits that we identify above are based on a qualitative assessment of the impacts of our proposal. We expect to be in a position to be able to quantify some of these impacts when we move to final proposals. Notwithstanding, given the qualitative benefits that we identified, and the measures that we are putting forward to mitigate risks and potential costs to consumers, our preliminary conclusion in this IA is that our proposed package of measures will provide a net benefit to consumers in the GB energy market.

1.17. The figure below summarises the key impacts of our proposal on consumers:

**Figure 1 Summary of impacts on consumers**

Proposed measures		Aware of alternatives available	Access market information	Assess alternative offers	Confidence and incentives to Act
1. Supplier cheapest deal	Supplier cheapest tariff on bills and Annual Statements	✓	✓	✓	✓
2. TCR	TCR	✓			
	Best buy tables	✓	✓		
	Personal projection			✓	
3. Tariff simplification	Cap on tariffs			✓	✓
	Standardisation, discounts and bundles			✓	✓
4. Clearer and simpler information	Prompts on bill, Annual Statements, Price Increase Notifications, end of contract	✓			✓
	TIL		✓	✓	
	Info on supplier performance		✓	✓	
	PIN			✓	
	End of contract letter			✓	
	Annual statement			✓	
5. SOC	Enforceable Standards of Conduct	✓	✓	✓	✓
6. Protecting consumers on fixed term offers	Rules on auto-rollovers			✓	✓
	Rules on unilateral variations				✓
Market cheapest deal	Market cheapest tariff information	✓	✓		✓

Source: Ofgem 2012

## 2. Objectives and approach

---

### Chapter Summary

In this chapter we set out the objectives we aim to achieve with our proposed package of measures. We also describe the approach we follow in assessing the impact of our proposal, and provide an outline of the structure of the document.

### Objectives for the RMR proposal for domestic consumers

2.1. The key objective of our proposal is to enhance effective engagement by consumers, and to strengthen competition in the domestic retail energy market. Within the overall aim of improving effective consumer engagement, we are looking to achieve three objectives with our proposal:

- make the market simpler, by helping consumers to make cross-market comparisons;
- make the market clearer, by assisting and prompting informed switching decisions through improved information to consumers; and,
- make the market fairer, by providing further consumer protection, promoting improvements in supplier conduct and ultimately building consumer trust, so that they have an incentive to engage in the market.

2.2. We aim to make the market simpler by providing consumers with personalised information on the cheapest deal offered by their current supplier. We also expect that the market will become simpler with the introduction of the TCR, the cap on the number of tariffs per supplier, and with the introduction of additional tariff simplification rules.

2.3. We look to achieve a clearer market through prescribing the content and format (to differing extents) of the key information provided on Bills, Annual Statements, End of Fixed Term Notices and Price Increase Notices, and requiring suppliers to introduce a Tariff Information Label. We will also aim to achieve a clearer market through providing consumers with increased information regarding supplier's customer service performance, such as complaints handling, or customer satisfaction.

2.4. Our proposal to achieve a fairer market includes introducing enforceable SOC, as well as new rules on contract terms around fixed term and evergreen tariffs.

## Approach to the IA

2.5. In this section we set out our approach to conducting this draft IA. We also outline the current balance between qualitative and quantitative assessments of the impacts.

2.6. The purpose of this IA is to assess the impacts of our proposal, and in particular to assess the net impact on consumers. We do this by assessing how likely our proposed package is to achieve the objectives that we set out above. We start by analysing how our proposed package of measures is likely to address the barriers to consumer engagement and effective competition. We also assess the distributional effects of our proposal, and how it may impact on competition, sustainable development, and health and safety.

2.7. Our analysis is based on the assessment of our proposal against the counterfactual scenario. The counterfactual (or base case) represents the alternative situation that would exist if our proposal was not implemented.<sup>10</sup> While we have considered different options for each measure, our analysis considers exclusively the impacts that our proposed package of measures (formed by the preferred option for each measure) will have in relation to the counterfactual.<sup>11</sup>

2.8. In defining each one of the measures to include in our proposed package, we have looked at a number of different options. We have analysed each option to decide the optimal measures to include in the package, and/or the optimal design for any specific measure. Chapter 8 sets out the assessment of the different options we have considered for each one of the measures that we include in our proposal.

2.9. The analysis conducted in this draft IA is essentially qualitative. This is driven by the lack of data at this stage to conduct a quantitative assessment for all of the proposals. Chapter 4 sets out how we propose to quantify suppliers' costs of implementing our proposed package of measures once we move to final proposals. We are requesting data from stakeholders based on this approach, so as to be able to undertake some quantification of the impacts.

2.10. In our analysis we also look at the potential risks and unintended consequences from our proposal. Our analysis on risks and unintended consequences (see Chapter 7) shaped our proposed package of measures. Our present proposed package considers and, where possible, is designed to mitigate the risks and unintended consequences that we identified.

2.11. In assessing our proposal we look at the impacts that our proposed package of measures may have on consumer effective engagement in the energy market.<sup>12</sup>

---

<sup>10</sup> The counterfactual is a hypothetical alternative situation that reflects the best judgment as to what would have occurred in the absence of the RMR proposal. This includes, for example, the impacts of policies that have been implemented, but have a delivery date in the future (e.g. the smart metering rollout, the green deal, etc.).

<sup>11</sup> We do not assess the impacts of multiple alternative options to our proposal.

<sup>12</sup> Effective engagement is measured by the level of awareness that consumers may have about

This includes the impact that our measures have on the incentive on consumers to engage. It also looks at the indirect impact this engagement has on competition and outcomes for consumers.

## Structure of the document

2.12. The remainder of the document is structured as follows:

- Chapter 2 considers the RMR objectives and sets out the approach to conduct this IA;
- Chapter 3 assesses the impacts on consumers;
- Chapter 4 assesses the impacts on competition;
- Chapter 5 assesses the impacts on sustainable development;
- Chapter 6 assesses the impacts on health and safety;
- Chapter 7 considers risks and unintended consequences ;
- Chapter 8 sets out the different options assessed in each of the measures in our proposed package.

## 3. Impacts on consumers

---

### Chapter Summary

This section sets out the potential impacts on consumers of the domestic RMR proposal. We identify the key barriers to consumer engagement, and assess the likely impacts on consumers by analysing how our proposed package of measures addresses these barriers.

**Question 1:** Do you agree with our assessment of the impacts of our proposed package of measures on consumers? Please explain your views.

3.1. In this section we assess qualitatively the likely impacts on consumers of our main proposals. Based on quantitative and qualitative research, we assess how likely our proposal is to mitigate the key barriers to consumer engagement: tariff complexity, poor information and lack of consumer trust. We assess how these impacts will affect consumer engagement and switching behaviour.

3.2. We also set out our proposed approach to quantify the costs of implementing our proposal. We are using this consultation to request data from suppliers on the different costs they may incur with our proposal.

### Tariff complexity

3.3. Many consumers perceive that the tariffs in the domestic energy market are too complex for them to engage with. A high number of tariffs and different price structures add complexity to the energy tariffs. This enforces consumers' perception that energy tariffs are complex. For these reasons, those consumers who do attempt to engage have difficulties in assessing their current circumstances against the options that are available in the market.

3.4. We have identified a number of causes of complexity in the GB energy tariffs. These include:

- Number of tariffs;
- Structure of tariffs;
- Discounts and bundles;
- Exploitation of limited consumer capacity.

#### *Number of tariffs*

3.5. Recent analysis based on an information request to suppliers suggests that the number of tariffs open for consumer to sign up to, as at 28 August 2012, is



around 900.<sup>13</sup> Due to the high number of tariffs, consumers are likely to encounter a large range of choices when looking for a new tariff.<sup>14</sup> This is particularly an issue for those consumers unable or unwilling to use online comparison sites which can filter options.

3.6. Dead tariffs also contribute to tariff complexity.<sup>15</sup> According to information provided by suppliers, there are over 650 dead tariffs. These tariffs make it harder for consumers to identify their own tariff (for example, on a switching site list). They therefore contribute towards making tariff comparisons harder.

#### *Structure of tariffs*

3.7. One source of the current tariff complexity is the wide range of price structures used in tariffs. At present, tariff structures include tariffs with a standing charge and single unit rate, a single unit rate, two-tiers of unit rate (typically, the first unit rate being very high but spanning a small amount of consumption with the impact that it replicates a standing charge) and (less frequently) more complex tariff structures such as multi-tiered unit rates.

3.8. Complexity in tariff price structures constrains tariff comparisons, prevents consumers from understanding their tariff, and how its bill relates to the amount of energy consumed. For example, over a third of the open non-Time of Use (ToU) tariffs offered in the market has unit rates that vary by the level of consumption.<sup>16</sup>

#### *Discounts and bundles*

3.9. Discounts and bundling practices add further complexity to the energy tariffs, as they increase the number of variables that consumers have to consider. Suppliers apply a range of different discounting practices that adds undue complexity to the domestic market. Bundling can also add significant additional complexities in the choices consumers face. Bundling practices have multiple forms, with energy products combined with other utilities, other products and insurance premiums such as heating maintenance. Comparisons across the market become more difficult, due

---

<sup>13</sup> Source: Ofgem analysis of supplier tariff permutations as at 28 August 2012 using information available from our information request to suppliers, across both large and small suppliers (including White Labels), meter types, and payment types. Numbers are based on London region. It should be noted that this tariff definition is wider than the tariff definition used to generate tariff numbers for the original RMR March 2011 analysis.

<sup>14</sup> Looking at each of the previous incumbent suppliers' websites we found there to be between four and eleven high level tariff options presented for five of the suppliers and for another no high level option was presented and instead consumers were led through the process (internet research, September 2012).

<sup>15</sup> A dead tariff is an evergreen that serves existing customers but is not open to new customers. We do not include fixed term tariffs in this definition.

<sup>16</sup> Ofgem analysis of impact of our tariff structure proposals on availability of current tariffs, as at 28 August 2012, using information available from our information request to suppliers. This analysis was undertaken across both large and small suppliers (including White Labels), all payment types, for standard meters only. Numbers are based on London region. It should be noted that this analysis was undertaken in consideration of percentage reduction in original tariff data, as opposed to reduction in 'core tariffs', which we define in our consultation document.

to the increase in the number of variations, but also because product offerings are often different across suppliers.

#### *Exploitation of limited consumer capacity*

3.10. Behavioural biases can explain, at least in part, why consumers find it challenging to engage in the domestic energy market and to assess and compare their options. Our research suggests that consumers in the energy market exhibit these behavioural biases. These biases, coupled with the causes of tariff complexity mentioned above, can put consumers off engaging in the market, cause them to abandon a search if they start one, and leave them unsure if they have made the correct choice (reducing the incentive to engage again).<sup>17</sup> Research with vulnerable consumers also supports this finding, indicating that those with limited numeracy/literacy want less choice.<sup>18</sup> The consultation document outlines the effects of these biases in more detail.

3.11. The economic literature also suggests that firms may have an incentive to take advantage of behavioural economics biases. They may obfuscate prices, or increasing choice or complexity.<sup>19</sup> They may also use price promotions and framing to distract and distort decision-making. Firms may also make it more difficult for consumers to act to get the best deals, for example by increasing switching costs.<sup>20</sup>

### **Impact of proposals on tariff complexity**

#### *Tariff simplification*

##### Number of tariffs

3.12. Our research has shown that some consumers are surprised by the number of tariffs available,<sup>21</sup> and many think there are too many tariffs.<sup>22</sup> In responses to our December 2011 consultation, consumer groups cited a high number of tariffs as a contributory factor in consumer disengagement. We expect that, under our proposal to cap the number of core tariffs, typically up to 52 core tariffs per fuel may be available to any particular consumer (four from each of the suppliers), including any white label tariffs that suppliers wish to offer.<sup>23, 24</sup>

---

<sup>17</sup> Ipsos MORI, (August 2012), 'Consumer engagement with the energy market, information needs and perceptions of Ofgem, findings from the Ofgem Consumer First Panel Year 4: second workshops (held in March 2012)'.

<sup>18</sup> FDS International (February 2011), '2011 Vulnerable Customer Research', p.38.

<sup>19</sup> Office of Fair Trading (March 2010), "What does behavioural economics mean for competition policy?" p.16.

<sup>20</sup> X. Gabaix and D. Laibson, (2006), Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets, Q.J. Econ., 121(2), 505-40.

<sup>21</sup> Opinion Leader (March 2011), 'Ofgem Consumer First Panel, Report from the second set of workshops'.

<sup>22</sup> Ipsos MORI (January 2012).

<sup>23</sup> This equates to 4 core tariffs x 13 current suppliers = 52 core tariffs in the market. More tariffs could be offered if suppliers make use of the additional tariff allowed for collective switching.

3.13. Figure 2 below provides further details of previous incumbent suppliers and small suppliers' current open core tariff numbers for non-ToU tariffs in relation to our proposed core tariff cap.<sup>25, 26</sup> It also shows the current number of named open tariffs in the market.<sup>27</sup> White labels are added to the totals in brackets.

3.14. Taking electricity consumers with a standard meter as an example, our proposals would reduce the current total of 90 core tariffs by around two-thirds.

**Figure 2. Open tariff numbers for non-ToU tariffs by supplier type**

		Tariff Names		Core tariffs	
		Electricity	Gas	Electricity	Gas
<b>Big 6</b>	Min	4 (5)	4 (4)	6 (6)	4 (4)
	Max	13 (14)	15 (15)	17 (32)	15 (35)
	Median	7 (9.5)	5.5 (10)	8 (9.5)	8 (8.5)
	<b>Current total</b>	<b>47 (58)</b>	<b>45 (56)</b>	<b>56 (83)</b>	<b>51 (78)</b>
	<b>Cap total</b>			<b>24</b>	<b>24</b>
<b>Small Suppliers</b>	Min	0 (0)	0 (0)	0 (0)	0 (0)
	Max	3 (3)	3 (3)	2 (2)	2 (2)
	Median	1.5 (1.5)	1 (1)	1.5 (1.5)	0.5 (0.5)
	<b>Current total</b>	<b>10 (10)</b>	<b>7 (7)</b>	<b>7 (7)</b>	<b>4 (4)</b>
	<b>Cap total</b>			<b>24</b>	<b>24</b>

Note: Figures in brackets include white label tariffs. Source: Ofgem, 2012

3.15. The number of dead tariffs also adds complexity to the comparison of tariffs, especially in terms of identifying the consumer's current tariff.<sup>28</sup> Figure 3 below provides further details of previous incumbent suppliers and small suppliers' current dead core tariff numbers for non-ToU tariffs.<sup>29</sup> It also shows the current number of named dead tariffs in the market. White labels are added to the totals in brackets.

<sup>24</sup> The charges for supply of electricity/gas combined with all other terms and conditions that apply, or are in any way linked, to a particular type of contract for the supply of gas/electricity to a domestic customer excluding certain matters such as dual fuel discounts, variations in charges relating to payment method, appropriate surcharges and optional additional services.

<sup>25</sup> Numbers shown for core tariffs are for payment by direct debit. Not all small suppliers offer direct debit as a payment method, hence some core tariff numbers for small suppliers are zero in the table. Also, some small suppliers only offered to sell gas and electricity together as dual fuel rather than individually, hence some named tariff numbers are zero in the table.

<sup>26</sup> We only received data for six of the small suppliers, hence the illustrative cap of 24 core tariffs.

<sup>27</sup> Individually named products offered by suppliers for electricity and gas.

<sup>28</sup> See Appendix 2.

<sup>29</sup> Numbers shown for core tariffs are for payment by direct debit.

**Figure 3. Dead tariff numbers for non-ToU tariffs by supplier type**

		Tariff Names		Core tariffs	
		Electricity	Gas	Electricity	Gas
<b>Big 6</b>	Min	3 (3)	3 (3)	3 (3)	4 (4)
	Max	85 (85)	7 (7)	86 (86)	14 (14)
	Median	5.5 (5.5)	5.5 (5.5)	5.5 (5.5)	6 (6)
	<b>Current total</b>	<b>112 (112)</b>	<b>32 (32)</b>	<b>112 (112)</b>	<b>41 (41)</b>
<b>Small Suppliers</b>	Min	0 (0)	0 (0)	0 (0)	0 (0)
	Max	1 (1)	0 (0)	1 (1)	0 (0)
	Median	0 (0)	0 (0)	0 (0)	0 (0)
	<b>Current total</b>	<b>1 (1)</b>	<b>0 (0)</b>	<b>1 (1)</b>	<b>0 (0)</b>

*Note: Figures in brackets include white label tariffs. Source: Ofgem, 2012*

3.16. Our proposal to ban dead tariffs (where they are more expensive than the cheapest equivalent open tariff) will reduce the number of options that consumers have to navigate before making a price comparison. Our analysis suggests that for the previous incumbent suppliers, around a third of their dead tariffs are more expensive than their equivalent live evergreen tariff.<sup>30</sup> We expect under our proposals these tariffs would be eliminated and consumers transferred onto more competitive deals.

3.17. The overall number of tariffs is a particular issue for those consumers who are unwilling or unable to use price comparison sites. 5.2 million households in GB are without internet access.<sup>31</sup> Such internet sites can filter results for consumers, avoiding the need to trawl through every option available.

3.18. We expect that the cap and the elimination of expensive dead evergreen tariffs will reduce complexity as they will have fewer options to choose from. We recognise that consumer choice can be beneficial and should be welcomed if that choice provides products that consumers value. However, our evidence shows that consumers think there are too many tariffs. This suggests the level of choice in the market is reducing consumer engagement. Ultimately, we expect a reduction in tariffs will help to make consumers more receptive to investigating tariffs, and contribute to increased engagement.

#### Structure of tariffs

3.19. Our research has shown that consumers are confused by the structure of tariffs. Research suggests that consumers are confused by the large number of components of the tariff, and by the format and presentation of the tariff information. Consumers prefer simpler formats.<sup>32</sup>

<sup>30</sup> Data based on bill values for the previous incumbent suppliers' evergreen tariffs on a standard meter for median consumption (16,500kwh Gas, 3,300kwh electricity) for all three payment methods.

<sup>31</sup> Office of National Statistics (2012), 'Internet Access - Households and Individuals', August 2012.

<sup>32</sup> Opinion Leader (March 2009), 'Ofgem Consumer First Panel: Research Finding from the Second Events

3.20. The qualitative research undertaken in summer 2011 considered a number of options for limiting the number and format of tariffs.<sup>33</sup> Restricting standard tariffs to the standing charge and unit rate method of charging and dropping the two tier unit rate method was considered to be a helpful change. Most respondents were unaware of the two tier method and, when it was explained, they found it more complicated to understand. A standing charge presented as a fixed cost, particularly £ per month, was seen as more tangible and generally in line with people’s budgeting. Our proposal to standardise tariff structures to a standing charge and unit rate will help to make the presentation of tariffs simpler. The TCR is being introduced alongside this to provide one number by which consumers can compare tariffs.

#### Discounts and bundles

3.21. Ofgem’s Consumer First Panel research found that many panellists were confused by the number of components of energy tariffs, including discounts.<sup>34</sup> Consumers generally see energy suppliers as the same and in the absence of clear information on how their prices differ they have little incentive to switch. Discounts such as loyalty points can help to differentiate offers and provide tangible choices. Research found that consumers like options that can save them money and that consumers would be unhappy with the removal of dual fuel discounts.<sup>35</sup>

3.22. This evidence suggests that a balance needs to be struck between reducing complexity and maintaining the discounts consumers appreciate. Our proposals allow suppliers to offer dual fuel discounts and the scope to offer other discounted tariffs so long as the number of tariffs is consistent with the proposed cap. We expect this will give suppliers a sufficient degree of commercial freedom to offer the discounts that consumers value.

3.23. Our September 2012 information request to suppliers shows that there are 44 bundled products and services in the market. These include energy services bundled with other products such as green energy, insurance products for home care, nectar points, vouchers and charities. Many of these are offered as ‘tied’ bundles, i.e. they are only available with a specific tariff. We consider that this causes undue market complexity. Our tariffs simplification proposal will allow suppliers to offer and apply these products and services in a standardised way that helps reduce tariff complexity.

#### *Protecting consumers on fixed term offers*

3.24. The prohibition on price increases and other adverse unilateral variations will simplify the fixed-term tariffs market for consumers. It may also reduce the number of tariffs available in the market.

---

– Billing Information and Price Metrics’ and Opinion Leader (October 2009), ‘Ofgem Consumer First Panel: Research Finding from the Third Events’.

<sup>33</sup> Creative Research (October 2011), ‘Tariff Comparability Models, Volume 1 - Consumer qualitative research findings’.

<sup>34</sup> Opinion Leader (March 2009).

<sup>35</sup> Creative Research (October 2011).



3.25. The effect of this will be to simplify the choices available to consumers and the decision process, thereby reducing the complexity in the market. This is linked to the impact of our proposals for introducing a cap on tariff numbers.

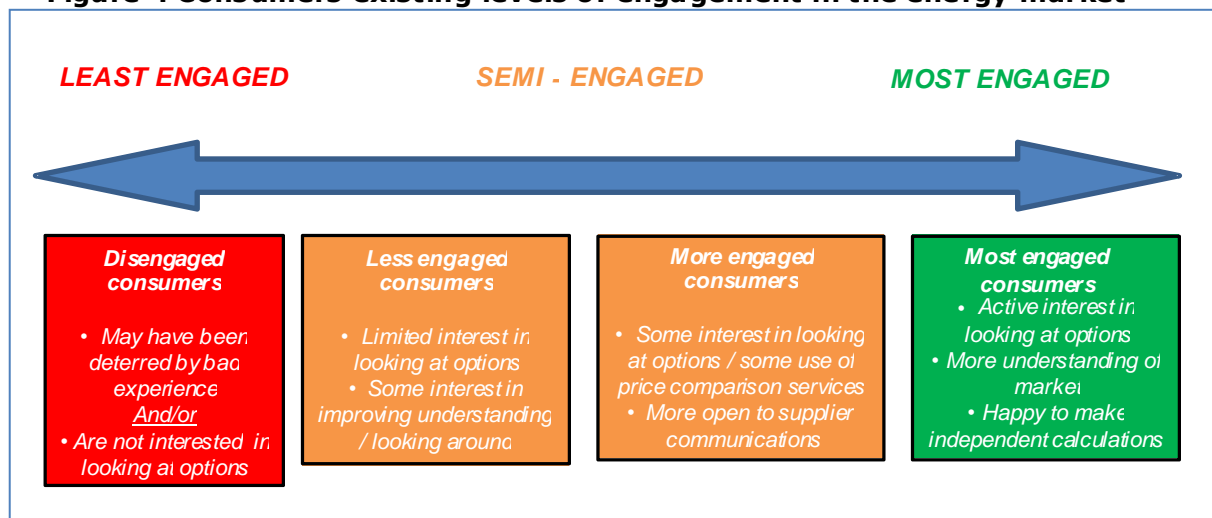
3.26. However, some consumers prefer variable price and tracker tariffs, and will therefore be disadvantaged by this prohibition if these aren't replaced by similar products that comply with our rules. However, it was noted in our Tariff Comparability Quantitative Research that consumers broadly prefer fixed term and fixed price tariffs in comparison to other price mechanisms (when asked which they would probably choose, 47% of consumers tested chose fixed, 9% chose tracker and 6% chose variable price tariffs).<sup>36</sup>

3.27. These proposed rules provide another potential benefit for some consumers by reducing barriers to those consumers accessing fixed price products (if this would be their preference), by making reducing complexity in this market. This would provide additional predictability and certainty for these consumers.

TCR

3.28. The response from consumers to the information they receive or see, including the TCR, will be different for different types of consumers. Figure 4 below sets out the key characteristics for existing levels of engagement in the energy market.

**Figure 4 Consumers existing levels of engagement in the energy market**



Source: Ipsos MORI (October 2012)

3.29. Overall, our research into the TCR showed that different types and formats of information appeal to different types of consumers. For example, for less engaged consumers, simplicity of information was key. Any presentation of TCR information

<sup>36</sup> Ipsos MORI (October 2011), 'Consumer reactions to varying tariff comparability, Quantitative Research conducted for Ofgem'.

that appeared overcomplicated or difficult to understand tended to cause an immediate barrier to engagement. Whereas, to more engaged consumers, more accustomed to making tariff comparisons, the inclusion of additional elements such as TCRs for low/medium/high users and personal projections was often welcomed.<sup>37</sup>

3.30. Overall, most consumers we consulted found the TCR concept appealing and believe it could be useful in helping them understand the relative prices of different tariffs, and to reduce the complexity they face today when comparing tariffs. Our research indicates that, in some scenarios by including a tariff comparison metric when consumers are assessing a range of options, their ability to identify the cheapest tariff increases significantly.<sup>38</sup>

## Poor information

3.31. Unclear, incomplete or complex information is a significant barrier to consumers' effective engagement. Even once engaged with the market, consumers require key information, such as consumption levels, in order for that engagement to be effective through well-informed switching decisions.

3.32. To engage effectively consumers need to be **aware** that there are alternatives available (i.e. they need to be prompted to engage), to be able and have an incentive to **access** market information, and to be able to **assess** alternative offers.<sup>39</sup>

3.33. We have identified however, a number of barriers that prevent consumers' ability to be aware of alternatives, access information, and assess options. These include:

- The quality of information suppliers provide to consumers is unsatisfactory;
- Consumers misconceptions about suppliers and the energy market; and,
- Lack of trigger points for consumers to engage with the energy market.

3.34. Information provided to consumers is often perceived to be unclear or too complex.<sup>40</sup> This contributes to a lack of consumer understanding about energy tariffs, and prevents them from easily accessing key information they need to assess the alternatives available. In some instances, suppliers' communications to consumers have been found to be overly complex, not sufficiently personalised to the individual consumer, incomplete, or lacking clarity, e.g. in the communication of the principal terms of energy contracts. Consumer First Panellists note that energy market language tends to confuse them and terms are not well understood. Many consumers

<sup>37</sup> Ipsos MORI (October 2012), 'Consumer views on Tariff Comparison Rates, Findings from the Ofgem Consumer First Panel workshops held August 2012'. The research tested the overall TCR concept and four distinct scenarios which illustrated different options for how the TCR might work in practice. Participants were asked to comment on each scenario separately, on individual elements of scenarios, and on the potential impact of the TCR on their switching behaviour and overall engagement.

<sup>38</sup> Ipsos MORI (October 2011).

<sup>39</sup> OFT (2010), 'What does behavioural economics mean for competition policy?', p.15-16. See also Chapter 1 in the consultation document.

<sup>40</sup> Opinion Leader (March 2009).

do not find the communications from suppliers easy to understand which can deter further engagement.<sup>41</sup>

3.35. Approximately one in five of those who have never switched supplier are unaware that they can switch to a different supplier.<sup>42</sup> Similarly one third of people who report they have not switched to a different tariff or payment method in the last year were not aware that they could do this with their current supplier.<sup>43</sup> Some consumers believe that suppliers have put them on the best tariff for them.<sup>44</sup> Consumers' misconceptions about the energy market can be both a cause and a consequence of their lack of awareness and inability to access and assess alternatives. Many consumers feel powerless when faced with price increases and other adverse changes made unilaterally by suppliers. Our previous evidence has also shown that the energy market has few trigger points at which consumers are prompted to explore the energy market and their options. Indeed some consumers, especially in Wales and Scotland show loyalty to what they perceive to be 'national brands'.<sup>45</sup>

3.36. The lack of complete, relevant information in current communications from suppliers to consumers has resulted in information asymmetry on the consumers' side, and constrained their ability to engage effectively with the market.<sup>46</sup>

### **Impact of proposals on poor information**

#### *Supplier cheapest deal*

3.37. Our research suggests that an important barrier to switching tariffs while staying with the same supplier is lack of awareness that there may be cheaper tariffs available.<sup>47</sup>

3.38. Information about a supplier's cheapest tariff will directly address this issue, giving consumers clear, specific and personalised information. Consumers will receive information on the best priced options available to them. Tailoring this information to the consumer, for example by considering the type of meter or the payment method they currently use, will also help raise a consumer's awareness of different features of their energy supply. The cheapest tariff messaging and signposting needs to be presented in a clear and self-explanatory way to be effective. This is one of the reasons for its inclusion on the front page of the bill/statement of account.

---

<sup>41</sup> Opinion Leader (January 2009) 'Ofgem Consumer First Panel: Research findings from first event' and Opinion Leader (March 2009).

<sup>42</sup> Ipsos MORI (January 2011), 'Customer Engagement with the Energy Market - Tracking Survey',

<sup>43</sup> Ipsos MORI (January 2011).

<sup>44</sup> SPA Futurethinking (October 2012b), 'Energy bills, annual statements, price increase notification letters and tariff information labels: proposals for consumer testing'.

<sup>45</sup> Insight Exchange, (October 2012), 'Consumer research and collaborative engagement on the proposed Standards of Conduct – Domestic Customers, Full Report'.

<sup>46</sup> Anecdotal complaints/contacts information to Ofgem, Consumer Direct and Ombudsmen also indicated that some consumers received mis-information or insufficient information from suppliers (e.g. unclear information, price increase information was not personalised, etc.).

<sup>47</sup> SPA Futurethinking (October 2012b).



3.39. Our research shows that a perceived lack of information is considered one of the barriers to engagement, and some consumers don't necessarily trust the information currently provided.<sup>48</sup> The cheapest tariff information helps tackle these concerns by providing consumers with clear and tailored information and making them better-informed about the options available to them. This, in turn, enables them to make accurate decisions about their energy options.

3.40. The cheapest tariff information also provides an additional trigger for consumers to engage and improve their knowledge of the energy market through exploring their tariff options. By providing a comparison of their current tariff to a cheaper option, it is anticipated that some consumers will be sufficiently attracted by the level of saving available to move to that tariff or to further investigate the options available to them. It is envisioned that such information will prompt and enable some consumers to contact their supplier to assess which tariffs are the best fit for their circumstances.<sup>49</sup>

3.41. Our research suggests that providing consumers with information on cheaper tariffs available from their own supplier is regarded as helpful by some consumers and is likely to encourage a degree of engagement with the market, and switching to cheaper tariffs.<sup>50</sup> However, these effects are difficult to quantify as it is not yet known how many consumers will become more engaged as a result of this proposal.<sup>51</sup> By improved understanding of the costs of different offerings we expect that more consumers will compare the product they receive with others on the market. This may help consumers realise that better options are available, thus affecting making the market seem more transparent and/or prompting consumers to consider switching.

#### *Clearer and simpler information*

3.42. Consumers should be confident that they can navigate through the market, and be comfortable that they understand the options available to them. To achieve, this we are aiming to improve the quality and accessibility of information. This involves making communications simpler and more consistent for consumers through the development of standardised formats, content and language. Prescribing and thereby standardising appropriate format, language and content which appears on key communications can help ensure that the purpose is clear and key information is better understood.<sup>52</sup>

3.43. This will address some of the gaps we identified above, where consumers were provided with information that was generic, incomplete or unclear. The following section outlines the impacts on consumers of the lack of consumer knowledge of different aspects.

---

<sup>48</sup> Ipsos MORI, (August 2012).

<sup>49</sup> SPA Futurethinking (October 2012b).

<sup>50</sup> SPA Futurethinking (October 2012b).

<sup>51</sup> This is something we hope to measure through a forthcoming trial or field experiment involving a volunteer supplier.

<sup>52</sup> Lawes Consulting and Lawes Gadsby Semiotics (November 2011a), 'Retail Market Review: Energy bills, annual statements and price rise notification; advice on the use of layout and language'.

### Prescribing content of key information channels

3.44. The additional information requirements that we are proposing will empower consumers by providing information that currently is not readily available. We also aim to ensure key communications have a clear purpose, and that they are distinct and noticeable. Our research shows that communications with multiple core messages is less effective and can obscure the understanding of material provided. Where large volumes of additional information are included, key information is often presented in a disjointed or scattered way.<sup>53</sup>

3.45. The clarity of information available to consumers should increase following our proposals to strengthen the licence conditions that were introduced as a result of the Probe, and prescribe the content of specific communications. This includes requiring a clear title for communications, the inclusion of personalised tariff details, such as a consumer's tariff name, payment type, key information regarding contract terms and details of any change to that contract.

3.46. Our consumer testing of our information templates indicated consumers found all the relevant information they would need to understand the purpose of our key information channels and consider engagement in the market.<sup>54, 55</sup> This will ensure consumers are provided with the information they need in order to engage with the market and make well-informed decisions. In addition, the reinforced requirements for signposts to switching and impartial advice will provide consumers with additional trigger points for considering their energy options and engaging with the market.

### Tariff information label

3.47. The Tariff Information Label, in particular, is designed to help consumers understand and compare the features of different energy tariffs, by making communications simpler and more consistent for consumers. Academic language research provided insight into appropriate terminology and structure of the Label.<sup>56</sup> Consumer research indicated that many of the items proposed for inclusion in the Label are useful to consumers (e.g. tariff type, unit rate, standing charge and payment method), and that many consumers see value in a tool that allows them to compare tariff features more easily.<sup>57</sup> This will provide consumers with the means to understand the key features of their tariff and compare them with other tariffs, and therefore to engage effectively.

3.48. While some participants struggled to engage with the Label during our research, others thought that the information would be useful when they consider

---

<sup>53</sup> Lawes Consulting and Lawes Gadsby Semiotics (November 2011a).

<sup>54</sup> We tested with consumers our information templates for the Bill, Annual Statement, TIL and Price Increase Notifications. They were also effective in allowing the consumer to see key information that they would expect to be able to find very easily and quickly (such as how much to pay and by when on a bill).

<sup>55</sup> SPA Futurethinking (October 2012a), 'Energy bills, annual statements, price increase notification letters and tariff information labels: proposals for consumer testing'.

<sup>56</sup> Lawes Consulting and Lawes Gadsby Semiotics (November 2011a) and Lawes Consulting and Lawes Gadsby Semiotics (November 2011b), 'Notes on the Tariff Information Label' (as yet unpublished).

<sup>57</sup> Ipsos MORI (January 2012) and SPA Futurethinking (October 2012a).

switching.<sup>58</sup> This finding reinforces our view that the Label will not be valuable for all consumers. Some consumers will find the Label to be too much information while it would be an effective tool for those consumers that are willing and able to consider a range of information.

#### Standardisation of key terminology

3.49. In order to improve the quality and accessibility of the information available to consumers, we are also making recommendations to standardise language and terminology across key documents. This draws on the findings of linguistic experts,<sup>59</sup> design experts and results from our consumer research.<sup>60</sup> In particular, our recent consumer testing suggested communications should be clear, easy to read and understand, and free from jargon.<sup>61</sup>

3.50. Our Consumer First Panel suggests that while improving the design and content of supplier communications may be a key enabler to engagement in the energy market for some, it is unlikely to have any great effect until the majority of the terms and concepts used are understood by consumers.<sup>62</sup>

3.51. Our proposals to standardise the use of key terminology and language across certain communications will ensure suppliers to use clear and simple language in their communications.<sup>63</sup> This will assist consumers to more easily understand the key messages from the key communication channels.

#### Standardising format of key information channels

3.52. Consumers will obtain clearer information under our proposals to prescribe and standardise the format of some key communications. These proposals ensure that the purpose of each of the communications is clear and that important information is understandable. Our research also indicates that under our proposals, many consumers find key communications distinct, clear and purposeful. This is fundamental to address the confusion and complexity issues that currently exist in the energy market.<sup>64</sup>

3.53. Consumers value our proposals to have key messages and information presented in a consistent way across the industry, key information grouped together and to clearly differentiate Annual Statements from Bills. Research indicates that this is likely to facilitate consumer understanding of, and comfort with, relevant material over time. It also suggests that consumers would be able to compare suppliers and tariffs on a like-for-like basis more easily. Research also suggests that our proposals will help improve the transparency of Price Increase notifications and improve the

---

<sup>58</sup> SPA Futurethinking (October 2012a).

<sup>59</sup> Lawes Consulting and Lawes Gadsby Semiotics (November 2011a).

<sup>60</sup> Ipsos MORI (January 2012).

<sup>61</sup> SPA Futurethinking (October 2012a).

<sup>62</sup> Ipsos MORI (January 2012).

<sup>63</sup> SPA Futurethinking (October 2012a).

<sup>64</sup> Lawes Consulting and Lawes Gadsby Semiotics (November 2011a).

comparability of tariffs (it is easier for consumers to use this information for budgeting and switching).

#### Summary of information improvements

3.54. Our consumer research has identified the key steps that consumers go through when assessing their energy options.<sup>65</sup> We have designed our proposals having regard to how they will impact upon the various stages of a consumer's "journey", and when prompts to engage in the market are required. The stages can be characterised in terms of the steps a consumer may take to explore their energy options, the information they would require at each stage, and from which source they could get this information.<sup>66</sup> Each of the communications for which we are proposing changes may have an impact on multiple stages of the consumer journey.

3.55. While we recognise through our proposals certain pieces of information appear on multiple communications, repetition is necessary in some circumstances in order to reinforce certain messages. Furthermore, given that there are different types of consumers with different needs and who will respond to different prompts, some repetition is necessary to deliver the information that is needed at the various stages of the consumer journey.

3.56. By looking at the purpose of the communications overall, and combining this with the consumer journey, we can see the strength of the package at delivering more effective consumer engagement.

#### *Introducing a TCR and personal projection metric*

3.57. The TCR will improve consumers' access to tariff information. By expressing the tariff price as a single number, the TCR will make it easier for consumers to look at the difference between a range of alternative tariffs. However, the TCR is not a tool to accurately assess the cost of different tariff options for an individual consumer. This is the purpose of the personal projection.

3.58. The TCR and personal projection will make it easier for consumers to compare tariffs on a like-for-like basis. By improving the understanding of the costs of different tariffs, consumers may compare their current tariff with others on the market. This may help consumers realise when better options are available from other suppliers, thus affecting their perception of satisfaction and/or prompt them to consider switching. This should also improve consumers' knowledge of the market and, in particular, of which tariffs might save them money if they were to switch. It may also help boost consumer confidence.

---

<sup>65</sup> Ipsos MORI (January 2012).

<sup>66</sup> Broadly speaking, these stages are mapped out in terms of triggers/prompts, current tariff features, energy usage information, alternative tariff options, best fit for the consumer, savings or gains available, and ultimately the decision to switch or not.

3.59. Engaging with suppliers is an important step in increasing consumers' knowledge about the energy market. The TCR and personal projection will increase the number of triggers for consumers to engage with suppliers. As a single metric included on a number of key communications, the TCR will act as a prompt for engagement by clearly and simply empowering consumers to compare different tariffs easily. The personal projection reinforces these triggers by tailoring the metric to a consumer's level of energy usage and is therefore specific to them.<sup>67</sup> The personal projection is also a key feature of the "cheapest tariff" messaging, providing additional prompts to consumer engagement.

3.60. As part of the TCR proposal, personal communications from suppliers will also improve consumer knowledge by indicating whether they are low, medium or high users of energy. Our research shows that such signposting may be beneficial to the accuracy of consumer choices, speed of decision making, and may also make consumers feel that their choice was easier.<sup>68</sup> Signposting may also increase consumers' awareness of how their usage compares to other consumers.

#### *SOC*

3.61. Under the proposed SOC suppliers (and their representatives) will be required to consider consumer needs and to treat all consumers fairly. As outlined in the licence condition, this includes providing information (whether in writing or orally) to a consumer that is complete, accurate and not misleading. Suppliers will also be required to communicate effectively to consumers. They will be required to present information which is relevant to the consumer and is fair in terms of content and how it is presented. The SOC will therefore contribute to the improvement of the quality of information consumers receive from their suppliers. This in turn can help consumers to understand their energy tariff and the options available to them.

#### *Protecting consumers on fixed term offers*

3.62. Our proposals related to auto-rollovers, particularly End of Fixed Term Notices, address the lack of information or clarity in suppliers' communications to consumers. Specifically, the 42 calendar day advance notification letter prompts consumers to act, providing them with the TCR and personal projection metrics, information on the cheapest tariff available from their supplier, and a signpost to switch or seek independent advice.

3.63. Together with the personalisation of information to the consumer, the use of standardised terms and language will promote the understanding of different features of fixed term tariffs. Our proposal on auto-rollovers also prompts and aids consumers to make an informed decision, and to understand what will happen if they do not to act by the end of their contract.

---

<sup>67</sup> Where possible, we have sought to simplify the information provided to consumers where the TCR plays a key role (e.g. on bills the summary no longer requires a unit rate and indicative cost per day, as both of these are subsumed within the TCR metric).

<sup>68</sup> Ipsos MORI (2012), 'Consumers' views of price comparison guides and tariff structures', page 8.

3.64. The prohibition on price increases and other adverse unilateral variations will directly target the lack of predictability for consumers. This will help to mitigate consumers' feeling of helplessness in the face of price increases (and other adverse unilateral variations to contracts).<sup>69</sup> It will contribute to aligning the expectations of consumers (through restricting many non-fixed-price fixed term tariffs), and improve their understanding and knowledge of the fixed term market.

## Lack of consumer trust

3.65. Consumers' level of trust in the energy market is low and engagement levels have been falling for a number of years. In the Probe, we outlined that the energy market had the lowest consumer confidence of 50 surveyed sectors. A similar report for Consumer Focus in 2009 also found energy as the lowest ranked sector for customer service.<sup>70</sup>

3.66. The causes for lack of consumer trust that we have identified include:

- Consumers perceptions of suppliers' excess profits;
- Consumer negative experiences in their interactions with suppliers;
- Poor information available to consumers;
- Poor customer service.

### *Consumers' perceptions of suppliers excess profits*

3.67. The overall perception of the energy industry is fairly negative and rarely rises above neutral. The negativity on the whole is less about personal experience as an individual consumer and more as a result of perceptions of excess profits. This is seen as particularly unfair because suppliers are selling an essential service. Where consumers feel that their energy supplier has treated them poorly, this exacerbates their negative feelings over the profit issue.<sup>71</sup>

### *Consumer negative experiences*

3.68. Experiences that are not in line with consumer expectations with regard to their interactions with suppliers are a driver of lack of trust in the energy suppliers and market. This may lead to reduced engagement from consumers and ultimately lower competitive pressure.<sup>72</sup>

### *Poor information available to consumers*

---

<sup>69</sup> Ipsos MORI (January 2012).

<sup>70</sup> Ipsos MORI (August 2008), 'Customer Engagement Survey Report prepared for Ofgem' and Ipsos MORI (March/April 2009), 'Report on the 2009 Consumer Conditions Survey' p.4.

<sup>71</sup> Insight Exchange (October 2012).

<sup>72</sup> Ipsos MORI (August 2008), (March/April 2009), (January 2012).

3.69. In the previous section we discussed how the lack of clear information was contributing to a lack of consumer knowledge. To a large extent, consumers rely on information provided by suppliers. This can place consumers at a disadvantage if the information they are given is not clear or appropriate to their circumstances or needs.<sup>73</sup> For instance, Ofgem Consumer First Panellists told us that consumers do not find communications from suppliers particularly user-friendly or easy to understand which can deter further engagement. They are perceived as being unnecessarily complicated and many consumers are confused by the purpose and content.<sup>74</sup> Consumers may therefore lose interest in the energy market, as the end product is viewed as 'all the same' across the market.<sup>75</sup>

#### *Customer service*

3.70. Many consumers cannot understand why suppliers do not improve customer service, so it is consistently of a high standard, and feel this should be a basic aspect of the energy service they provide. As noted in previous sections of this document this frustration on the part of consumers is closely linked to lack of trust in individual energy suppliers and with the industry more broadly. Again, such views can form from a consumers own experience and/or experience of others' that they are aware of.<sup>76</sup>

### **Impact of proposals on lack of consumer trust**

#### *SOC*

3.71. Our proposals requiring suppliers to treat consumers fairly and take their needs into account will improve supplier behaviour and ensure consumers are better protected. Enforceable SOC will also help improve consumers' experience of interactions with suppliers and the market, and consequently improve levels of consumer trust in the industry. Additionally, the principles-based approach to regulation provides suppliers with the ability to be flexible, innovative and outcomes driven in delivery of the SOC.<sup>77</sup>

3.72. In our consumer testing, we found that most consumers agree that the SOC should be introduced, but they were surprised that such protections were not already in place. For those that have had poor experiences, they felt that if suppliers adhered to the SOC, they should see an improvement in supplier conduct. There was some cynicism about whether these SOC will create the required change and consumers noted the need for "government", or some other body, to ensure supplier actions are in line with such practices.<sup>78</sup>

---

<sup>73</sup> Insight Exchange (October 2012), Ipsos MORI (January 2012).

<sup>74</sup> Ipsos MORI (January 2012).

<sup>75</sup> Insight Exchange (October 2012).

<sup>76</sup> Insight Exchange (October 2012), Ipsos MORI (August 2008), (March/April 2009), (January 2012).

<sup>77</sup> RMR (December 2011) consultation responses. Opinion Leader (2009), 'Ofgem Consumer First Panel, Research findings from the First event (Year 2)', Insight Exchange (October 2012).

<sup>78</sup> Retail Market Review December 2011 consultation responses. Insight Exchange (October 2012).

*Clearer and simpler information*

3.73. We consider that our proposals to improve the quality and accessibility of information in the energy market would have a positive impact on consumer trust. As discussed above in the context of the effect of our proposals on market complexity, consumers value communications from their energy suppliers that are: short or at least succinct; clear and easy to read and understand; personalised; and free from jargon<sup>79</sup>. We have designed our information remedies with these preferences in mind. We consider that consumers are more likely to trust a market that they understand as opposed to one that is opaque to them. Our information remedies would, therefore, play an important role in re-building consumers' trust in the energy market.

*TCR*

3.74. The TCR is designed to increase consumers' understanding of, and access to information on, relative prices. The personal projection is designed to enable consumers to make accurate comparisons of the cost of energy tariffs on a like-for-like basis. These measures may increase consumers' confidence in their ability to navigate the market. Greater confidence and understanding of the energy can help to increase trust. By providing a prompt to engagement, best buy tables might lead consumers to engage with the market more frequently. This greater frequency of engagement should bring familiarity with the market which, in turn, may have positive effect on consumers' trust of the market.

*Tariff Simplification*

3.75. It is clear from our research that tariff complexity and the number of tariffs causes frustration amongst consumers.<sup>80</sup> They find it difficult to determine if they are on the best deal for their circumstances.

3.76. Our proposals to simplify tariffs will help to show the differences between suppliers' unit prices, discounts and bundled offers and services. It will be easier for consumers to compare tariffs (and suppliers) against each other, providing a greater degree of clarity to the tariff comparison exercise. And the tariff cap will mean less opportunity for suppliers to introduce multiple tariffs that are not distinctive from each other, meaning less opportunity to confuse consumers.

3.77. We expect that our proposals will help consumers to feel confident that tariffs are transparent and that suppliers have to present tariff information (in terms of discounts and the structure of the tariff) in a standardised way. If consumers are satisfied that we have led and directed tariff simplification, there is a greater chance that they will have faith in the process and its outcomes. Over time, we expect that tariff simplification will help to increase consumer trust in the market.

<sup>79</sup> SPA Futurethinking (October 2012a).

<sup>80</sup> Insight Exchange (October 2012) p.25.



### *Protecting consumers on fixed term offers*

3.78. A prohibition on price increases and other adverse unilateral variations will ensure alignment of tracker tariffs with SLC 23 and relevant legislation. Together with our proposed provisions to tighten the rules for notification of and consent to mutual variations, these rules will provide additional protections for consumers. Our proposals for improving communication of principal terms of fixed term contracts should also increase consumer trust in the market.

3.79. The impact of our proposals about auto-rollovers will be to increase the trust of consumers in the market by:

- Ensuring that consumers are not rolled over onto an inappropriate or more expensive tariff or worse terms where a termination fee would apply, and creating a space ('trigger points') for consumers to be able to switch without incurring switching costs;
- Ensuring that consumers are not 'locked in' to another fixed term tariff, in the case that they do not act by the end of their contract period;
- Requiring a price protection window covering the entire switching process for those consumers that decide to switch, so that consumers pay a known price for their energy.

## **Engagement: quantity and quality**

3.80. Our latest consumer engagement tracking survey shows that since privatisation 63% of gas and 65% of electricity consumers say that they have never switched supplier.<sup>81</sup> The rate of switching has been in decline in recent years. This is shown in figures published by DECC on domestic electricity and gas transfers in GB.<sup>82</sup> Similarly, Ipsos MORI's consumer engagement tracking survey also shows that switching is in decline.

3.81. Evidence from behavioural economics suggests that individuals are 'loss averse'. In other words, a loss has a significantly greater impact on an individual than the equivalent gain.<sup>83</sup> As a result, financial losses to the consumer, for example in the form of termination fees or of the time spent trying to switch, are likely to have a greater impact on switching than the same level of savings available from switching to a new deal.

---

<sup>81</sup> Ipsos MORI (April 2012). We recognise that these figures are reliant on the respondents' ability to recall their past behaviours, and our analysis of trends over time suggests the tendency to under-report previous switching behaviour is increasing. Nevertheless, it does suggest that a majority of consumers perceive themselves to have been largely inactive in the market.

<sup>82</sup> See DECC's Energy Trends and Quarterly prices. Dataset available at [www.decc.gov.uk/assets/decc/statistics/source/prices/gep271.xls](http://www.decc.gov.uk/assets/decc/statistics/source/prices/gep271.xls).

<sup>83</sup> Kahneman, D., Knetsch, J. And Thaler, R. (1990), 'Experimental tests of the endowment effect and the Coase Theorem', *The Journal of Political Economy*, 98: 1325-1348.

3.82. One fifth (20%) of those who say they've never switched believe switching is a hassle.<sup>84</sup> Qualitative research suggests this is a commonly held belief among all but a minority of engaged consumers: many believe it will be a time consuming and potentially problematic experience, either because they have experienced this in the past, know others who have struggled or not gained, or just assume it will be difficult.<sup>85</sup>

3.83. Our evidence shows that many consumers find it difficult to assess whether they will gain financially from switching their supplier. Many believe financial gains will be small or short term, and so do not investigate further. Many simply feel that the amount of time and effort required to navigate their energy options and potentially to decide to switch tariff or supplier is disproportionate to what they believe they would ultimately gain.<sup>86</sup>

### **Impact of proposals on engagement**

#### *Consumers ability to assess alternatives*

3.84. Our proposals to standardise tariff structures, discount and bundling practices will help to simplify the price comparison exercise. Consumers will face more certainty in the market and will have less variation to process when choosing between different offers. We expect that this will help consumers to assess more easily which tariff offers the best price and the effect of any other discounts and or bundled offers.

3.85. Presenting key tariff information in a Tariff Information Label should also help to improve the quality of switching. Research with the Consumer First Panel has shown that most consumers appreciate that accessing the details of one's current tariff is the first step in making a comparison with alternative tariffs.<sup>87</sup>

3.86. Other research which aimed to test the Tariff Information Label with consumers showed that while some less engaged consumers may find the Label to be too much information, some respond well to the concept and say that the information would be useful if they were considering switching.<sup>88</sup> Some consumers felt that the Label would make it less complicated to choose a new tariff as the key features of each tariff would be clearly presented in a comparable format.

3.87. Through our communication requirements for the Standards of Conduct, consumers will be informed of what suppliers are aiming to do to meet consumer needs. We will also be improving the transparency of suppliers' relative performance. This information can be used by consumers in their switching decisions which can lead to more effective and informed switching.

---

<sup>84</sup>Ipsos MORI (April 2012).

<sup>85</sup> Opinion Leader (March 2011), Ipsos MORI (January 2012), (August 2012).

<sup>86</sup> Ipsos MORI (March 2012).

<sup>87</sup> Ipsos MORI (March 2012).

<sup>88</sup> SPA Futurethinking (October 2012a) and DECC (March 2010), 'Quarterly Energy Trends', p.48-49.

3.88. By providing information about the cheapest tariff available from the existing supplier, we effectively provide a default option for consumers. It will provide them with clear information which enables them to make accurate decisions about their energy options.

3.89. Overall research also suggests that simply improving the language, design and layout of information channels is unlikely to prompt the vast majority of consumers to review their tariff options, as most remain unconvinced of the value of engagement (i.e. how much they could save as a result). If aiming to engage consumers and prompt them to consider their energy options, the key aspects of any improvements to supplier communications should be providing personalised saving messages, signposting impartial switching advice and consumer rights information.

3.90. By making comparisons between tariffs easier, the TCR tackles directly the 'hassle' factor (i.e. time and effort required) in exploring the market. Our tariff simplification proposals aim to have the same effect, by reducing the number of tariffs it limits the options consumers will face.<sup>89</sup> This could lead to increased rates of regular switching and a decrease in the proportion of consumers that report they have never switched. Our consumer research indicates that consumers have a strong preference for personalised information to allow them to effectively understand how this impacts them.

3.91. In addition, if a consumer decides to switch, in response to a price increase or other adverse unilateral variation, or at the end of a fixed term contract, we are proposing to remove the requirement for a consumer to notify their supplier of their intention to switch, on or before the date of the variation / end of the fixed term period. This should simplify the process of switching for consumers.

#### *Incentives on consumers to act*

3.92. Our quantitative evidence suggests that many consumers could save money by switching suppliers or by moving to the cheapest deal offered by their current supplier. We also published evidence on the benefits on savings in the appendix to our March document.<sup>90</sup>

3.1. Figure 5 below shows the indicative savings that consumers can make from switching, across all four payment methods. In summary:

- Consumers can save an average of £72 and a possible maximum of £158 per year by switching to the cheapest deal in the market for their payment method;
- Consumers can save an average of £107 per year by switching to the cheapest deal offered by their supplier across all payment methods.

<sup>89</sup> We are aiming to explore this issue through further academic research. Behavioural experiments will show whether consumers are more likely to switch when faced with more or fewer choices.

<sup>90</sup> [http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR\\_Appendices.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_Appendices.pdf).

**Figure 5 Estimated potential savings from switching**

	<b>Cheapest</b>	<b>Average</b>	<b>Annual savings</b>	<b>Maximum savings</b>	<b>Savings from switching to supplier best deal<sup>91</sup></b>
<b>Direct Debit</b>	£1,120	£1,192	£72	£156	£48
<b>SC with prompt pay discount<sup>92</sup></b>	£1,190	£1,257	£68	£149	£113
<b>SC without prompt pay discount</b>	£1,203	£1,286	£83	£175	£142
<b>Prepayment</b>	£1,203	£1,268	£65	£152	£124
<b>Average</b>	<b>£1,179</b>	<b>£1,251</b>	<b>£72</b>	<b>£158</b>	<b>£107</b>

Source: Ofgem, 2012

3.2. These levels of potential savings indicate that there are real benefits to consumers from engagement. We expect that this, together with the effects of our proposal in the consumers' ability to access information and assess alternatives, should provide a strong enough incentive to make consumers overcoming the hassle of switching.

<sup>91</sup> Note that this analysis excludes online tariffs. It does not consider the saving that could be achieved by moving from one online tariff to the cheapest online tariff. Under our proposal, a consumer would not be offered an alternative online tariff if they were not already on an online tariff.

<sup>92</sup> Prompt pay refers to the discount a consumer would receive if they paid their bill promptly.

## 4. Impacts on competition

---

### Chapter Summary

This section sets out the potential impacts on competition of the domestic RMR proposal. We identify the likely overall impacts across suppliers as well as differential impacts across suppliers.

**Question 2:** Do you agree with our assessment of the impacts of our proposed package of measures on competition? Please explain your views.

**Question 3:** How much incremental cost would you incur to implement our proposed package of measures?

**Question 4:** What would be the percentage reduction in costs, in relation to the cost estimates provided in the previous question, if you were not required to provide personalised information under our measures for the supplier cheapest deal, personal projection, bill, annual statement, price increase notification, and end of contract letter?

4.1. In this section we assess qualitatively the impacts on competition of our main proposals. We assess how likely our proposal is to affect supplier rivalry in the market, barriers to entry and expansion, small suppliers as well as the ability of suppliers to innovate.

4.2. This section also presents our preliminary estimates of the costs involved in implementing the policy proposals. We welcome stakeholder views on these costs in their responses to this consultation.

### Impacts in terms of supplier rivalry in the market

#### Overall impact across suppliers

4.3. Our proposed RMR package will affect market competition by changing the nature of rivalry between suppliers and making competition in the market more effective. We have divided our analysis of the impact of our proposal into two relevant dimensions of supplier competition:

- Impact on suppliers' incentives to compete; and
- Impact on preventing suppliers' ability to compete in the market in ways that could cause consumer harm.

4.4. In the remainder of this section we provide an analysis of how our proposal affect these dimensions of supplier competition.

*Impact on suppliers' incentives to compete*

4.5. Our updated RMR package is designed to facilitate and promote consumer engagement in the market impacting positively upon supplier's incentives to compete and fostering effective market competition.

4.6. The proposal should impact heavily upon the demand-side. Consumers should be able to increase their understanding of the market, have the opportunity to make well informed decisions and be able to compare product offerings across suppliers in a meaningful way. This should be done in a market environment where consumers can engage with confidence with their supplier or prospective supplier.<sup>93</sup>

4.7. The potential impact of the proposal is to reduce the proportion of sticky consumers and transform them into more active and engaged consumers, making the overall market demand more responsive to prices and quality of products being offered. More consumers switching or threatening to switch should increase rivalry between suppliers and work as an incentive for them to provide greater quality or more efficient economic prices.<sup>94, 95</sup>

4.8. Further, we also expect other more indirect impacts of competition. Where increasing effective competition results in higher customer churn rates we might observe vertically integrated energy companies resorting to the wholesale market to meet their energy supply obligations.<sup>96</sup> This has the potential to increase wholesale market liquidity and improve supply side competition.

4.9. We recognise that there is scope for "coordinated effects". Firstly, with fewer tariffs in the market coupled with the TCR and other simplification measures, suppliers may find it easier to monitor each other's prices and/or bundled products and services. Over time, it might be that this greater transparency allows suppliers to respond more easily to rivals' strategies, thereby reducing the differentials that exist between them.

4.10. However, there are already co-ordinated effects in the market (Chapter 2 of the consultation document provides further details). On balance, we consider that a more engaged consumer base will help to reduce these effects and will outweigh any incentive for firms to co-ordinate their actions. For example, a more engaged consumer base, one which is better able to assess tariff options, will look to see where the best deal lies across the supplier spectrum. It will have greater awareness of small and independent suppliers and may be more willing to explore the deals that these suppliers offer if they can see clearly that they are more competitive. We may see the emergence of different business strategies that result in different cost

---

<sup>93</sup> Chapter 3 sets out in greater detail how the different components of the updated RMR package may impact upon consumer engagement.

<sup>94</sup> With respect to the 'status quo', we expect that the efficient competitive price to be lower than current observed prices.

<sup>95</sup> We also expect market entry to be easier with an increased proportion of active consumers. We discuss this effect of our proposals in the next section of this chapter.

<sup>96</sup> Note that in a scenario of increased competition, vertical integrated companies will tend find it more difficult to construct balanced 'up' and 'down' stream energy portfolios.

structures and innovative products. Ultimately, by simplifying the market, our proposal could reduce barriers to entry and lead to changes in what are relatively stable market shares.

4.11. Secondly, it is possible that suppliers remove their cheapest deals from the market if our proposal result in raising the prominence of those deals. Suppliers may decide that there is too great a risk of consumers moving to the cheapest deal in high numbers and reducing their ability to maximise revenues and profits.

4.12. We recognise the possibility that our proposal could lead to a short-term reduction in the availability of deeply discounted deals. However, over the longer term, a more engaged consumer base should help to increase competitive pressure on suppliers and force suppliers to look for efficiency savings. We expect that if these cost savings are passed onto consumers, it will result in generally cheaper tariffs.<sup>97</sup>

*Impact on preventing supplier's ability to compete in ways that could cause consumer harm*

4.13. Our proposal also impacts on suppliers' ability to engage in profitable practices that result in consumer harm. This impact is achieved in a number of different ways:

- The SOC will obligate suppliers to treat their consumers fairly and require them to take consumer needs into account in relation to all interactions in the market. As mentioned in the consultation document Ofgem can take enforcement action if it considers that a supplier has not complied with the Standards of Conduct.<sup>98</sup> The introduction of the SOC will limit a supplier's ability to take actions or omissions of information that significantly favour the interest of the supplier and give rise to the likelihood of detriment to a consumer.
- By reducing the problem of imperfect information and improving consumers' bargaining power, the TCR proposal limits suppliers' ability to take advantage of uninformed consumers (e.g. in the information they give them when they are marketing to them).<sup>99</sup>
- We also recognise that our proposed limit on open tariffs and ban on dead tariffs will reduce, though not eliminate, the ability of suppliers to segment

---

<sup>97</sup> This assumes there is no scope for new entrants to undercut existing suppliers by offering an even cheaper tariff.

<sup>98</sup> See Chapter 8 of the consultation document.

<sup>99</sup> In a perfect world, i.e. 'perfect competition', both consumers and suppliers have full information on anything that might influence their respective decision-making process, for example all suppliers' costs, products and prices. In an imperfect world, the party with better or more complete information has a competitive advantage over the other party, potentially leading to market failure. At present, suppliers are better informed than consumers, leaving the latter at a competitive disadvantage. By improving accessibility of information and comparability of tariffs, the proposal gives consumers the tools they need to more effectively engage in the market. If successful, consumers will be in a better bargaining position, and each will be better able to choose the supplier offering the most appropriate tariff.

the market since there will be less scope to design tariffs specifically targeted at attracting or recovering costs from particular consumer categories

- Overall, fixed term rules have the potential to limit suppliers' ability to segment the market between active and inactive consumers by making the fixed term market less complex and easier to understand, and therefore more accessible to less confident consumers. Further, our new proposed rules will also limit the extent to which suppliers can further segment the market within the fixed term market. Suppliers will no longer be able to offer initial attractive deals with the expectation that consumers will be automatically rolled over to fixed term tariffs on less favourable terms.
- Requiring suppliers to inform consumers of their cheapest available tariff has the potential to limit supplier's ability to segment the market between more active and engaged consumers, and those less active and engaged, by providing all types of consumer with clear, accessible information on cheaper energy options. Further, this will also limit suppliers' ability to obfuscate tariff information, making clear what options a consumer has and making it easier for them to make comparisons.
- Our existing ban on termination fees for evergreen contracts and our proposal to widen the definition of termination fees to cover loyalty discounts reduces the extent to which suppliers can 'lock-in' consumers to contracts.

### **Differential impacts across suppliers' incentives and ability to compete**

4.14. We note that some of the measures in our proposed package may result in a differential impact across suppliers.

4.15. Our proposal will simplify and standardise tariffs, increasing their transparency. We expect that this will encourage 'sticky' consumers to engage in the market and explore their tariff options. As most sticky consumers are customers of the previous incumbent suppliers, it may be that this engagement exerts greater competitive pressure on them than on small suppliers. Nonetheless, small suppliers will also be affected by our proposal. For example, we note that three of the nine small suppliers have two-tier tariffs. These will no longer be permitted under our proposal.

4.16. Under our new fixed term rules, suppliers may find it harder to pass on non-controllable costs, e.g. network charges. In particular, this may be more challenging for smaller suppliers, as larger suppliers may be better able to financially manage this risk. However, there may be certain circumstances which are beyond the control of the supplier where price increases are appropriate. Our proposal still allow for tariffs with ex ante automatic variations, which could be synchronised with estimates of expected variations in network charges (or other costs). Under exceptional circumstances, these variations may be considered by the Authority for derogation from the prohibition on price increases and other adverse unilateral variations.



4.17. We acknowledge however that visibility of future network charges is limited for suppliers. We have recently published our decision in relation to mitigating network charging volatility.<sup>100</sup> The measures we are introducing are intended to improve the predictability of allowed network revenues, which will improve suppliers' ability to price network charges into their fixed term offers.

### **Impact on barriers to entry and expansion and small suppliers**

4.18. Our proposal may, in certain instances, have the potential to raise barriers to entry and expansion, or affect small suppliers. However, as the analysis below shows, these impacts are materially counterbalanced by relevant mitigating factors.

4.19. Additionally, we expect our proposals to lead to increased engagement and trust in the energy market. By increasing awareness of alternatives, and enabling consumers to access key information and assess their options, our proposals are expected to enable consumers to engage effectively.

4.20. Given the opportunities for potential savings mentioned above (see Figure 5), the increase in effective engagement should lead some consumers to switch, and therefore switching levels may increase overall. This should have a positive impact on smaller suppliers' ability to expand, and on the prospects of potential new entrants.

#### *SOC*

4.21. In its response to the December 2011 consultation, one small supplier suggested that the main costs of the SOC are likely to come from compliance and regulatory reporting, which fall disproportionately on smaller suppliers, as a fixed cost. Other small suppliers felt there would be little if any difference in costs to them, compared to the previous incumbent suppliers.

4.22. However, we do not expect that our proposal adds a significant level of additional regulation to potential new entrants or disproportionate additional costs to business expansions. In any case, consumer expectations are that any reasonable supplier should comply with the Standards at a minimum.<sup>101</sup> Therefore, any supplier should be doing this as a matter of course.

4.23. In any event, we would act proportionately in an enforcement case and take all circumstances of the case into account when assessing the seriousness of a case.

---

<sup>100</sup> Ofgem (October 2012), 'Decision on measures to mitigate network charging volatility arising from the price control settlement'.

<sup>101</sup> Insight Exchange (October 2012).

*TCR*

4.24. We note that the TCR proposal could, in principle, lead consumers to focus on price to the exclusion of other features of energy tariffs. This outcome could have a disproportionate adverse effect on smaller suppliers, to the extent that they are looking to compete on non-price grounds (such as in offering green tariffs).

4.25. In particular, it may mean that the tariffs offered by smaller suppliers would not feature on best-buy tables and so would be less visible to consumers. In turn, this could create a barrier to entry or expansion for smaller suppliers.

4.26. However, given that the provision of best buy tables would be determined in the market there would be an opportunity for tables to be published that focus on non-standard products (such as green tariffs). Ofgem would not restrict commercial decisions on how best-buy tables should be published. Best buy tables could contain a column in which the key features of a tariff would be explained and hence consumers could consider information other than price when comparing tariffs.

4.27. It is also worth noting that the Tariff Information Label would contain a full description of tariff features and so consumers would have access to price and non-price information when comparing tariffs. Finally, our proposal to publish information on suppliers' performance would provide greater visibility for those small suppliers that choose to compete on the basis of service quality.

*Tariff simplification*

4.28. Our quantitative analysis shows that on average, the seven small suppliers offer two core tariffs. Only one small supplier would have to reduce their tariff numbers under our proposals to cap tariff numbers. This suggests that when new suppliers enter the market, they do not tend to offer a high number of tariffs as an entry strategy. Our proposal is therefore in line with current small suppliers' commercial behaviour.

4.29. Under our proposed simplification rules on discounts suppliers will be able to offer discounts as long as they are offered as a separate tariff in their four-tariff limit. This should allow new entrants and small suppliers commercial freedom whilst achieving overall tariff simplification.

4.30. Some small suppliers have raised concerns that the deeply discounted tariffs other suppliers have offered were making it harder for them to attract new customers. Since we expect our proposals to reduce the scope for market segmentation, we expect the advantage afforded to incumbent suppliers will reduce, giving smaller suppliers increased opportunity to expand. We would also expect that reducing segmentation would increase the entry prospects of potential new suppliers.

*Protecting consumers on fixed term offers*

4.31. We expect our proposed fixed term rules to reduce a barrier to entry and expansion in the fixed term market by avoiding consumers being automatically rolled over to fixed term contracts with termination fees.<sup>102</sup>

4.32. However, our proposed fixed term rules have the potential to increase the cost of providing fixed term offers which could disproportionately impact new entrants, small suppliers or become a barrier to expansion. For example:

- Some respondents have noted that price protection windows or providing written notifications increase the costs of providing fixed term offers;
- Our proposed rules on unilateral variations may reduce the scope to pass on non-controllable costs to consumers on fixed term contracts;
- Restrictions on tariff types reduce suppliers' ability to hedge their product portfolios as they currently do;
- Prohibiting auto-rollovers to fixed term offers potentially makes demand less predictable, making it more difficult to forecast and increasing some costs.

4.33. We acknowledge that suppliers might be exposed to wholesale price shocks during the price protection window. Even though potential entrants or small suppliers might be less capable of managing this risk because they have smaller customer bases, we also expect that they will be able to adapt their hedging strategies to minimise this impact.

4.34. Prohibiting auto-rollovers to fixed term offers might make demand more uncertain and result in suppliers resorting more often to wholesale spot markets. This might impact more on potential entrants or smaller suppliers as they generally face greater trading costs in comparison to larger suppliers. However, as noted in some stakeholders responses, if auto-rollovers were to be removed suppliers are also likely to work harder to retain their customer base limiting the impact on suppliers' costs but suppliers would incur additional cost in attempting to retain customers.

4.35. Restrictions on tariff types might mean that suppliers may attach additional risk premium or enter more costly hedging strategies to manage this reduced flexibility. This might impact more on potential entrants or smaller suppliers as they have smaller customer bases.

4.36. Overall, we do not expect our fixed term rules to be material enough to block entry, limit expansion or induce exit of potential entrants or small suppliers but we acknowledge they could negatively impact on their competitiveness in the fixed term market in the shorter term. However, in the longer term, we consider that our proposed rules can mitigate this negative impact because of their potential to remove a significant barrier to entry and expansion by avoiding consumers being

---

<sup>102</sup> We note that our proposed fixed term rules are consistent with consumer protection legislation.

automatically rolled over to fixed term contracts with termination fees. As a result, we expect these rules to be in the consumer interest.

#### *Clearer and simpler information*

4.37. In general, we do not consider that the content or format restrictions of our information remedies will affect barriers to entry or expansion. However, we note that the Tariff Information Label will ensure that non-price tariff information is presented to consumers in a clear and accessible format before they select a new tariff. By increasing the visibility of non-price tariff information, we consider that the Tariff Information Label could help small suppliers to demonstrate their market niche.

4.38. We note that our information remedies will impose compliance costs (see discussion below) on suppliers and this may represent a barrier to entry or expansion. For instance, some consultations responses and comments at our stakeholder roundtables from both large and small suppliers suggested that there may be significant costs involved in the implementation of the information remedies. However, other responses suggested these would be much less significant as the proposed requirements would not be very different from the information they currently provide.

4.39. In particular, smaller suppliers and new entrants may be hit disproportionately by the fixed costs related to the necessary systems changes of implementing new communication templates, resulting in higher costs for compliance per consumer. In order to establish the full cost implications for new entrants, we look to suppliers to provide us with their estimated costs.

## **Impacts on innovation**

### **Overall impact across suppliers**

4.40. We expect that our proposals will allow suppliers sufficient flexibility to innovate, ensure that innovations generate genuine value to consumers and ensure that the ToU market is not negatively impacted by our proposals.

#### *SOC*

4.41. We are proposing to use a principles-based approach to regulation to implement our SOC and allowing suppliers a degree of flexibility and freedom to deliver against the SOC. Suppliers will have the space to be innovative and find solutions to challenges in the retail market, which would not be possible with a directives based approach to improving standards. Therefore, the SOC should allow for innovations in both service and technology within the energy industry.

### *Tariff simplification*

4.42. Overall, our tariff simplification proposals are intended to allow for a degree of innovative product differentiation that consumers value within a simplified market where consumers are more confident of being able to compare tariffs and choose the best one for them.

4.43. Although our cap on the number of open tariffs and rules on discounts and bundles will limit the tariff options that suppliers can offer to consumers, our proposals will still allow a significant amount of innovation in tariff offerings including a range of ToU tariffs. Our proposal to limit tariffs to a standing charge and unit rate would not preclude suppliers from offering different unit rates for different times of the day, dates etc. as long as only one unit rate applies at any one time. We will also consider derogations where there is a strong case that more innovative tariffs would be in consumers' interests. Also, since our cap is set on a supplier basis there is still significant scope for a range of innovative tariffs to be offered across the market.

4.44. Further, we note that under our tariff simplification proposal, suppliers would be free to offer evergreen and fixed term tariffs with a range of features, discounts and product bundles. We have proposed rules for how each of these would be treated but our proposal would allow suppliers to continue to compete through product differentiation as well as on price and service quality.

4.45. Our proposals to simplify tariff structures will mean that two-part tariffs, for example so-called 'no standing charge' tariffs where the first unit rate is set higher than the second in order to replicate the effect of a standing charge, will no longer be available to consumers. In many cases the attraction to these tariffs is due to a misunderstanding that they will result in lower energy bills than the standing charge equivalent tariffs. However, we recognise some consumers (particularly those that have very low energy consumption) value these tariffs. Our proposals allow suppliers to set the standing charge at zero if they consider this is appropriate, our proposals therefore need not harm those that have very low energy consumption.

4.46. Our proposed rules on discounts also mean that suppliers cannot offer loyalty and other time bound discounts on variable or evergreen tariffs. We recognise that some consumers value these discounts and in some cases see them as a reward for staying with their supplier. However, we consider loyalty discounts to be analogous to termination fees and therefore inconsistent with the licence regarding evergreen tariffs.

### *Protecting consumers on fixed term offers*

4.47. A respondent suggested that our previous fixed term rules would risk consumers losing their ToU benefits<sup>103</sup> if at the end of a fixed term contract they were to default onto a standard tariff. However, our updated proposals will ensure

---

<sup>103</sup> In the December 2011 consultation, we proposed consumers to default to the evergreen tariff.

that in the event a consumer is on a fixed term ToU tariff, there will need to be an evergreen ToU tariff for their meter type to default on to.

4.48. Our proposed fixed term rules will restrict types of tariff available in the market. For those tariffs, e.g. specific tracker mechanisms, innovation may in this regard be limited. However, we consider that there is plenty of scope for alternative fixed term offers to be made available, which comply with our proposals or for these to be offered as evergreen tariffs. We expect an uptake in availability and innovation in these offers.

4.49. Concerns have been raised by respondents to the December 2011 consultation regarding the standardisation of the content and formatting of elements of key communications between the supplier and the consumer. This could potentially affect suppliers' ability to differentiate themselves (through innovative communications) from each other and therefore compete.

4.50. We acknowledge that, in certain instances, we have been quite prescriptive in our approach, which will create space constraints for suppliers on certain communications. We have, however, attempted to minimise these requirements to allow suppliers to put their stamp on the communications and differentiate themselves.

4.51. We also note that increased prescription may make the licence less future-proof, for instance, the standardised formats for price increase information on the PIN may not be easily adaptable to tariff innovation. To mitigate this risk we have provided some flexibility in our proposed format to allow for more complicated tariff structures which may arise through the development of ToU.

### **Differential impacts across suppliers**

4.52. Our SOC proposal will apply to all suppliers. The principles based approach allows all suppliers the chance to be innovative in their dealings with consumers, although some suppliers will choose to be more innovative than others. This will be a function of business strategy and individual decisions rather than a consequence of our proposals. We feel this will be an opportunity for the industry to adopt a different mindset with regard to how they interact with consumers, and increase the degree to which they put these interactions at the heart of their business. We recognise that some suppliers are already considering this type of shift in their business culture, so some suppliers may face a greater degree of change to comply with the SOC than others.

4.53. The impact of our prohibition on price increases and other adverse unilateral variations in the fixed term market may have impacts on the hedging ability of suppliers as well as their ability to pass through certain costs. These may be more impactful on small suppliers. However, on balance, we consider the consumer protection benefits arising from this policy outweigh the potential impact on small suppliers.

## Approach to the quantitative assessment of costs

### December 2011 consultation responses

4.54. In a number of areas our proposals have changed materially from those published in December 2011. While we received some limited information from respondents on these costs, not only did they vary dramatically across respondent for the same proposal, we consider that the information provided to us is now unlikely to be relevant, particularly in the case of our tariff proposals. To help us develop our proposals further, we would like respondents to this consultation to provide detailed cost estimates for each area of our proposals. Below we provide further details on what information we expect to receive.

#### *SOC*

4.55. In our December 2011 consultation responses most suppliers suggested they had not estimated costs of the SOC roll out.<sup>104</sup> Some small suppliers felt the costs related to the roll out of the SOC would be negligible, although one suggested that the costs could fall disproportionately on smaller suppliers as regulatory reporting is a fixed cost. However, under our proposal there will be no formal regulatory reporting requirement. We would envisage that the cost to ensuring that a supplier has the appropriate internal processes, including auditing processes, to cover regulatory oversight will vary between suppliers. We recognise that some suppliers appear to have already implemented changes to their business in line with the spirit of the SOC. We would envisage that costs imposed on some of these suppliers will be lower than others.

4.56. As mentioned in our consultation document it would be for each supplier to consider how to treat consumers fairly and meet their needs. For this reason we see that the cost may vary between suppliers dependent on how they decide to internalise the SOC. Similarly, costs may vary depending on how easily a supplier's processes and systems can accommodate relevant changes.

#### *Clearer and simpler information*

4.57. In their responses to the December 2011 consultation, stakeholders raised concerns about the cost of providing personalised pricing information because of the requirement for sophisticated computing systems. However, other suppliers indicated that our proposed templates would be easy to implement and within existing system capability.

---

<sup>104</sup> Only one of the large suppliers provided a cost estimate – a one-off cost of £500k. Other larger suppliers indicated that changes needed to comply with the SOC could involve more significant changes to their systems, procedures and auditing practices, which could impose more substantial costs.

### **Approach to quantifying costs**

4.58. We have been unable to conduct a quantitative assessment at this stage due to the lack of data to inform the costs and benefits of each measure. Suppliers provided very limited data on costs and benefits in their responses to the December 2011 consultation. Our proposed package has changed significantly since December, and consequently in a number of areas the cost information provided to us also is no longer relevant. We are therefore asking respondents to provide detailed evidence of the costs of our proposals. This will inform our subsequent policy consideration, final proposals and final impact assessment.

4.59. It is important to establish a robust framework on which we can base any quantification of costs. This will provide a common base that all respondents will use when providing any data about costs. Respondents will have a common set of assumptions, which is fundamental to ensure that the data we receive is consistent, and that we can audit its quality.

4.60. To establish this framework, we discuss the categories of costs that suppliers may incur as a result of the implementation of our proposed package of measures. Where necessary we discuss the methodology to estimate these costs. Finally, we identify the specific questions on which we are asking stakeholders' views.

### **The proposal and the counterfactual**

4.61. We are looking to monetise the costs that will result from implementing our proposed package of measures. The detail of these measures is provided in Chapter 4 to 9 of the consultation document.<sup>105</sup>

4.62. The objective of requesting this information is to allow us to estimate the impact of our proposed package of measures against the counterfactual. The counterfactual represents the outputs and outcomes that would have occurred in the absence of the RMR intervention. The counterfactual is necessary for comparing actual outputs and outcomes to what they would have been in the absence of the RMR intervention.<sup>106</sup>

4.63. The estimation of costs should consider exclusively the incremental impacts from the implementation of our proposal. This means that the cost estimates should exclude any costs that would have been realised in any case, even if we did not implement our proposed package of measures.

---

<sup>105</sup> To justify their responses, stakeholders should provide any information on the assumptions, or any other additional information on the rationale that they have used to achieve their estimates.

<sup>106</sup> This includes, for example, the impacts of policies that have been implemented, but have a delivery date in the future (e.g. the smart metering rollout, the green deal, etc.).



## **Estimating costs**

4.64. We would like suppliers to provide granular cost information that will enable us to understand the marginal impact of each measure in our proposed package. We are therefore requesting suppliers to provide data on each cost category breakdown by the different elements of our proposed package of measures: supplier cheapest deal (both the cost of calculation and cost for this to be presented on key communications), TCR, tariff simplification, information improvements (broken down by the cost implication of format requirements and content per channel), SOC and fixed-term tariffs rules. We would like these costs to be presented as one-off costs and ongoing annual costs.

4.65. We recognise however that there may be significant scale effects and synergies by implementing these changes simultaneously. For example, the incremental systems or software costs from implementing the supplier cheapest tariff on top of the improvements in information may be reduced or negligible. The monetisation of these costs should consider only the efficient incremental costs of implementing each of the measures in our proposed package.

4.66. In the responses to the December 2011 consultation and through our stakeholder engagement program, some suppliers have also signalled that the higher the level of personalisation of pricing information, the higher would be the costs of implementing the proposal. Other suppliers however were less concerned with this issue. We are interested in understanding the sensitivity of cost categories to the level of personalisation of pricing information.

4.67. To facilitate the identification of the cost categories, it is useful to distinguish between one-off costs and ongoing costs. We intend to provide further detail on what information we are seeking from respondents in a separate guidance note that we will produce during the consultation period. Our initial views are that the following cost information should be provided. This is indicative and not an exhaustive list.

### *One-off costs*

4.68. One-off costs are incurred in setting up the systems and processes required by our proposed package of measures. Some of these costs may be hardware costs, systems costs, and internal process costs.

### Hardware costs

4.69. To implement our proposed package of measures suppliers may need to install new hardware. The costs of new hardware would include any one-off costs that suppliers will incur with the provision, hosting and security of any additional IT infrastructure.

4.70. Some responses to the December 2011 consultation indicated that our previous proposals could lead to significant system capacity costs. However, other suppliers mentioned that some of our proposals could be implemented easily and within existing system capability.

4.71. The extent to which suppliers will need to invest in IT infrastructure to accommodate any of our proposed measures will depend on each supplier's current infrastructure, and also on how its current practices differ from our proposal.

#### System costs

4.72. Suppliers may need to update their systems following the implementation of our proposed package of measures. System costs are the one-off costs required to update or change the billing, back-office or any other systems that may result from implementing our proposal. These should cover one-off software development costs, but exclude any hardware costs.

4.73. Our proposed measures on information improvements, the cheapest tariff, and the TCR and personal projection are prescribing the use of specific content, and in some cases of the use of specific formats in suppliers' communications. Systems may need to change to accommodate these specific requirements. There may also be scope to update systems to cope with the introduction of the SOC, depending on how suppliers approach this measure, and how different their current practices may be from the proposed principles. There may also be scope for system changes resulting from the implementation of the tariff simplification (e.g. standardise tariff structures) and fixed-term tariff rules measures.

#### Process costs

4.74. In response to our proposal suppliers may need to change their processes. These are one-off costs of any changes in processes that may result from implementing our proposed package of measures. Process costs may also refer to costs of introducing new processes.

4.75. Staff training or the introduction of new auditing processes are examples of process costs that suppliers may incur. Where a new process is introduced, suppliers should provide the description of the process, how our proposal led to its introduction, and the rationale behind the cost estimate.

#### *Other one-off costs*

4.76. These would be any other one-off costs that the supplier could incur with the implementation of our proposal. If cost data is provided for this category, suppliers need to describe the cost, ensure that the cost is incremental, and explain the rationale for the cost estimate.

#### Ongoing costs

4.77. Ongoing costs are the day-to-day costs of managing and running the processes that may result from implementing our proposal.

#### Costs in managing customer queries

4.78. Our proposed package of measures will introduce new information in the energy market, and may change some of the ways in which consumers interact with suppliers. Consumers will need time to understand the new information, including how to use it. For example, the TCR is a new concept that we are introducing, and consumers will not immediately know what it represents and how it should be used.

4.79. It is therefore possible that suppliers may face an increase in the number of customer queries following the introduction of our measures. To understand the likely scale of this cost, it is necessary to estimate the likely increase in the number of queries from customers. It is reasonable to expect that after some time, consumers will have comprehended the new concepts and be more apt to navigate through the market. To estimate this cost, we are therefore requesting suppliers to estimate in advance the increase in the volume of queries from customers. We are also requesting suppliers to provide information on how long it could take for the number of queries to return to the levels pre-RMR implementation.

#### *Auditing costs*

4.80. It is possible that our proposal may lead suppliers to introduce new auditing and monitoring processes, or to change their current processes. We are requesting suppliers to estimate the ongoing costs of managing and running these audit costs.

#### Costs in running new processes


4.81. As mentioned above, our proposal may lead suppliers to introduce new processes. This category captures the ongoing costs of managing and running such processes. We are asking suppliers to describe any new process they introduce, why it is necessary, and the rationale for the cost estimates provided.

#### Other ongoing costs

4.82. These would be any other ongoing costs that the supplier could incur with the implementation of our proposal. If cost data is provided for this category, suppliers need to describe the cost, ensure that the cost is incremental, and explain the rationale for the cost estimate.

#### **Questions on implementation costs**

4.83. We are asking the following questions to suppliers, in relation to the costs of implementing our proposed package of measures:



The Retail Market Review – Draft Impact Assessment for the updated domestic proposals

- 1) How much incremental cost would you incur to implement our proposed package of measures?
  
- 2) What would be the percentage reduction in costs, in relation to the cost estimates provided in the previous question, if you were not required to provide personalised information under our measures for the supplier cheapest deal, personal projection, bill, annual statement, price increase notification, and end of contract letter?

## 5. Impacts on sustainable development

---

### Chapter Summary

This chapter assesses the potential impact of our proposed package of measures on three key sustainable development themes. These themes are: eradicating fuel poverty and protecting vulnerable consumers, managing the transition to a low carbon economy, and smart metering.

**Question 5:** Do you agree with our assessment of the impacts of our proposed package of measures on sustainable development? Please explain your views.

### Protecting vulnerable consumers and eradicating fuel poverty

5.1. In performing our functions, Ofgem must have regard to the needs of the following particular groups of consumers: those of pensionable age, those that have a disability, those that are chronically sick, those on low incomes and those living in rural areas. In chapter 2 we explored the impacts of our proposal on domestic consumers more broadly. In this section we focus on vulnerable consumers.

5.2. Ofgem has published proposals for a new Consumer Vulnerability Strategy<sup>107</sup>. This recognises the potentially dynamic nature of vulnerability and that identifying vulnerability is not just about focusing on certain groups of people. Additionally, vulnerability may stem from more than an individual's personal circumstances, and it may vary from market to market. We have identified a set of factors that may make someone more vulnerable than other people to experiencing detriment. Such factors include, but are not limited to, being chronically sick or disabled, having limited numeracy and literacy skills or being bereaved and unaccustomed to managing the household bills.

### Insight into vulnerable consumers

5.3. Vulnerable consumers are generally less likely to be willing or able to engage with the energy market.<sup>108</sup> A clear relationship exists between social grade and switching rates, with professional and managerial ABs much more likely to have switched than state-supported grade Es.<sup>109</sup> Also particularly apparent is the disparity between the main ethnic groups, with white respondents much more likely to switch than those from black and minority ethnic groups (BMEs).<sup>110</sup>

5.4. The barriers to engagement that consumers may face are likely to be more acute for vulnerable consumers, especially when compared with active ones who are more confident participating in the market. For example, internet use is linked to

<sup>107</sup> Ofgem (September 2012), 'Proposals for a new Consumer Vulnerability Strategy', Ref. (124/12).

<sup>108</sup> FDS International (February 2011).

<sup>109</sup> Ipsos MORI (April 2012).

<sup>110</sup> Ibid.

various socio-economic and demographic characteristics, such as age, sex, disability, geographical location and weekly earnings. Adults who are less likely to have used the internet include the elderly and disabled. Individuals with a disability are approximately three times more likely never to have used the internet than individuals with no disability.<sup>111</sup> Those consumers with internet access are more than twice as likely to have switched in 2011 compared to those without. Consumers without internet access are unable to use online switching sites which can filter tariff results for an individual. In looking to facilitate 'best buy tables' we hope to make information on tariff options across the market more accessible to consumers who are unable or unwilling to use comparison sites.

5.5. Throughout our RMR research we have sought views from a range of consumers including different types of vulnerable consumers. From across our research we recognise that consumers are all different – they have different needs and interests, and engage in the market in different ways. Therefore, different parts of the package are likely to appeal to different types of consumers.

5.6. Our package of proposals aims to encourage and equip consumers to engage effectively in the market. Clearer and simpler supplier information aims to make the market more accessible for more consumers. Price increase notifications, for example will be tailored to the individual and state what the impact of the increase will be for that consumer. Such information can help to make consumers more aware of their energy costs and could help them to budget.

5.7. Research shows that some consumers, including vulnerable groups, assume that their supplier would automatically put them on the best tariff<sup>112</sup>. Some consumers are surprised by the thought that they may not be on the best possible tariff which can cause annoyance that they had not been informed of this, even though some had been with their current supplier for a considerable time<sup>113</sup>. We are proposing that bills show a supplier's cheapest tariff both by a consumer's payment type and their cheapest tariff overall. This is designed to make it clear and easy to see that there are other options and clearly detail, in pounds and pence, what a particular consumer could save from switching to that tariff. However, our research suggests that across consumers savings would need to be 'significant' for consumers to be prepared to take action to switch tariffs even with their own supplier (although expectations do tend to be lower among less affluent socio-economic groups).<sup>114</sup>

5.8. Some respondents to our previous consultation RMR proposals were concerned regarding the potential for vulnerable consumers to be disadvantaged by our proposals, particularly in relation to our tariff simplification proposals. We have changed significantly our tariff proposals which are now based on a significant limitation to the number and complexity of tariffs rather than implementing

---

<sup>111</sup> Office for National Statistics (Q2 2012), 'Internet Access Quarterly Update Q2 2012'.

<sup>112</sup> FDS International (February 2011).

<sup>113</sup> SPA Futurethinking (October 2012b).

<sup>114</sup> Findings from 2012 tracking engagement survey indicate that, on average, switchers expected on the last occasion to save around £173 per year by switching. Expectations are related to social grade – the ABs expect to save more – and inversely to age – 15-34s expect to save more than older switchers, especially the 65+.

significant controls around the value of the standing charge or the number of standard tariffs each supplier can have.

5.9. Our new proposal addresses these concerns. Firstly, our proposal should not lead to a two-tier market in which competition is focused in the fixed portion of the market at the expense of competitive variable evergreen deals. Both fixed and variable tariffs will be given equal prominence under our proposals, allowing consumers to see more easily which deal type is the most competitive for them. Secondly, they will allow suppliers to set a standing charge at a level they deem appropriate, rather than a single standing charge as we originally proposed. Suppliers will be able to choose themselves the balance between standing charges and unit rates.

5.10. Our proposal to simply tariffs with a standing charge and single unit rate will impact how suppliers design their tariffs and any signals this may send out to consumers. Low income consumers tend to be, but are not necessarily, low energy users<sup>115</sup>. Some suppliers offer tariffs where the unit rate reduces after a certain consumption level has been reduced. Our proposal will not allow such tariffs, to which low users are less able to benefit.

5.11. Some consumers do not necessarily need to take action to benefits from the RMR proposal. Our proposal requires suppliers to move all consumers on uncompetitive dead tariffs to their cheapest deal.

5.12. The SOC are designed to improve all interactions between suppliers and consumers. They will require suppliers to treat all customers fairly. We envisage that the SOC would require a supplier to identify, understand and accommodate the needs of their vulnerable consumers.

5.13. Despite the RMR package, some vulnerable consumers may remain unwilling or unable to engage with the market. For example, they may be loyal to what they perceive to be national brands, consider it be a hassle or have other priorities in their lives<sup>116</sup>. Our research into the Tariff Comparison Rate found that for many disengaged consumers – and vulnerable consumers are more likely to be disengaged – interest in the TCR rarely extended to their envisaging how they would actually use it to compare their current tariff cost with alternatives.<sup>117</sup>

### **Further measures**

5.14. The impact of the RMR proposal on consumers, including vulnerable groups will be monitored as part of the enhanced monitoring work.

5.15. We are working to ensure that consumers have access to, and confidence in, intermediaries (such as advisors or sales agents) and we want to facilitate collective

---

<sup>115</sup> Centre for Sustainable Energy (March 2011), 'Understanding High Use, Low Income Consumers'.

<sup>116</sup> FDS International (February 2011).

<sup>117</sup> Ipsos MORI (October 2012).

switching schemes. Door to door sales representatives are more important as sources of information on deals and for making a switch for those 65+, those without internet access and those in the DE social group<sup>118</sup>. The use of sales persons in public places has been increasing too.

5.16. We are looking at trialling the market cheapest deal initiative with suppliers, specifically for vulnerable consumers. We consider this proposal to be particularly useful for those consumers who are unable or unwilling to use switching sites and find it hard to compare tariffs across the market. Firstly, we would need to consider which consumers should receive this information. Our working assumption is that to begin with, this initiative would be targeted only at the most sticky consumers (for example those who have been with their current supplier for more than 3 years) and some categories of vulnerable consumers, (for example, those in receipt of the Warm Homes Discount).

5.17. Further work to protect and empower vulnerable consumers has been proposed under Ofgem’s new Consumer Vulnerability Strategy.

### **Impact on fuel poverty**

5.18. Consumers who spend at least 10 per cent of their income on keeping their property heated to a reasonable level are considered to be in fuel poverty. The reality of this is that many such households are not heated to a reasonable level and are cold and damp. This has implications for health and social well being.

5.19. We do not consider that this package of proposals will create any negative impacts on households experiencing fuel poverty. The benefits of the package will be equally available to consumers in fuel poverty as to other consumers.

5.20. Fuel poverty is most common among those who live in private rented accommodation. Consumers living in rented accommodation are less likely to have switched supplier<sup>119</sup>. Providing clear information about a supplier’s cheapest deal is designed to provide a useful prompt to consumers. Fuel poverty is linked to, but not necessarily determined by, being on a low income. Such consumers therefore have the most to gain from the measures we are proposing which should help them have the confidence and tools they need to assess whether they are on the best deal.

## **Managing the transition to a low-carbon economy**

5.21. This section describes the impacts of our proposed package of measures on the environment and on managing the transition to a low carbon economy. We focus our analysis on the impacts that our proposal may have on green tariffs, and also on the impacts on consumers’ awareness of their energy usage and wider energy issues.

---

<sup>118</sup> Ipsos MORI (April 2012).

<sup>119</sup> Ibid.



## Consumer awareness of energy usage

5.22. Our research on consumers' views of price comparison guides and tariff structures indicates that most participants did not know how much energy they consume.<sup>120</sup> Consumers use rules-of-thumb, such as considering the composition of their household or considering the number of type of appliances they own, to decide if they were a low, medium or high user.

5.23. Our proposal to simplify tariffs with a standing charge and single unit rate will impact how suppliers design their tariffs and any signals this may send out to consumers. Some suppliers offer tariffs where the unit rate reduces after a certain consumption level has been reached. Our proposal will not allow this which will avoid any signals or perceived 'reward' that a high user can continue to consume and it will cost them less to do so.

5.24. Our measure to improve consumer information will make information on consumption much clearer and more accessible, in terms of kWh and categorising consumers as low, medium or high.<sup>121</sup> This information is primarily designed to help consumers choose the best tariff for their circumstances. However it can also make consumers more aware of their consumption in the run up to the smart meter roll out. Being classed as a high user may prompt some consumers to consider their energy use. Being classed as a low user may be reassuring for some consumers, though we recognise that some consumers may potentially consider it to be socially undesirable, or even a sign of being on a low income.

5.25. Some parallels can be drawn with research DECC commissioned to look into putting benchmark comparisons on bills. They researched the likely impact of telling a consumer, on their bill, if they were below average, average or an above average user compared to their neighbours. Those participants, who noticed the benchmark and used less energy than the average household in their area, said they would be unlikely to use more energy because of the benchmark. This was because these participants were either using as much energy as their budgets permitted and could not afford to increase their usage, or in a minority of cases they had already taken substantial steps to reduce their consumption. Those consumers who were labelled as above average reported they were only likely to act if they were significantly above average use compared to their neighbours.

5.26. The SOC allows scope for innovation of products and services. With the introduction of the Standards, over time, levels of consumer trust can improve which will help increase consumer engagement. The SOC might further encourage suppliers to think carefully about how they educate their customers about energy use and how consumers can obtain this, as well as how they can get access to Green Deal funding to reduce their energy use.

---

<sup>120</sup> Ipsos MORI (September 2012).

<sup>121</sup> Our research shows that many consumers struggle to understand what a kWh is. Providing clearer information on energy consumption and tangible examples of kWh can help to improve energy literacy and may further encourage energy savings. In our consultation document we are welcoming views on how this may best be achieved.

5.27. We have proposed to restrict the content provided on suppliers' communications to information directly related to their purpose. This is to ensure that information and messages key to a consumer's understanding and potential engagement with the market, such as pricing and tariff information, are not obfuscated by large amounts of additional information, such as energy saving advice. Although we are restricting this information being provided through these particular channels, we consider that our proposal can improve consumers' awareness of key energy information and promote overall engagement. This can help raise awareness to wider energy and environmental issues, and through time we expect this may encourage consumers to save energy.

### **Green tariffs, Green Deal and Energy Company Obligation**

5.28. One of our proposals is for suppliers to list its cheapest tariff overall and cheapest tariff for that consumer's payment method. Such an approach may exclude green tariffs from these options, as they can incur a premium. Through facilitating the publication of best buy tables, however, we expect that this issue is minimised. We expect that relevant organisations will be able to identify certain types of tariffs, such as green tariffs, available across the market to facilitate choice.

5.29. Under our earlier RMR proposals suppliers could only offer fixed term green tariffs. We have revised this proposal and under our current proposed package of measures suppliers will be able to offer variable evergreen or fixed term green tariffs. This provides a wider a range of options for both suppliers and consumers.

5.30. To the extent that our proposal is able to raise consumers' awareness of energy information and wider energy issues, it may lead consumers to be more environmental conscious. We expect that this could also have a positive effect in the take-up of green tariffs. We do not anticipate however that this effect will be significant.

5.31. We have considered the impact that our updated RMR proposal might have on the Green Deal and the Energy Company Obligation energy efficiency programmes as they are currently envisaged.<sup>122</sup> We acknowledge that suppliers will have to comply with our proposal, in particular, with our proposed tariff simplification rules. Tariff simplification rules will apply to energy products when they are bundled with Green Deal and/or the Energy Company Obligation related products. However, we expect that our proposal allows for sufficient commercial freedom to market the Green Deal and Energy Company Obligation related products without materially impacting either on their implementation and/or future take up.

### **Smart metering**

5.32. The Government policy to roll out smart metering across GB over the coming decade has the potential to transform how energy markets operate. Consumers are

---

<sup>122</sup> The Energy Company Obligation programme is expected to be effective from early 2013.

expected to have ready access to much more information about their energy usage, helping them use energy more efficiently.

5.33. We expect our proposal to increase effective consumer engagement in the energy market. More engaged consumers are likely to be in a better position to realise the potential benefits of smart metering, including through uptake of ToU tariffs. Therefore, we consider that the RMR proposal is complementary to the roll-out of smart metering.

5.34. In this section we set out the links to, and potential impacts of several elements of our proposed package of measures on smart metering.

#### *Cheapest deal information*

5.35. The roll-out of smart metering will provide consumers with more detailed information on their energy consumption than is currently available. One possible use of this information is for consumers to determine whether they might benefit from moving to a TOU tariff.

5.36. Suppliers may also be able to use detailed consumption data from smart meters to identify whether a TOU tariff could be the cheapest option for a consumer, in line with our proposal. However, the government has proposed that there should be a new framework that sets out what consumption information suppliers can access from a consumer's smart meter, and what choice the consumer should have about this. Therefore if, for example, a consumer chooses not to share detailed consumption information with their supplier, the supplier might not be able to evaluate whether a TOU tariff would be cheaper for that consumer. We are therefore seeking views through this consultation as to whether our 'cheapest tariff' proposals need to separately consider consumers with a smart meter.

#### *TCR*

5.37. The TCR provides an opportunity to educate consumers about energy units in advance of the roll-out of smart metering and the introduction of ToU tariffs.<sup>123</sup> These tariffs will be priced in terms of p/kWh and prices may change during the course of the day. Providing a TCR in units of p/kWh will therefore help to build consumers' understanding that the price of energy per kWh is a key difference between energy tariffs.

5.38. To accommodate ToU tariffs within the TCR we must make assumptions about a consumer's load profile (i.e. consumption at different times of day) in addition to the average consumption assumption that is required for all TCRs. However, the load profile will be different for each consumer and so a TCR calculated in this manner may be misleading for consumers. In particular, it may under or overestimate the savings that are available. This could undermine take up of ToU tariffs.

---

<sup>123</sup> The implications of the TCR proposal for ToU tariffs are discussed in Chapter 8.

5.39. At present, the most common ToU tariffs on offer to domestic consumers are Economy 7 and Economy 10, which offer cheaper prices overnight. We have proposed a methodology that can accommodate these tariffs within the TCR, making an assumption about the proportion of consumption that occurs during the night.

5.40. However, in future, smart metering can enable more sophisticated ToU tariffs to be developed. This could include tariffs with more than two different unit rates for different times of day. In addition, some tariffs may be 'dynamic' such that either the unit rate and/or the period when these rates apply vary. It is more difficult to accommodate these tariffs in the TCR. For example, as the number of time periods with different unit rates increases the TCR risks becoming increasingly inaccurate for an individual consumer due to the assumptions that must be made about load profile.

5.41. Given the difficulties described in the previous paragraph, it is not clear whether the TCR would be appropriate for sophisticated ToU tariffs. If we decide the TCR would mislead consumers and so should not be calculated for such tariffs, there is a risk that the TCR policy would discourage the development of more sophisticated tariffs.

#### *Tariff simplification*

5.42. We want to ensure our proposed tariff cap is compatible with the smart meter roll-out, so suppliers will be able to offer four ToU tariffs per meter type, including for smart meters, in addition to four non-ToU tariffs. This provides a degree of future-proofing of our proposals, building in flexibility so that suppliers can continue to innovate on ToU tariffs as smart meter technology develops in the next few years. And our proposal on two-part tariffs will allow suppliers to vary the unit rate with time of day or time of year, therefore accommodating dynamic ToU tariffs.

5.43. In the short-term, suppliers will be able to meet the needs of consumers with E7, E10 and other existing meters. However, we will pay close attention to this issue and monitor accordingly. Our proposed review (no later than 2017) will examine this in more detail.

#### *Clearer and simpler information*

5.44. As the roll out of smart meters progresses, the accessibility and quality of information available to consumers will improve. We will be giving greater consideration to whether additional obligations are necessary for suppliers to help ensure consumers are realising the benefits of this additional information.

5.45. We are mindful, therefore, that in the future we may need to accommodate these advancements into some of our more prescriptive requirements, in particular on the additional information requirements we are proposing. We are aware that standardisation of formats or content will need to be flexible to ensure it is

compatible with more dynamic, complex, ToU tariffs that may be made available in the future.

5.46. We may also need to reassess whether there is still a need to provide all this information to consumers, given that smart metering can give consumers easier access to granular consumption data. However, for the full benefits of smart metering to be realised, enhancing consumer engagement in the market through our RMR proposal will be essential.

#### SOC

5.47. The use of a principles based approach to regulation under the SOC allows for market development that may emerge in the future to be taken into account. This approach will allow flexibility for innovation to occur in the market. Under requirements of the SOC suppliers will need to take into account any change in consumer needs and the environment. They will need to ensure that they are treating consumers fairly and are appropriately meeting their needs. Therefore, the SOC are technology neutral. However, in time, it may be possible for smart meters to allow suppliers to better meet the needs of their consumers – for example, through information accessible from smart meters.

#### *Protecting consumers on fixed term offers*

5.48. We are aware of the innovative tariff design being undertaken in relation to the roll-out of smart meters; we have designed our policy proposals to allow for such ToU tariffs. However, we recognise that current licence requirements together with the rules proposed regarding price increases and other adverse unilateral variations may limit more dynamic ToU arrangements in fixed term contracts. If suppliers intend to offer such dynamic ToU fixed term tariffs, we will consider cases for exemptions to our proposals (provided such tariffs remain consistent with the consumer protection requirements of the gas and electricity directives, regarding notification of price increases and other adverse unilateral variations).

## 6. Impacts on health and safety

---

### Chapter Summary

In this section we look at the potential impacts of our package of measures on health and safety.

**Question 6:** In your view, what would be the health and safety impacts resulting from the implementation of our proposal? Please explain your views.

6.1. We have not identified any relevant impacts that the implementation of our proposed package of measures could have on health and safety. We are interested in having stakeholders' views on any potential impacts that our proposal could have in relation to health and safety.

## 7. Risks and unintended consequences

---

### Chapter Summary

This chapter assesses the potential risk and unintended consequences of our proposed package of measures.

**Question 7:** Do you agree with our assessment of the risks and unintended consequences that could result from our proposal? Please explain your views.

7.1. In earlier sections of this IA we have discussed the likely impacts on consumers and competition of recommended options. This section discusses any risks and possible unintended consequences of the proposed options.

### Risks

#### Regulatory risk for suppliers

7.2. In relation to the SOC, concerns were raised in responses to the December 2011 consultation about the potential for regulatory risk. Our policy proposal covers all interactions between consumers and suppliers. Given the wide scope of this licence condition, concerns were raised that suppliers could be exposed to risks if our expectations in relation to the SOC were not clear. Also, there were concerns that the scope of the SOC would be so general that requirements could be interpreted very broadly and in ways that would not deliver the intended benefits for consumers.

7.3. To address these concerns and help clarify our intent with regard to expectations around the SOC we:

- introduced a fairness provision;
- have plans to introduce provided some guidance; and
- developed a bespoke approach to enforcement for the SOC.

7.4. As noted in the consultation document, the addition of an overarching fairness objective will help focus supplier activity in relation to the SOC, in a way that is consistent with our underlying policy intent. This framing makes our policy intent and vision for suppliers clear, which in turn will mitigate regulatory risk.

7.5. Our consultation document outlines that we propose to provide clarification about the terminology used in the SOC to ensure that suppliers and consumers are aware of how to interpret these terms. This clarity will also reduce regulatory risk as suppliers and consumers are clear about our aim and requirements with reference to the SOC.

7.6. Stakeholders noted that our proposed approach to enforcing the SOC would have an impact on how they worked in practice. Our approach to enforcement is outlined in the consultation document. We expect that this approach should help to mitigate unintended consequences of regulatory risk. Where supplier actions are not in line with our policy intent we may take enforcement action.

7.7. As we see a role for the Ombudsman Services: Energy (the Ombudsman) with regard to individual cases of consumer complaints in relation to supplier conduct, there may be a risk, based on experiences in some markets, that the Ombudsman’s determinations will develop precedent over time. However, based on our proposal, it does not seem that the Ombudsman’s actions will be inconsistent with our policy intent. As outlined in our consultation document, the remit of the Ombudsman for energy is not the same as in other industries. The Ombudsman judges cases individually and treats them on a case by case basis. Therefore, the Ombudsman would not set precedent in their rulings. We would generally look to work with the Ombudsman to help foster a shared understanding of our objectives and expectations related to the SOC.

7.8. In summary, we consider that the enforcement approach and further detail provided regarding how we see the SOC working in practice mitigates the concerns raised by suppliers and the potential for regulatory risk.

### **Risk of continuing consumer disengagement**

7.9. There is a risk that, despite the introduction of our RMR proposal, some consumers will remain disengaged. There is a spectrum of possibilities with regards to the change in the level of consumer engagement. This can lie between no change in the level of engagement to a market where consumers are fully engaged.

7.10. It is likely that the impact of our proposal on engagement would lie somewhere between these two extremes. Indeed, we consider that the key risk in this context is that the gap between engaged and disengaged consumers could widen as a result of our proposal. To mitigate this risk, we have proposed several policies that are targeted at less informed consumers, including:

- supplier’s cheapest tariff message on bills;
- providing clear prompts to engagements; and
- simplifying and standardising terminology.

7.11. Additional measures that we are proposing to mitigate the risk of disengagement include:

- market trial of the Annual Statement (including the supplier cheapest deal message and the Tariff Information Label) to see what impact it has on consumers as a whole and on specific consumer groups. We propose to amend the format and policies in line with the findings of this research;



- proposal to trial the market cheapest deal which is focused on addressing the group of consumers who are least likely to be empowered by these proposals;
- put in place enhanced and ongoing monitoring focusing both on:
  - a. the direct impact of our proposals on specific consumer groups; and
  - b. the overall impact on competition in the market.

7.12. A further aspect of disengagement that could result from our proposal is the risk that consumers would only consider the supplier's cheapest deal and would not look at alternative options. However, we see the supplier's cheapest deal proposal as part of a complementary set of initiatives which aim to give consumers a stronger prompt to engage and provide the information that consumers need to assess alternative offers, both from their current and alternative suppliers.

### **Risk of consumer frustration**

7.13. Providing consumers with information about a cheaper tariff that might not be available to them could be extremely frustrating. For example, the cheaper tariff may be available only through a payment method that they do not have access to or may only be available online. This frustration could lead the consumer to further disengage from the energy market as they are not able to benefit from the savings that have been brought to their attention.

7.14. For this reason we are conducting further testing and developing our policy in this area, to ensure the messaging on supplier communications is as personalised and effective in fostering engagement as possible. This is also why we have proposed a narrow definition of the supplier's cheapest deal and are providing consumers with the personal projection for that tariff. The personal projection will enable consumers to compare this tariff with other tariffs in the market. Finally, we are considering the market cheapest deal proposal specifically to address the comparison difficulties faced by those who do not have internet access or lack the confidence to use it.

7.15. However, our revised proposals will still enable consumers to make comparisons on key features of tariffs more easily. They will reduce the overall number of tariffs in the market, not just variable evergreen tariffs as we proposed in December 2011. We are consulting on our proposed limit of four core tariffs per supplier but will consider the appropriate level in light of responses to this document. Our proposals aim also to standardise tariff structures, which may contribute to remove the confusion that can be created by two-tier tariffs. Overall, we consider that our tariff simplification proposals go far to mitigate the risk of significant consumer frustration. However, we will monitor the effect of our proposals.

7.16. Our fixed term tariff proposals might also lead to frustration among some consumers. Indeed, prohibiting auto-rollovers to fixed term offers might have a different impact on different groups of consumers. Those consumers who would prefer to be rolled over to a subsequent deal and not engage in the renewal process could be worse off as a result of our proposal. However, consumers on fixed term contracts are likely to be 'active consumers' who perceive the cost of engagement in

the market to be relatively low. Therefore, we consider the risk of frustration arising from this proposal to be limited. We also note that the impact on consumers is mitigated by our proposal that those not renewing a fixed term contract are migrated onto the supplier's cheapest evergreen tariff.

7.17. As discussed in Chapter 8, a prohibition on price increases and other adverse unilateral variations will restrict available tariff types, thereby leading to a loss of certain tariffs that may be favoured by some consumers (e.g. tariffs which track other tariffs). Our Tariff Comparability Qualitative Research shows consumers generally assumed that fixed duration tariffs are also fixed price, and the quantitative research suggests a fixed-price fixed term tariff is an attractive choice for many consumers. Neither of these findings suggests that consumers have a strong expectation to see non-fixed price fixed term tariffs in the market.

### **Risk of consumer detriment**

7.18. There is a risk that our proposal leads to a reduction in competitively priced variable and fixed offers due to coordinated effects. However, we have discussed this in Chapter 3 and consider that overall competitive pressure exerted by a more engaged consumer base outweighs this risk.

7.19. Our proposals on auto-rollovers will make it harder for suppliers to offer very cheap fixed term offers to consumers in the hope that they rollover onto less competitive offers at the end of the contract. In this scenario, active consumers who take steps to switch when the fixed term deal comes to an end might lose out whilst those who might have been caught by the auto-rollover would benefit. However, some current practices (as outlined above) might constitute a barrier to entry or expansion for small suppliers because they are less able to match these cheap fixed term offers. Therefore, in this regard, banning auto-rollovers might make it easier for small suppliers to enter and expand, which would increase the degree of competition in the market.

7.20. Restricting the types of fixed term offers that are available may have implications for suppliers' hedging strategies. With restricted ability to vary prices, suppliers may attach additional risk premium / enter more costly hedging strategies to manage this reduced flexibility. This may have the effect of increasing the prices of the remaining offers in this market. It should be noted however that suppliers will still be able to vary prices through the mechanisms identified in the exceptions and the provisions for mutual variations discussed in our consultation document.

7.21. In addition, it was noted in consultation responses that restricting fixed term offers may push consumers into the evergreen market. This might have occurred because suppliers would remove some tariffs that were attractive to consumers and could lead to consumers disengaging from the market. However, our current proposals should align the fixed term market with consumer expectations that fixed term offers would have reduced price variation. We expect that aligning the fixed term market with consumer expectations would increase engagement in this part of the market.

## Possible unintended consequences due to suppliers' responses

7.22. We have considered two key strategies that the suppliers could adopt in response to our proposals to introduce a TCR, simplify tariffs and inform consumers of their supplier's cheapest alternative tariff. 'Frustrate strategies' would be designed to limit the effect of our interventions while 'non-compliance' would involve suppliers choosing not to comply with one or more Licence conditions. These are discussed in turn.

### Frustrate strategies

#### *'Fiddle the numbers'*

7.23. Suppliers could seek to reduce the effectiveness of our proposal by attempting to make TCRs incomparable between tariffs. There are a number of routes through which this could be done including the misinterpretation of rules (intentional or otherwise), the use of inappropriate consumption figures for consumers when calculating personal projections or the use of inconsistent assumptions when calculating TCRs for different tariffs.

7.24. To mitigate this behaviour we propose to clearly specify a complete calculation methodology. This methodology would include unambiguous rules for each type of discount or product bundle such that the cope for interpretation is minimised. In the event that a supplier misuses the TCR, we would take appropriate enforcement action.

#### *'Try to confuse'*

7.25. This strategy would be designed to make it difficult for consumers to use the TCR effectively. If it is possible to confuse consumers and exploit their limited capacity, consumers may lack confidence to use the TCR and so would not engage in the market. This would allow suppliers to maintain a sticky customer base and earn relatively high margins on supplying energy to these customers.

7.26. To this end, suppliers could use a range of tactics, including providing a poor explanation of how to use TCRs at the point of introduction, making it hard to find out the relevant TCR for the consumer's consumption (low, medium or high) and/or presenting information concerning the cheapest alternative tariff unclearly. Our proposals for tariff simplification will make it harder for suppliers to pursue such a strategy.

7.27. Suppliers could also attempt to 'game' the TCR by setting regional tariff prices such that the TCR (which is an average across GB) would not be a reasonable reflection of the average unit cost of energy in any given region. We have chosen weights in the TCR calculation to mitigate this behaviour. We would also expect suppliers to treat consumers fairly and comply with both the spirit and letter of our

proposals when calculating TCRs, including the SOC. However, we note that this expectation may not be sufficient to prevent gaming by suppliers.

7.28. Finally, suppliers could attempt to set prices in such a way that the TCR would appear to be low but the tariff would actually be relatively expensive for consumers outside that exact consumption level. Our proposal to require suppliers to provide TCRs for low, medium and high users on Tariff Information Labels in conjunction with our proposal to standardise the structure of tariffs would mitigate this risk.

7.29. Suppliers could further mitigate the risk of consumer confusion by giving clear information to their customers. This would include explanatory information at the point of TCR introduction and information to be included on suppliers' regular communications. Finally, stakeholders should note that we would monitor suppliers' responses to our proposals and could signal that responses that are adverse to the consumer's interest would trigger more radical intervention.

#### *Tariff proliferation and 'bait and switch' strategies*

7.30. Our proposed cap on the number of open tariffs and elimination of uncompetitive dead tariffs will help prevent suppliers responding to our proposal to improve price comparability by increasing the number of tariffs that must be compared in order to identify the best tariff for the consumer. However, suppliers could choose to have a very high turnover of fixed term tariffs, for example, opening and closing a tariff every week. This strategy could lead to consumer frustration if they explore a deal and subsequently find it is closed.

7.31. We propose to monitor the market to see whether this risk materialises. We recognise that our tariff cap is location specific. It may be that suppliers offer more than four tariffs but that these are spread across more than one region. For example, a supplier could offer four separately branded tariffs in London and another four differently branded tariffs in Scotland.

7.32. However, we do not consider that this is a significant risk. Suppliers are unlikely to develop multiple tariffs with different branding as it would:

- make it more difficult to get these tariffs into national best buy tables and other national media; and
- result in significant regional marketing and duplication of resources for suppliers across GB.

7.33. Nonetheless, we will monitor the extent to which this practice occurs and the extent to which it may cause consumer harm (for example if consumers in one location are offered more competitive tariffs than those in another). We will consider further action if we see evidence of practices that are harmful to the interests of consumers.

7.34. Suppliers could use a 'bait and switch' strategy to attract consumers in response to our proposal. For example, they might advertise a cheap tariff that is available only to a small number of consumers and would direct those that apply too late to a less competitive tariff.

7.35. Suppliers could also offer attractive prices for fixed term offers, while profits would be recouped on inactive consumers transferred to the most expensive evergreen tariff at the end of the contract. We propose to mitigate this behaviour by ensuring that consumers default to the cheapest variable tariff at the end of a fixed term contract. Our restriction on tariff numbers would also mitigate the risk of both alternative 'bait and switch' strategies. Finally, we are keen to understand whether stakeholders consider that Ofgem should have a role in facilitating the publication of best buy tables. For example, Ofgem could pre-empt a strategy of the switch and bait strategy by setting eligibility criteria for tariffs to be included in best buy tables. Such criteria could include requiring tariffs to be on offer for a minimum period and for a minimum number of consumers.

7.36. Suppliers might also engage in aggressive marketing strategies when approaching the end of the contract period with the objective of maintaining their customer base. However, this risk is mitigated with our proposed SOC remedies, licence conditions, consumer protection law and our monitoring duties.

*Emphasise non-price features of tariffs*

7.37. The introduction of a TCR and cheapest alternative tariff information may affect the nature of competition in the retail market. In particular, suppliers may begin to use non-price features of tariffs as the focus of competition. This strategy might make it difficult for consumers to compare tariffs.

7.38. We understand that non-price features of tariffs are valued by some consumers and do not wish to prohibit such offers. Transparency is important – consumers must be aware of whether opt-outs are available and the cost of the non-energy product if they decide not to opt-out.

7.39. To mitigate this potential comparability problem, we have proposed to apply different rules to the TCRs of bundled products, depending on the nature of bundling (i.e. whether the bundle is tied, opt-in or opt-out).

7.40. Rather than making greater use of product bundling, suppliers could make greater use of additional features such as loyalty points. We have proposed that these features would be excluded from the TCR calculation because the monetary value of the feature may not be clear. Therefore, it is possible that our proposals would lead prices to converge and competition to focus almost entirely on non-price features. This would be a particular concern if prices were to converge at a high level due to the removal of cheap tariffs.

7.41. The use of additional features as the focus of competition would not be a concern if consumers had, for all tariffs, complete information about the characteristics of each feature, the monetary value of that feature and were able to process that information. However, behavioural economics has shown that consumers have limited capacity to process information. Indeed, the TCR has been introduced to help overcome the limited capacity issue for tariff prices but would be of no help in comparing additional features.

7.42. While to some extent additional features such as loyalty points can be used to attract customers and so can be an element of the competitive market, they can also be used to exploit information asymmetries and consumers' limited capacity. An increasing use of non-price features for competition would lead to the TCR becoming less effective as a tariff comparison tool. Depending on the extent of growth in non-price competition, it is possible that the net effect of our measures on ease of comparison would be negative (i.e. the TCR would be ineffective and consumers would find it more difficult to compare a vastly increased number of non-price features of tariffs than they had in comparing the price of tariffs that are less differentiated).

7.43. To mitigate the risk of non-price competition making the market more complex for consumers, we are proposing rules on bundles, non-price offers and discounts as this would limit the degree of confusion that a supplier could cause. In particular, the requirement for suppliers to offer the same bundles/non-price offers across all tariffs or use up a separate tariff will limit the scope for suppliers to 'game' the proposals in this manner. We could also consider putting in place more restrictive measures if we find that suppliers have responded strategically to our proposals with the aim of maintaining consumer confusion.

7.44. It is also worth noting that our proposal to tie bundled products and services to tariffs will mean that suppliers will not be able to offer unlimited bundles alongside their tariffs. If a supplier wishes to offer a tied bundle, it must do so as part of one tariff, which will count towards the limit. We note that suppliers would be free to promote the bundle in marketing and other promotional material.

#### *Remove White Label tariffs*

7.45. It may be that suppliers remove their white label products so that they can use their four tariffs for their own products. If this is the case, there would perhaps be fewer marketing channels for energy products and a possible reduction in overall consumer awareness of the deals available. However, two factors mitigate this risk. Firstly, as long as a tariff's terms and conditions are identical, white labels do not count towards the tariff cap. So a supplier could still offer a white label tariff that is identical to an existing tariff and market it accordingly. Secondly, our other proposals aim to simplify the market and make it clearer for consumers to understand. We expect that any reduction in consumer awareness caused by a reduction in white labels would be offset by the impact of our overall RMR package.

### *Product differentiation*

7.46. Two extremes with regards to product differentiation are possible. One extreme would be that, with a limit on the number core tariffs, suppliers may be able to design their tariffs so that they are the only supplier offering a tariff of that term, bundle etc. It might be less attractive for competing suppliers to design their tariffs to compete for that market segment because the cap on tariffs implies they would have to close down one of their other tariffs.

7.47. In this scenario, the market would still offer a range of choice of tariffs but comparisons between tariffs might be harder as the services being offered would be different. Our requirement for a supplier to offer at least one evergreen tariff helps to reduce one dimension (i.e. differentiation by contract term) arising in part of the market and our requirement for all optional bundles to be offered across all of a supplier's tariffs eliminates another dimension of within supplier comparisons.

7.48. In the other extreme, suppliers might attempt to mimic their competitors' offerings so that suppliers offer very similar tariffs. In this scenario tariffs would be easier to compare although the amount of choice offered to consumers would be lower than the scenario above. However, we expect our reforms to encourage new entry and assist those looking to gain market share through product differentiation or offering more competitive prices. Therefore, while we might see some convergence of prices, we would expect that with more engaged and confident consumers there is more scope for suppliers to break away from this convergence and to gain market share through doing so.

7.49. Finally, we have considered the possibility that a single corporate group may apply for multiple supply licences to allow them to offer more than four tariffs. Our licence drafting will address this concern by ensuring that any licence holders that are part of the same corporate group will be treated as one, no matter how many licenses they hold.

### **Non-compliance**

7.50. The discussion above has outlined a number of potential strategic responses to our proposal and proposed how these might be mitigated. However, there remains a risk that suppliers may choose not to comply with the licence conditions and so our mitigating actions might have limited effect. We will monitor suppliers' responses to our proposal and would assess whether suppliers are compliant. Where a breach is suspected, we may take enforcement action, in line with our published Guidelines.<sup>124</sup>

---

<sup>124</sup> Ofgem (June 2012), Enforcement Guidelines on Complaints and Investigations <http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20guidelines%202012.pdf>.

## 8. Assessment of alternative options

---

### Chapter Summary

This section sets out the alternative options considered in developing our package of proposal. These are presented for each of the RMR proposed package of measures.

**Question 8:** Do stakeholders agree with our assessment of the alternative options to our proposed package of measures? Are there any alternative options we have not considered? Please explain your views.

8.1. In this section we present in turn the options considered when coming to a decision on our package of proposals. The evolution of our thinking since the December 2011 proposals is presented first, followed by the consultation responses which helped inform our thinking. The options available in terms of the type of policy proposal are explained and followed by a discussion of the alternative design options available within the chosen proposal.

### Supplier's cheapest deal

#### Developments since December 2011 proposals

8.2. In our December 2011 consultation, we didn't consider the requirement for suppliers to provide consumers the information on the 'cheapest tariff' in detail. We only indicated that in the case of bills and annual statements further changes may be needed to these documents to facilitate government-led initiatives such as the Green Deal as well as discussions concerning incorporating details of a supplier's 'cheapest tariff' into bills.

8.3. We also stated that we will continue to work with industry, consumer groups and Government to consider how best to support provision of such information to consumers while meeting the objectives outlined in the consultation.

8.4. We believe that the aim of a voluntary agreement between the Government and energy suppliers that included providing information about the best deal for them ('Clegg agreement') supports our RMR proposals.<sup>125</sup> However, our view is that a more consistent approach and an enforceable framework are required.

8.5. Since December, we have worked with design experts and conducted further consumer research to further refine the templates for bills, annual statements and price increase notifications in order to incorporate the messaging on supplier's "cheapest" tariff.

---

<sup>125</sup> For details please refer to:

[http://www.decc.gov.uk/en/content/cms/news/dpm\\_bestdeal/dpm\\_bestdeal.aspx](http://www.decc.gov.uk/en/content/cms/news/dpm_bestdeal/dpm_bestdeal.aspx).



8.6. In summary, our proposal is that suppliers will be required to provide each of their customer personalised information about the cheapest tariff they are offering and amount of savings available to them if they switch to that tariff.

8.7. We propose that there are two sets of cheapest tariff message given to consumers: (1) 'narrow' - defined as the cheapest tariff offered by that supplier for their payment method, consumption level and meter type, and (2) 'wide' - defined as the cheapest tariff of all their available tariffs available irrespective of payment method, meter type or other preferences, but based on consumers' own consumption.

8.8. In order to provide this information, suppliers will be required to: (1) follow TCR rules on treatment of discounts and bundles; (2) calculate a personal projection for all eligible tariffs and supplier offers; (3) identify the cheapest tariff under both narrow and wide definition, and (4) provide this information in key communications (i.e. Summary Box on Bills, Annual Statements, Price Increase Notifications and End of Fixed Term Notices).

### **Options considered**

8.9. The options we considered relating to the implementation of our proposal and definition of the cheapest tariff are set out below.

#### *Implementation*

Options considered: Voluntary vs. enforceable approach

8.10. The alternative to the formal and enforceable framework (i.e. licence obligation backed by enforcement) is to rely on the current voluntary agreement between the Government and energy suppliers that included providing information about the best deal for consumers ('Clegg agreement').<sup>126</sup>

8.11. As pointed out in the consultation document, we are contemplating regulatory action because suppliers have not addressed similar problems in the past through voluntary initiatives, including our proposals from the Probe, which sought to improve consumer experiences in their interactions with suppliers.<sup>127</sup>

8.12. The proposed approach would ensure that the information on the cheapest tariff is more consistent, transparent and accessible to all consumers and help disengaged consumers in identifying the cheaper tariff for them and increase consumer engagement with market.

---

<sup>126</sup> For details please refer to:

[http://www.decc.gov.uk/en/content/cms/news/dpm\\_bestdeal/dpm\\_bestdeal.aspx](http://www.decc.gov.uk/en/content/cms/news/dpm_bestdeal/dpm_bestdeal.aspx).

<sup>127</sup> See Chapter 4 in the consultation document.



8.13. By making the provision of the information on the cheapest tariff enforceable, we will ensure that suppliers have the incentives to successfully deliver this message. Suppliers are saying that without speaking to their customers it’s impossible to assess what would be the “best deal” for them. So they felt that any information they provided regarding the cheapest tariff for a customer should only be the starting point for a conversation. Previous experience clearly suggests that a voluntary approach would not deliver it.

8.14. Our approach allows us to prescribe where the message appears as we believe that there is real benefit from the message appearing on Bills, Annual Statements, Price Increase Notifications and End of Fixed Term Notices. We believe that there is a real benefit to consumers seeing the savings they can make.

8.15. Under a voluntary approach, without specifying what the cheapest tariff should be and without prescribing the message, there is potential that a large proportion of consumers would remain unaware of the fact that they are not on their current supplier’s cheapest tariff, or of the savings they could make from moving to this tariff. Our research has shown that understanding the amount of savings, in pounds per month or per year, is a key driver to engagement.<sup>128</sup>

*Definition*

8.16. We considered five possible options that could be implemented to define and provide consumers with the information on the cheapest tariff from their current supplier. As part of our assessment of these options, the pros and cons associated with each option are explored in Table 2.1 below:

**Figure 6. Summary of options for defining supplier cheapest tariff**

Policy option	Pros	Cons
<b>Option 1:</b> Cheapest tariff across all tariffs offered by that supplier ('wide definition')	<ul style="list-style-type: none"> <li>- useful for some consumers</li> <li>- offers greatest savings</li> <li>- this level of savings may be high enough to be compelling for many and act as effective prompt for engagement and switching</li> </ul>	<ul style="list-style-type: none"> <li>- not available and appropriate for all consumers (for PPM, SC or those on fixed tariffs)</li> <li>- it may often imply changing payment method, and if this is not clear it may damage consumer confidence</li> <li>- cost implications for suppliers</li> </ul>
<b>Option 2:</b> Cheapest evergreen standard tariff offered by that supplier within consumer's current payment method	<ul style="list-style-type: none"> <li>- simple tariff</li> <li>- available to all consumers</li> <li>- has no termination date and no minimum contract length</li> <li>- incentives to switch are not distorted by the existence of a termination fee</li> <li>- may be more appealing for less engaged consumers, or those who do not feel comfortable changing tariff type or payment method</li> </ul>	<ul style="list-style-type: none"> <li>- doesn't highlight supplier's cheapest tariff</li> <li>- may be more expensive than the customer's current deal, which could undermine the purpose of the message on savings</li> <li>- unlikely to be a significant prompt for many consumers</li> <li>- offers consumers only a limited choice as suppliers offer limited number of standard tariffs</li> </ul>

<sup>128</sup> SPA Futurethinking (October 2012b).

The Retail Market Review – Draft Impact Assessment for the updated domestic proposals

	<ul style="list-style-type: none"> <li>- less burdensome in terms of costs to suppliers than Option 1</li> </ul>	<ul style="list-style-type: none"> <li>- supplier has the ability to vary the terms, given the evergreen nature of these tariffs</li> </ul>
<p><b>Option 3:</b> Cheapest tariff offered by that supplier within consumer's current payment method, consumption and meter type ('narrow definition')</p>	<ul style="list-style-type: none"> <li>- doesn't imply changing payment method</li> <li>- likely to be suitable for consumers' current circumstances</li> <li>- makes the choice simpler</li> <li>- appeals to less engaged consumers, or those less confident in navigating the market</li> <li>- less burdensome in terms of costs to suppliers than Option 1</li> </ul>	<ul style="list-style-type: none"> <li>- doesn't highlight supplier's cheapest tariff</li> <li>- offers consumers only a limited choice</li> <li>- difficult to calculate without consumption</li> <li>- savings may not be very high</li> <li>- producing the offer personalised by payment method will be more costly for suppliers than Option 2</li> </ul>
<p><b>Option 4:</b> Generic message and signposting for information on cheapest tariff</p>	<ul style="list-style-type: none"> <li>- encourages consumers to speak to someone whom they may trust more</li> </ul>	<ul style="list-style-type: none"> <li>- doesn't highlight the cheapest tariff</li> <li>- doesn't provide personalised information</li> <li>- concerns that consumers may be reluctant to approach someone to discuss their energy options</li> <li>- very limited impact on consumer engagement as personalisation and use of personal data to illustrate or provide savings are more effective ways of engaging consumers</li> </ul>
<p><b>Option 5:</b> No change – suppliers provide details of premium/discount between customer's current and supplier's standard direct debit tariff on annual statements</p>	<ul style="list-style-type: none"> <li>- easy to implement</li> <li>- no/minimal additional costs for suppliers</li> </ul>	<ul style="list-style-type: none"> <li>- doesn't highlight the cheapest tariff provided only once a year</li> <li>- doesn't provide personalised information</li> <li>- very limited impact - it won't facilitate greater levels of consumer engagement</li> </ul>

8.17. Based on the research and analysis undertaken, we adopted the combination of narrow definition (Option 3) and wide definition (Option 1) as our preferred option for defining the cheapest tariff.<sup>129</sup> This research also highlighted that personalisation and use of personal data to illustrate or provide savings are more effective ways of engaging consumers than using generic information.

8.18. This proposal will make it easier for consumers to engage with the market. Consumer research and testing clearly show that many consumers are interested to see if there are cheaper tariffs available from their existing supplier using personalised information on their consumption.<sup>130</sup> Many are interested in what they could save through a switch that doesn't require a change to payment method and meter type. In addition, they also want to see the information on the level of savings that could be made irrespective of payment method or other preferences (which are

<sup>129</sup> Ibid.

<sup>130</sup> Ibid.

likely to be higher), but may involve changing payment type or moving to online bill management.

## Tariff Comparison Rate

### Developments since December 2011 proposals

8.19. In December 2011, we proposed to introduce a price comparison guide. This 'Standard Equivalent Rate' (SER) was designed to improve comparability between the prices of standard and non-standard tariffs. We suggested that the guide could be presented as a 'standard equivalent' unit rate (p/kWh) or as an indicative cost at certain consumption values (e.g. 'tariff X costs £Y per month for a low electricity user').

8.20. Following consultation, we have considered our policy position in light of stakeholders' responses. We now propose not to set the standing charge of standard tariffs as part of the RMR package of remedies.<sup>131</sup> Given that the SER relied on an Ofgem-set standing charge, we have considered how best to develop the price comparison guide proposal. The Tariff Comparison Rate (TCR) is the output of that work.

8.21. In responses to our consultation questions on the price comparison guide, stakeholders were broadly supportive of the concept. There was a general consensus that it can be difficult for consumers to compare the price of energy tariffs at the moment and that a standard comparison metric would be helpful. Some stakeholders stated that the guide should be presented in £/year while others stated that it would be valuable for the guide to be presented in terms of both monetary estimates and a p/kWh rate. Some respondents emphasised the importance of building consumers' understanding of whether they are low, medium or high users.

### Options on the methodology for TCRs and personal projections

8.22. It is important that TCRs and personal projections are comparable across energy tariffs and suppliers. In this section, we discuss the policy options that we considered for several aspects of the methodology. These are summarised in Figure 7 below.

**Figure 7. Summary of options for defining the TCR methodology**

Policy design area	Options
Units	Option 1 Indicative costs (£/year or £/month)
	Option 2 Unit rates (p/kWh or £/MWh)
Discounts and penalties	Option 1 Include all non-contingent discounts in the TCR

<sup>131</sup> The reasons that we have chosen not to continue with our earlier proposals are discussed in detail in our consultation document.

	Option 2 Include non-contingent discounts but exclude contingent discounts from the TCR
	Option 3: Include non-contingent and contingent discounts in the TCR
	Option 4: Include all non-contingent discounts in the TCR and prohibit contingent discounts
Dual fuel tariffs presentation	Option 1: Compile a single TCR for each dual fuel tariff based on assumptions about gas and electricity consumption
	Option 2: Calculate separate TCRs for the gas and electricity elements of dual fuel tariffs
Dual fuel tariffs calculation	Option 1 Treat dual fuel discounts as a type of contingent discount such that they would be excluded from the TCR and specified separately
	Option 2 Include dual fuel discounts in the TCR
	Option 3 Include dual fuel discounts and define the split between fuels
Treatment of features such as loyalty points	Option 1 Exclude the value of additional features from the TCR
	Option 2 Include the value of additional features in the TCR
Treatment of bundles products	Option 1 Include only the energy component in the TCR for bundled products (for opt-in bundles)
	Option 2 Define specific product offerings/bundles so TCRs can be calculated and compared across suppliers for these specified bundles
	Option 3 Include the entire bundled offering in the TCR (for opt-out and tied bundles)
	Option 4 Exclude bundles products entirely from TCR
Number of consumption assumptions for TCRs	Option 1 Median consumer only
	Option 2 Low, median, high consumers
Regional issues	Option 1 Use regional TCRs
	Option 2 Use national TCRs

#### *Units for the TCR and personal projections*

8.23. In Spring 2012, Ofgem commissioned Ipsos MORI to test the ability of consumers to use a price comparison guide expressed in different units (£/MWh, p/kWh, £/month and £/year).<sup>132</sup> It also explored consumer preferences and whether any of the metrics are likely to mislead consumers.

8.24. The qualitative phase of the research suggested that there is little difference in consumers' ability to use the metrics when expressed in different formats. The quantitative research did not find a significant difference in performance across formats or between presenting the price comparison guide in terms of unit rates or indicative costs. All formats had a success rate of between 50 and 60 per cent when consumption bands were not signposted. However, the performance of the guide was enhanced by signposting to consumption bands: among those who are helped by

<sup>132</sup> Ipsos MORI (September 2012).

signposting, on average the ability to identify the cheapest supplier is increased by eight percentage points.<sup>133</sup>

8.25. Given the lack of firm evidence for either approach, the choice between unit rates and indicative costs has depended on other factors.

- Option 1: indicative costs (£/year or £/month).

8.26. In the Ipsos MORI (2012) research, many participants showed a preference for presenting the price comparison guide in terms of £/month. This finding is consistent with earlier consumer research and may support the indicative costs approach.

8.27. While there is little difference between the indicative costs and unit rate metrics in terms of consumers' ability to compare tariffs, we consider that there is a difference in terms of the effectiveness of the measures as a prompt. It is reasonable to assume that consumers are more likely to engage in the market if the range of prices is large than if they are clustered around a central value. A wider range of TCRs would indicate to consumers that significant savings might be made by switching energy tariffs.

8.28. Presenting the TCR in monetary terms would lead to a wider range than would the p/kWh approach, and hence may be more likely to prompt consumers to engage in the market. Similarly, £/year is likely to be a more effective prompt than £/month because savings would appear greater. Using annual costs also takes account of seasonal variations in consumption whereas monthly costs would not.

- Option 2: unit rates (p/kWh or £/MWh)

8.29. While this approach is less effective as a prompt to engagement, it may limit the risk of consumer detriment arising from unfulfilled expectations. Irrespective of the TCR units, there is a risk that consumers would believe that the TCR is a personal estimate. However, the consequences of this belief are likely to be more serious under the indicative costs approach, especially if the consumer uses more energy than was assumed in calculating the TCR. In this case, the consumer would face a bill that exceeds their expectation. This would frustrate many consumers and may mean that some are unable to pay their bills if their household budget had been adjusted in light of the expected cost of energy. This risk is less serious under the unit rates approach because consumers would not expect to pay a fixed monetary amount and the importance of energy consumption as a component of bills would be more apparent.

8.30. The long term relevance of the TCR is also an important consideration. As noted in Chapter 5, the TCR provides an opportunity to educate consumers about energy units in advance of the smart meter rollout and the introduction of dynamic ToU tariffs. These tariffs will be priced in terms of p/kWh and prices may change

---

<sup>133</sup> This was a statistically significant improvement.

during the course of the day. We note that the in-home display will express consumption in both p/kWh and £/month. However, if consumers are to respond to ToU tariffs effectively, they must be able to identify the cheap and expensive periods of the day and so must understand unit rates. Providing a TCR in units of p/kWh could therefore help to build consumers' understanding that the price of energy per kWh is a key difference between energy tariffs.

8.31. We have taken account of the issues discussed above in formulating our proposal that TCRs should be presented in p/kWh. While this approach may not be the best prompt to engagement, expressing supplier's cheapest tariff information as a personal projection in terms of £/year should mitigate this potential shortcoming. Using different units for the personal projection and TCR should help to avoid confusing consumers.

#### *Number of consumption assumptions for TCRs*

8.32. TCRs could be based on the consumption of the medium consumer alone or could be based on the consumption of low, medium and high consumers.

- Option 1: medium consumer only

8.33. Relying on a single assumption for a medium user would make the TCR a simple and relatively easy to understand concept. It would allow clear communication of tariff prices on billboards and other marketing materials and may be less likely to confuse consumers than the alternative approach.

8.34. However, this approach could be less useful as a comparison guide than the low, medium and high approach. For example, the tariff that is the cheapest based on medium consumption may actually be more costly than alternative tariffs for some users with different consumption levels. This could lead consumers to unwittingly switch to a more expensive tariff. Providing TCRs for low, medium and high consumers would mitigate this risk (but would not eliminate it).

- Option 2: low, medium and high consumers

8.35. Consumers have consistently told us that they would like to see information that is relevant to them. The approach of providing best buy tables for low, medium and high consumers is closer to meeting these expectations and would allow somewhat more relevant comparisons.

8.36. Indeed, many participants in our recent research expressed a preference for TCRs to be provided for low, medium and high consumers rather than medium only:<sup>134</sup>

---

<sup>134</sup> Ipsos MORI (October 2012), page 7.

“It was generally agreed that [TCRs for the medium user only]... would neither allow more engaged Participants to make accurate tariff comparisons, nor appear relevant enough to prompt less engaged Participants to start considering their tariff options. For some audiences, providing TCRs for low, medium and high users would therefore be more appropriate and effective.”

8.37. On the basis of our consumer research, we propose to provide separate TCRs for low, medium and high users.

#### *Regional issues*

8.38. Regional pricing creates a complication for the TCR, given that TCRs would be used in national best-buy tables and would appear in national advertisements. We have considered two options:

##### Option 1: regional TCRs

8.39. In principle, it would be possible to require suppliers to use regional TCRs where information is targeted at a particular locality (e.g. on a billboard or in regional press). However, this approach could be extremely confusing for consumers and may require suppliers to publish a ‘regional TCR’ and a ‘national TCR’ for the current tariff on bills.<sup>135</sup>

##### Option 2: national TCRs

8.40. Under this option, suppliers would present a TCR that is the average of the regional prices. This figure would be calculated as a weighted average where the weights are given by the proportion of a supplier’s customers that are in each region.

8.41. Given that the TCR aims to remove confusion from tariff price comparisons, and is expected to be used on national as well as regional advertising and appear on national best buy tables, we consider that TCRs would be presented as weighted averages across GB in all circumstances. We note that this approach could allow suppliers to ‘game’ the TCR by manipulating unit rates in different regions such that the TCR would not accurately reflect the average unit rate that would apply in any given region. However, we have selected the weights to minimise this risk. We would also expect suppliers to treat consumers fairly and comply with both the spirit and letter of our proposals, including the Standards of Conduct. A detailed discussion of possible gaming strategies is provided in chapter 7 of this document.

#### *Treatment of discounts and penalties*

8.42. We considered four policy options for discounts and penalties.

---

<sup>135</sup> This would be even more complex if the regional TCR used an assumption of average consumption within the region while the national figure used a GB average assumption.



- Option 1: include all non-contingent discounts in the TCR

8.43. Under this option there would be one TCR per tariff. The TCR would show the net cost of the tariff (i.e. after discounts are subtracted) and as such would be consistent with the bills paid by consumers. A key advantage of this approach is that, in the absence of contingent discounts, consumers could compare the price of energy tariffs using only the TCR. It would not be necessary for consumers to factor additional information on discounts into the price comparison exercise.

8.44. Excluding non-contingent discounts from the TCR would make it more difficult for consumers to compare tariff prices. Indeed, in this case it is not clear that the TCR would be an improvement on the status quo.

- Option 2: include non-contingent discounts but exclude contingent discounts from the TCR

8.45. Under this option, only contingent discounts would be excluded from the TCR calculation. Any contingent discount would be presented alongside a tariff's TCR in a best buy table and on suppliers' regular communications and marketing materials.

8.46. An advantage of this policy option is that consumers would be more confident that they could achieve the quoted TCR without taking additional action. The exclusion of contingent discounts would limit the likelihood that consumers are misled in the TCR that they would achieve by selecting the tariff. Suppliers would have less opportunity to 'game' the TCR because there would be fewer variables to include in the calculation.

8.47. However, this policy option could lead suppliers to compete on contingent discounts at the expense of TCRs. This effect would be exacerbated if consumers did not 'trust' the TCRs and the differences between them and made their choice of supplier based on the attractiveness of the contingent discount or offer. Consumers could be distracted from the price TCR comparison we want to facilitate through our policy.

8.48. In addition, excluding contingent discounts would mean consumers face a more complex price comparison exercise. Consumers would need to first compare TCRs and then compare contingent discounts. This could limit the effectiveness of the TCR.

- Option 3: include non-contingent and contingent discounts in the TCR

8.49. Under this option, contingent discounts would be included in the TCR calculation. The information associated with the tariff (the Tariff Information Label and other online/offline material) would explain that the lower TCR could only be achieved if the consumer meets the terms of the contingent discount.

8.50. Including contingent discounts in the TCR would mean consumers only have to compare one value to determine which is the lowest across suppliers. The comparison exercise would be easier for consumers than it would under Option 2.

8.51. However, TCRs could be misleading under this policy option. TCRs would not allow consumers to compare tariffs on a like-for-like basis under this policy option because the terms and conditions of contingent discounts might differ. Under this option, therefore, it is not clear that the TCR would make it easier for consumers to compare tariff prices.

- Option 4: include all non-contingent discounts in the TCR and prohibit contingent discounts

8.52. Under this option, suppliers would not be able to offer contingent discounts. All other discounts would be included in the TCR. An advantage of this approach is that it would make it easier for consumers to compare tariff prices because a variable would be removed from the calculation.

8.53. However, banning contingent discounts would be a highly interventionist proposal that would impinge on suppliers' freedom and could restrict innovation. It is unlikely that such a restriction would be proportionate.

8.54. Taking into account the issues discussed above, we propose to apply Option 2 to the TCR calculation. We judge that this option is the most likely to simplify price comparisons for consumers while limiting potential unintended consequences.

#### *Dual fuel tariffs - presentation*

8.55. We have considered two options for presenting TCRs for dual fuel tariffs.

- Option 1: compile a single TCR for each dual fuel tariff, based on assumptions about gas and electricity consumption.

8.56. This option would clearly distinguish dual fuel tariffs as a separate product and would ensure that it is easy to compare dual fuel tariffs across the market. However, dual fuel tariffs would not be comparable with single fuel tariffs.

- Option 2: calculate separate TCRs for the gas and electricity elements of dual fuel tariffs.

8.57. Under this option, best buy tables could clearly present such tariffs as dual fuel offers. This would allow consumers to compare the price of each fuel with alternative single fuel tariffs and thus could highlight the relatively high prices that the previous incumbent suppliers charge on their legacy fuels compared to their non-incumbent competitor(s). However, it would be more difficult for consumers to compare the total cost of a dual fuel tariff with alternative dual fuel tariffs under this

option as they would need to calculate the total cost from the gas and electricity elements.

8.58. Given that the TCR is designed to prompt consumers to engage with the energy market and compare tariffs, we consider that it is most appropriate to have separate TCRs for the gas and electricity elements of dual fuel tariffs.

#### *Dual fuel tariffs - calculation*

8.59. We have considered how dual fuel discounts should be treated in the TCR.

- Option 1: treat dual fuel discounts as a type of contingent discount such that they would be excluded from the TCR and specified separately;
- Option 2: include dual fuel discounts in the TCR; and
- Option 3: include dual fuel discounts and define the split between fuels.

8.60. We note that dual fuel discounts are only 'contingent' on the consumer's choice at the time of selecting a tariff and not on their subsequent behaviour. The discount is also based solely on the consumer's energy supply and is not contingent on the purchase of a non-energy product.

8.61. Given that the discount would apply from the point of sale onwards, we consider that it should be included in the TCR. This approach would make it easier for consumers to compare the price of dual fuel and non dual fuel tariffs using the TCR than if dual fuel discounts were excluded from TCRs and required the consumer to judge the impact of the discount on the TCR.

8.62. If dual fuel discounts are to be included in the TCR, the question arises of whether Ofgem should mandate how the discount is applied across gas and electricity. Mandating the split would make TCR for gas and electricity dual fuel tariffs more comparable across suppliers and so would benefit consumers. However, it may restrict suppliers' ability to compete and place a competitive constraint on their activities.

8.63. Having considered the issues, we propose that the TCR should include dual fuel discounts and that, for simplicity, half of the discount is applied to gas and half to electricity.

#### *Treatment of additional features such as loyalty points*

8.64. We considered whether additional features should be included in the TCR.

- Option 1: exclude the value of additional features from the TCR

8.65. Additional features are typically used as a marketing tool. It can be difficult to monetise the value of some of these features and so it could be sensible to exclude

the value of these features from the TCR. Under this policy option, suppliers could continue to advertise the features as part of their tariffs.

8.66. We note that this option would make it more difficult for consumers to compare energy tariffs as they must weigh their valuation of the features against the TCRs of different tariffs. However, this option would avoid difficulties that would arise if suppliers were required to include additional features in the TCR when it is difficult to monetise the value of such features.

- Option 2: include the value of additional features in the TCR

8.67. Given that additional features are valued by some consumers, there is an argument that the value should be reflected in the TCR. While this might be relatively easy for certain features (e.g. a wine voucher) it would be rather more difficult for others that do not have a unique monetised value (e.g. the monetary value of loyalty points depends on the product that they are used to purchase).

8.68. We are conscious of the fact that any policy for treating additional features can affect the incentives to offer different types of features. This option could lead to a distortion in the market by incentivising suppliers to offer only additional features that could be easily monetised. Alternatively, it could lead to suppliers offering features that are difficult to monetise and applying high values to these features so as to reduce the TCR of the tariff. This approach could make it difficult for consumers to understand the terms and conditions of the tariff and so could lead to consumer detriment.

8.69. Based on the discussion above, we proposed to exclude additional features from the TCR.

#### *Treatment of bundled products<sup>136</sup>*

8.70. We have considered whether or not the cost of bundled products should be included in the TCR. We have also considered how the type of bundling affects the optimal approach.

- Option 1: include only the energy component in the TCR for bundled products

8.71. Under this option, the TCR would be based on the cost of the energy element of a tariff alone. Additional fees charged for the extra products or services would not be included in the TCR and would need to be specified separately.

8.72. While the TCR would not reflect the total cost of the product bundle, it does allow consumers to compare energy tariffs on a like-for-like basis. In particular, the TCRs of bundled and non-bundled tariffs would be directly comparable.

---

<sup>136</sup> Currently, SLCs 22 and 24 contain requirements for bundled products.

8.73. However, it may be misleading to require TCRs to exclude certain bundled products, particularly where taking the bundled product is mandatory if the consumer is to access a particular energy tariff. The same concern would apply if the default option is to take the product bundle and the consumer would need to actively choose to opt-out if he wished to secure the non-bundled energy tariff.

- Option 2: define specific product offerings/bundles so TCRs can be calculated and compared across suppliers for these specified bundles

8.74. Under this option, suppliers would compile a single TCR for a defined bundled service offering. Ofgem would specify the components (services/products included) that could be included in each bundle to allow consumers to compare TCRs for these defined bundles across tariffs and suppliers.

8.75. However, true comparability between tariffs and suppliers would require that the terms and conditions of each tariff (including the bundled product) are identical. This is unlikely to arise in the absence of Ofgem's intervention but such intervention would place a constraint on suppliers' freedom and ability to innovate.

8.76. Under this option, it would not be possible to compare the TCRs for different product bundles. This is a significant problem and is likely to mean that the TCR would be of little benefit to consumers. Consumers are likely to be confused under this option and so several unintended consequences could arise.

- Option 3: include the entire bundled offering in the TCR

8.77. In this option, suppliers would calculate the TCR on the entire bundled product (including the energy and non-energy services). This option would provide a better estimate of expected tariff cost where bundles are tied or opt-out in nature than would Option 1. In this case, the TCR would equal the average expected cost of the bundle per kWh of energy consumed.

8.78. However, because the TCR would not be based solely on the energy component of a tariff, TCRs for bundled tariffs would not be directly comparable to non-bundled tariffs under this option. While this option would allow a more accurate comparison of the expected cost of non-bundled tariffs and those where taking a bundled product is mandatory, it is not necessarily appropriate where bundles are 'opt-in'. In this case, the consumer must make an active choice to take the bundled product and hence the default is a non-bundled tariff. In such circumstances, Option 1 is more appropriate.

- Option 4 – exclude bundled products entirely from the TCR

8.79. Under this option, suppliers would not be required to calculate a TCR for any tariff that includes a bundled product. This would avoid some of the complications that arise under the other options but would mean that consumers could not easily

compare the price of bundled and non-bundled tariffs. It would also mean that bundled tariffs would not be included in the best buy tables.

8.80. Taking into account the issues described above, we propose that a combination of Options 1 and 3 would be used, contingent on the type of bundle, when calculating the TCR for bundled products. As noted in the previous section, additional features would be excluded from the TCR.

8.81. We have proposed a different approach for personal projections. The treatment of bundled products in personal projections will depend on the consumer's current tariff choice. If the consumer has already chosen a bundled product, personal projections would assume that he wishes to retain that bundled product. This approach makes the information more meaningful for consumers and reduces the risk that they would be misled. We note that the terms and conditions of bundled products may differ such that the consumer would not compare like with like. However, we consider that it is important for consumers to receive information that takes account of their past decisions when they choose to engage in the market and explore the cost of different tariffs.

## Tariff simplification

### Developments since December 2011 proposals

8.82. In December 2011, we proposed to limit suppliers to one tariff per payment method in the evergreen market and to ban discounts and bundled products and services. We considered that these measures, along with an Ofgem-set standing charge, would allow consumers to make 'at-a-glance' tariff comparisons and assess their options more easily and effectively.

8.83. Our identification of the problems in the industry in relation to tariff complexity attracted broad support from a range of respondents. Respondents recognised the need to simplify the market in order to build consumer trust and engagement.

8.84. However, stakeholders also raised a number of concerns, for example that our proposals might not significantly reduce tariff numbers, that the scope for innovation and entry from small suppliers might be harmed and that the discounts and bundles that many consumers value would be eliminated from the evergreen market. Some did not necessarily agree that too much choice was detrimental to the interests of consumers. There was also concern that our proposals did not cover the fixed term segment of the market. Respondents also raised concerns about the costs of our proposals as well as potential unintended consequences.

8.85. In parallel to our December 2011 proposals, some previous incumbent suppliers began reviews of the ways in which they engage with their customers. They saw it as a chance to take on board any suggested improvements and to rebuild their customers' trust. As a result, suppliers have reduced their core tariffs and simplified

tariff structures and discount practices. We recognise that industry has made progress in the last 12 months. We also acknowledge that many small suppliers offer few named tariffs in any case, and use simplicity to differentiate themselves from the previous incumbent suppliers. Further details of industry initiatives are provided in the main consultation document and we have published on our website letters from suppliers, which set out steps they have taken to improve tariff simplicity.

8.86. Taking together RMR responses and suppliers' efforts, at this stage we no longer propose to take forward the tariff simplification proposals in RMR Core. That said, although our position has evolved since December 2011, we have assessed RMR Core as one of our alternative options in the section below.

8.87. This section provides an overview of options we considered to achieve tariff simplification. The key decisions to be made relate to standardising complex aspects of tariffs so that it is easier for consumers to assess their options, reducing the overall number of tariffs in the market and ensuring that any policy intervention provides a long-term solution. The alternative options are summarised in the table below and their advantages/disadvantages discussed in turn.

**Figure 8. Summary of options for the tariff simplification proposal**

Policy option	Pros	Cons
<b>Option 1 (our proposals):</b> Package of simplification measures including capping tariff numbers	<ul style="list-style-type: none"> <li>- reduces number of tariffs in the market</li> <li>- removes many complex tariffs from market</li> <li>- reduces complexity of bundled offers and services whilst providing supplier freedom</li> </ul>	<ul style="list-style-type: none"> <li>- some restriction on innovation</li> </ul>
<b>Option 2:</b> as option 1 though without cap on tariff numbers	<ul style="list-style-type: none"> <li>- removes complex tariffs from the market</li> <li>- suppliers have greater commercial freedom to offer widest range of tariffs</li> </ul>	<ul style="list-style-type: none"> <li>- does not safeguard against future tariff number increases</li> <li>- less effective at building consumer trust and confidence</li> </ul>
<b>Option 3:</b> as option 1 though without simplifying tariff structures	<ul style="list-style-type: none"> <li>- reduces number of tariffs in the market</li> <li>- may achieve indirect simplification of complex tariff structures</li> </ul>	<ul style="list-style-type: none"> <li>- does not guarantee tariff structure simplification</li> <li>- complicates consumer tariff comparison exercise</li> </ul>
<b>Option 4:</b> one tariff per payment method (December 2011 proposals)	<ul style="list-style-type: none"> <li>- reduces number of evergreen tariffs to the greatest degree</li> <li>- facilitates unit rate comparisons (combined with Ofgem-set standing charge)</li> <li>- eliminates complexity caused by discounting and bundling practices in evergreen market</li> </ul>	<ul style="list-style-type: none"> <li>- eliminates consumer's choice to choose discounts and bundled services in evergreen market</li> <li>- does not cap overall number of tariffs</li> <li>- restricts supplier innovation</li> </ul>
<b>Option 5:</b> principles-based approaches	<ul style="list-style-type: none"> <li>- provides parameters for suppliers to work in whilst allowing commercial freedom</li> <li>- arguably less complex to implement</li> </ul>	<ul style="list-style-type: none"> <li>- does not guarantee tariff simplification or a reduction in tariff numbers</li> <li>- does not provide suppliers with specific instructions and thus</li> </ul>

## Options considered

Option 1: (our proposals) a package of simplification measures including capping open core tariff numbers

- Our proposals (set out in the consultation document) aim to strike a balance between increased tariff simplification and reduced scope for market segmentation against giving consumers a choice of tariffs and retaining the discounts that they value. We consider that this option will be most effective in reducing tariff complexity and increasing consumer confidence. Although it is more restrictive of suppliers' commercial freedom in the fixed market than our December proposals, it balances this by loosening the restrictions we originally proposed in the evergreen market. In summary:
- our proposals to eliminate multi-tier tariff structures will mean that a large number of the most complex tariffs would be removed from the market. It will improve tariff comparability whilst still allowing tariffs to be cost-reflective.
- our rules on discounts will make tariffs clearer and simpler. Since our permitted discounts must take the form of adjustments to the standing charge and/or unit rate these proposals are consistent with, and share many of the benefits of, our required simplification of tariff structures.
- Our rules on bundles will reduce undue complexity whilst allowing suppliers to offer the bundles that consumers most value

8.88. Our appraisal of option 1 is set out in more detail in the other sections of this document. We considered four other options to address tariff complexity. These are discussed below.

Option 2: As option 1 though without a cap in tariff numbers

8.89. The design of this option would be the same as option 1 with the exception that there would be no cap on open core tariff numbers.

8.90. This option would retain some of the benefits of option 1 i.e. tariffs would be clearer and more comparable due to the removal of multi-tier tariffs. The application of discounts and bundled products and services would be standardised across the market. The lack of a cap on the number of tariffs would mean that suppliers would have a greater degree of freedom to offer a wider range of tariffs.

8.91. All other things being equal, we estimate that under this option around a half of open tariffs would need to be eliminated (or adapted) to comply with our rules on



tariff structures and ban on variable price, fixed term tariffs.<sup>137</sup> We also estimate that dead tariffs would fall by around a third.

8.92. However, although tariffs would reduce in the initial implementation phase, this may be a temporary effect. Option 2 would not prevent suppliers from introducing other types of tariffs in the future to replace those they had lost. The eventual reduction is likely to be smaller than our estimate and/or be transitory and any initial positive impact on consumer confidence may be lost. We consider that without a cap, suppliers could more easily 'game' our proposals and there would be a risk that key benefits from our proposals would not materialise.

8.93. Option 2 would be less effective than option 1 at increasing consumer confidence. Without a tariff cap, consumers and consumer groups may be less convinced that the market had changed for the better. We are concerned that consumer engagement in the market may be affected if suppliers continue to have free rein to introduce multiple new tariffs, despite the progress that they have made to date.

Option 3: As option 1 though without simplifying tariff structures

8.94. This would be as option 1 though without simplifying tariff structures. We would simply set a limit on the number of tariffs that a supplier can offer and introduce the rule to eliminate dead tariffs.

8.95. This option would address a key area of concern for consumers and consumer groups. It would reduce tariff numbers and provide a safeguard against tariff proliferation in the future.

8.96. Our concern with this option is that it does not guarantee that all suppliers would eliminate multi-tier tariffs. It may be that some suppliers eliminate multi-tier tariffs, whilst others retain them. Suppliers could also re-introduce a multi-rate tariff at a later date. Ultimately, this option would not ensure standardisation of tariff structures, which we consider an important step towards helping consumers compare tariff options.

Option 4: one tariff per payment method (December 2011 proposal)

8.97. In our December 2011 consultation, we proposed that each supplier would be limited to one tariff per payment method in the standard market (i.e. evergreen variable tariffs). We also proposed that discounts and bundled offers would be prohibited. To facilitate 'at-a-glance' comparisons on the unit rate, Ofgem would set the standing charge.

---

<sup>137</sup> This is based in our analysis of the impact of our tariff structure proposals on availability of current tariffs, as at 28 August 2012, using information available from our information request to suppliers. This analysis was undertaken across both large and small suppliers (including white labels), all payment types, for standard meters only. Numbers are based on London region. It should be noted that this analysis was undertaken in consideration of percentage reduction in original tariff data, as opposed to reduction in 'core tariffs', which we define in our consultation document.

8.98. Option 4 has a number of advantages. Firstly, it would significantly reduce tariff numbers in the evergreen market, even accounting for industry progress so far. It would simplify the overall range of evergreen tariffs to a greater extent than the other options. The majority of consumers are on evergreen tariffs, which lack any trigger point for engagement. This is the portion of the market that is likely to require the greatest degree of intervention to encourage consumers to explore their options.

8.99. Secondly, it would facilitate 'at-a-glance' comparisons on the unit rate of energy, allowing consumers to use hard copy media to determine which tariff is cheapest. This would be a useful tool in reaching the least engaged consumers who do not tend to explore their options online.

8.100. Thirdly, there would be no need to factor in the value of discounts and bundles, reducing the amount of supplementary information that a consumer has to consider as part of the price comparison exercise.

8.101. However, there are aspects of option 4 that are less favourable. Firstly, more engaged consumers do value choice and the opportunity to take advantage of discounts and offers. Dual fuel and online tariffs have grown in popularity and there would be a risk of consumer frustration if the associated discounts were to disappear as a consequence of enforcing this option.

8.102. Secondly, the overall number of tariffs in the market would not be capped, only variable evergreen. Some respondents to our December 2011 consultation noted that tariff proliferation could occur in the fixed area of the market. The result could be a supplier shift away from variable evergreen tariffs (which may suffer from a lack of competition) towards fixed tariffs, which would only benefit the most engaged consumers.

8.103. Thirdly, there is a risk that suppliers offer less competitive deals in the evergreen market and focus their attention in the fixed market. This would disadvantage the least engaged consumers who tend to be on variable evergreen tariffs.

8.104. Fourthly, there are practical challenges around setting a national standing charge.

8.105. Finally, suppliers consider option 4 to be restrictive and anti-competitive. Small suppliers in particular argued in responses to our December 2011 proposal that it would constrain their ability to offer niche products and gain market share by giving them a means to differentiate from the previous incumbent suppliers. Suppliers also expressed concern around Ofgem setting the standing charge and restricting their ability to set it according to their commercial drivers.

8.106. Overall, we now consider that we can achieve a better balanced package that simplifies tariffs whilst avoiding many of the disadvantages of option four.

## Option 5: principles-based approaches

8.107. We considered whether to provide principles-based direction to suppliers on limiting their tariff numbers and/or simplifying tariffs. This could be provided either through Standards of Conduct guidance or in a licence condition. Some examples could be:

- **discounts:** suppliers should offer cost reflective discounts. Contingent discounts could be prohibited or regulated. Rules could be introduced to ensure that certain discounts are displayed in a defined format;
- **bundles:** suppliers should offer only energy-related bundles or other partnership deals. Rules could be introduced to ensure that bundled products must be marketed and sold separately;
- **'new' tariffs:** suppliers should only offer a new tariff if they can demonstrate a clear commercial need to do so. Suppliers should submit retrospective statements to Ofgem justifying their reasons for introducing new tariffs.

8.108. This approach has several benefits. For example, using SOC guidance or rules in the licence removes the need for Ofgem to be overly interventionist in comparison to the other options. Some suppliers might prefer this approach as it would provide parameters in which to work whilst allowing them a degree of commercial freedom.

8.109. However, using SOC guidance or Licence rules to ensure suppliers reduce and/or simplify tariffs would necessarily be a less prescriptive approach than setting a tariff limit or eliminating multi-tier tariffs. There is therefore a risk that individual suppliers interpret these in different ways and there might be greater regulatory uncertainty for suppliers.

8.110. It would not directly address consumers' and consumer groups' concerns around tariff numbers. It is possible that they would criticise a principles-based approach for not doing enough to address tariff proliferation, perhaps reinforcing feelings of frustration and affecting their willingness to engage in the market.

8.111. Finally, a principles-based approach does not guarantee that the market will take the direction we want to see. While suppliers had the chance to simplify tariffs as part of the Probe, they did not do so. There is a risk that without a more prescriptive approach, the market will not be simplified to the degree that is required.

## Clearer and simpler information

### Developments since December 2011 proposals

8.112. As described in Chapter 7 of the consultation document, the aim of our information remedies package is that the information provided to consumers is easy

to understand and gives consumers the information they need to make well informed switching decisions.

8.113. To achieve this aim, in December 2011, we set out detailed proposals for prescribing the format and content (to different extents) of four documents – the Bill, the Annual Statement, the Price Increase Notice, and a new document, the Tariff Information Label. We also set out our expectations for the content of End of Fixed Term notices.

8.114. Consultation responses showed a high level of support for many of our proposals from consumer groups. The previous incumbent suppliers showed support in particular for the introduction of the Summary Box on Bills, stand alone, prescriptive Annual Statements, and the proposed format and information requirements within Price Increase Notices. Many also understood the benefit to consumers of having personalised information across the communications.

8.115. The views of small suppliers were that many of our proposals do not go far enough. Some did suggest that the adoption of a more prescriptive approach may impact innovation and their ability to differentiate their service offerings, particularly the proposed standardisation of formats. However, they supported some standardisation of terminology where this leads to clarity of communications. Suppliers' main concerns in general were regarding the initial and ongoing IT costs to implement the proposals.

8.116. Given our aims set out above, the responses to the consultation and the results from further consumer research and testing, we consider it appropriate to introduce proposals broadly in line with our December proposals.

8.117. In developing our proposals, we have worked with design experts to refine standardised templates and conducted further consumer research to understand how consumers react to specific layouts, information and language<sup>138</sup>. In developing our overall RMR package, we have also incorporated additional 'prompts to engage' through messaging on the consumer's cheapest tariff with their current supplier, and incorporated the TCR and personal projection into our prescribed formats. In addition, we have proposed to prescribe the content of an additional communication, the End of Fixed Term Notice.

8.118. Further information on the recommendations for each communication are provided in Chapter 7 of the consultation document, and example templates for each of the specific remedies is included in Annex 4 of the consultation document.

## Options considered

---

<sup>138</sup> We commissioned design experts Boag McCann and consumer research company SPA Future Thinking to assist with further development of the standardised formats for Bills, Annual Statements, PINs and the Tariff Information Label.

8.119. This section provides an overview of the policy options we have considered and the rationale and supporting evidence for our chosen proposals.

8.120. The key decisions to be taken in designing the information remedies package are: determining the optimal content and presentation of information; and the extent to which these should be standardised across the industry. These issues have been explored in consumer research and have been discussed at stakeholder roundtable events.<sup>139</sup> Taking into account these stakeholder engagement events and feedback from consultation responses, **we have considered the potential benefits and unintended consequences of different approaches.** The alternative policy options which have been considered are summarised in the table below:

**Figure 9. Summary of options for the clearer and simpler information proposal**

Option	Pros	Cons
<p><b>Option 1.</b> Clarify the original policy intent of the Standard Licence Conditions (SLC 23 and 31A).<sup>140</sup></p>	<ul style="list-style-type: none"> <li>• Low cost</li> <li>• No additional burden on suppliers</li> </ul>	<ul style="list-style-type: none"> <li>• No guarantee of simpler language</li> <li>• No guarantee of clearer format</li> <li>• No additional prompts</li> <li>• No standardisation</li> </ul>
<p><b>Option 2.</b> Additional information requirements only, without prescribed format, terminology or formulation of language.</p>	<ul style="list-style-type: none"> <li>• Flexibility for suppliers</li> </ul>	<ul style="list-style-type: none"> <li>• No guarantee of simpler language</li> <li>• No guarantee of clearer format</li> <li>• No standardisation</li> </ul>
<p><b>Option 3.</b> Option 2 plus <u>some</u> content to be presented using prescribed format, terminology or formulation of language.</p>	<ul style="list-style-type: none"> <li>• Clearer information</li> <li>• Simpler language</li> <li>• Standardised format across suppliers</li> <li>• Some freedom for suppliers</li> </ul>	<ul style="list-style-type: none"> <li>• Limited flexibility for suppliers</li> </ul>

<sup>139</sup> The Consumer Bills and Communications Roundtable Group (CBCRG) is a working group that has been established to look at the broad range of information and communications that energy customers receive. The CBCRG is comprised of representatives from Ofgem, Citizens Advice, Consumer Focus, DECC, Energy UK, Which?, and both Energy UK affiliates and non-affiliates. Links to meeting notes can be found at: <http://www.ofgem.gov.uk/Markets/RetMkts/consumer-bills-and-comms-round-table/Pages/index.aspx>.

<sup>140</sup> This option would entail tightening the drafting of the licence condition to reduce scope for alternative interpretation. For example, clarifying more precisely the existing information requirements and providing added weight to any guidance issued.

**Option 4.** Option 2 plus all content to be presented using prescribed format, terminology or formulation of language.

- Clearer information
- Simpler language
- Standardised format across suppliers

- Very limited flexibility for suppliers in implementation

### *Assessment of Options*

8.121. This section provides our assessment of the policy options that we considered. The features of each of the options are described and we assess the pros and cons of each approach.

#### *Option 1: Clarify the original policy intent of the Standard Licence Conditions (SLC 23 and 31A)*

8.122. We consider that SLC 23 on the Price Increase Notice and SLC 31 on Bills and Annual Statements are not currently working as intended.<sup>141</sup> Under this policy option, Ofgem would clarify the policy intent of these Licence Conditions but would not impose prescriptive requirements on suppliers.

8.123. We consider that this policy option could address some issues concerning the current interpretation of rules, for some suppliers, and note that the cost of complying with this policy is unlikely to be significant. However, we do not consider that relying on the current licence conditions and standards of conduct will be able to address all the issues identified. Indeed, we have already attempted to address these issues by taking a relatively non-prescriptive approach:

- In October 2010 we wrote to domestic energy suppliers to outline our expectations regarding SLC 31A and to prompt certain individual suppliers to review the information that they provide;
- We modified SLC 23 in April 2011 to address concerns about the clarity and content of notices. Alongside this we have written to suppliers to remind suppliers of our expectations for compliance with both SLC 23 and SLC 31A;<sup>142</sup> and
- To ensure our intent was clear we also issued guidance in August 2011 for SLC 23, and are currently in the process of developing further guidance on

<sup>141</sup> For example, current obligations require suppliers to provide consumers with key information in prominent positions on communications, including information on how to find impartial advice about switching supplier. Suppliers also have flexibility regarding how they display information within the relatively broad scope of the prominence requirements. In both cases, suppliers have fallen short of policy expectations.

<sup>142</sup> Decision to make modifications to standard conditions 23, 14 and 24 of the supply licences - (Reference number: 43/11), 28 March 2011. Available at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=38&refer=Markets/RetMkts/Compl/pricechange>.

SLC 31A.<sup>143</sup>

8.124. We recognise that a minority of suppliers demonstrated some good practices in response to these measures.<sup>144</sup> Overall, however, we consider that these measures have not resulted in the change that we consider necessary for the Bills, Annual Statements and PINs to work in the interests of consumers. Therefore, we are not confident that further guidance will be an effective way of meeting the objectives of the information remedies proposals.

8.125. Taking the above discussion into account, we consider that further prescription is necessary to ensure suppliers' communications deliver the full range of prompts and information consumers need to engage effectively.

*Option 2: Additional information requirements only, without prescribed format, terminology or formulation of language*

8.126. Under this option, Ofgem would specify the content that suppliers must include in Bills, Annual Statements, PINs, the Tariff Information Label and End of Contract notices. We would not prescribe the format in which the information should be presented or the language that should be used.

8.127. This approach could help to reduce confusion and increase consumers' knowledge. It would also allow suppliers flexibility to design style and layout of their communications to suit their customer base, while meeting our requirements.

8.128. However, we consider that there is a risk that the purpose of a communication would be obscured under this option if suppliers were to present information in a relatively unclear format or use complex language. In contrast, consumers were found to understand the impact of the pricing information on a Price Increase Notice when this was personalised and presented in a tabular format. Therefore, we consider that this option may not help to improve consumers' knowledge and understanding of the energy market.

8.129. A further risk under this option is that suppliers could include additional information that is not relevant to the purpose of a communication. Our consumer research found that where a significant amount of less relevant information is included, there is a risk consumers will disregard the communication without reading the important information and understanding its key messages.<sup>145</sup> A related risk is that it would remain possible for suppliers to send the Bill and Annual Statement in the same envelope, which would confuse the purpose of both communications.

---

<sup>143</sup> Guidance on notification of price increases – Standard Licence Condition 23. Available at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=42&refer=Markets/RetMkts/Compl/pricechange>.

<sup>144</sup> Ofgem internal review of supplier communications in relation to SLC 23 and SLC 31A in 2010 and 2011.

<sup>145</sup> Unless there is a clear call to action, such as the amount owed on a bill, then there is likely to be engagement with this, but nothing beyond this. Lawes Consulting and Lawes Gadsby Semiotics (November 2011a).

8.130. Our research also shows that consistency between different customer communications allows consumers to become more familiar with such information and makes it easier for them to understand and use the details provided.<sup>146</sup> There is no guarantee that such consistency would be obtained under this policy option and therefore we are concerned this approach would not adequately achieve our objectives.

8.131. Overall, we consider that this option would not fully address barriers of lack of consumer knowledge and understanding as there would still be a risk that consumers would not receive clear and accessible information.

*Option 3: Option 2 plus some content to be presented using prescribed format, terminology or formulation of language.*

8.132. Under this option, suppliers would be required to include the additional information described under Option 2. In addition, certain information will need to be presented in a standardised format and only content required by the condition will be able to be included. This is our proposed approach.

8.133. In developing our proposals under this option, we have taken into account findings from expert language research<sup>147</sup> and consumer testing<sup>148</sup>. The language research<sup>149</sup> found that using consistent terms and language and grouping together key pieces of information would help to improve consumers' understanding of the information provided on key communications and could help to prompt consumer engagement. We expect that the incremental benefit of requiring suppliers to use standardised language on the key communications will outweigh the cost.

8.134. The consumer testing informed the content and format that we have proposed for Bills, Annual Statements, PINs and Tariff Information Label. In order to ensure our prescriptions are proportionate, we propose that different levels of prescription would be applied to each communication type under this option. For example, we propose that all information will be subject to standardised format and language on the Annual Statement. The format of the Tariff Information Label is also entirely prescribed. However, on PINs and Bills we have targeted those areas of the communications that we feel are likely to deliver the greatest benefit to consumers from being made clearer. The format and style of the remainder of the PIN, Bill (subject to Green Deal requirements) and all content on the End of Fixed Term Notice will be determined by suppliers.

8.135. We note that standardising the format of key communications could potentially place costs on suppliers. However, we consider that our objectives are unlikely to be achieved in the absence of format standardisation because there would be no guarantee that information would be presented clearly. In addition, we consider that it is important to prescribe the format of key prompts to engagement such that the likelihood of success is maximised. Standardising the language used

<sup>146</sup> Lawes Consulting and Lawes Gadsby Semiotics (November 2011a).

<sup>147</sup> Ibid.

<sup>148</sup> SPA Futurethinking (October 2012a).

<sup>149</sup> Lawes Consulting and Lawes Gadsby Semiotics (November 2011a).



across the key communication channels will help consumers to become familiar with the terminology used in the market and will therefore make it easier for consumers to engage over time.

*Option 4: Option 2 plus all content to be presented using prescribed format, terminology or formulation of language.*

8.136. Under this option, the content, format and language of key communications would be further prescribed such that the entire content of all communications is subject to standardisation. These prescriptions would also be applied to other communication channels such as direct debit review letters.

8.137. This policy option would ensure that all key communications received by consumers would be consistent across energy suppliers. Consumers would become familiar with the content of each communication and the format in which it is presented. This familiarity could, over time, improve consumer understanding and so could improve consumers' knowledge of the energy market.

8.138. However, at this stage we do not consider that this policy option is proportionate to the problem that we have identified. We consider that the incremental benefit of this policy option over Option 3 is likely to be limited while incremental costs could be substantial.

#### *Preferred Proposal – Option 3*

8.139. Taking into account the issues discussed above, we consider it appropriate to propose Option 3. This policy option is broadly in line with our December proposals. We consider that the measures proposed for key communication channels under this option will ensure that consumers are prompted to engage. When consumers choose to engage, the policy option will ensure that they have sufficient information and understanding to make better quality switching decisions.

8.140. We have considered the proportionality of our policy option. In particular, we have considered whether it would be possible to achieve our objectives without imposing requirements on all of the key communications channels. For example, we considered the possibility of applying Option 3 only to Price Increase Notices and/or Annual Statements and/or Bills.

8.141. We consider that key communications at each stage of the year and at critical points (such as price changes) need to be improved if we are to ensure that consumers receive and understand the information they require to effectively explore their energy options and engage with the market.

8.142. On this basis we propose to implement Option 3 for all key communications. However, we propose to conduct field trials to assess how effective the proposed Annual Statement may be when implemented. This will help to build an evidence

base for the proportionality of our Annual Statement proposal and will provide an indication of the likely proportionality of the rest of the package.<sup>150</sup>

## Standards of Conduct

8.143. In December 2011 we proposed to introduce the SOC to apply to all interactions between suppliers and consumers and to make the SOC legally binding by incorporating them into an overarching, enforceable license condition.

8.144. Our core proposal for the SOC remains the same as that presented in our December 2011 RMR consultation document. The consultation document outlines our current proposal and further detail around how we see the SOC working in practice.<sup>151</sup>

8.145. Our proposal was seen as the best policy option to see improvements in the energy market at the level required.

### Developments since December 2011 proposals

8.146. As part of written responses to the December 2011 RMR consultation document we received feedback on our SOC proposals from a range of stakeholders. There was broad in-principle support for the proposed SOC in the domestic market.

8.147. However, a range of stakeholders expressed concerns about the regulatory risk that may arise from introducing the SOC as legally binding measures. It was suggested that concerns may be mitigated if the SOC were introduced as voluntary measures or if suppliers had a better understanding of how Ofgem intended to enforce new rules under the SOC.

8.148. As outlined below, introducing revised SOC as voluntary measures would not provide adequate protections for consumers. As a result, we have engaged with consumers, consumer representatives and suppliers to inform our thinking as we considered the detail of our SOC proposal. Through collaborative sessions with consumers and suppliers we facilitated a dialogue between these groups on how the SOC proposal may be taken forward and to further draw out consumer expectations of supplier conduct. Key messages from this research are presented in the sections below.<sup>152</sup>

8.149. Findings from our recent consumer research and collaborative engagement indicate that in general energy consumers have limited interactions with suppliers and therefore do not always have strong views about them.<sup>153</sup> However, where consumers have strong feelings about customer experiences in the energy market

<sup>150</sup> Our expert panel has indicated that experimental approaches are more effective than market research in understanding the impact on actual behaviour.

<sup>151</sup> See Chapter 8 of the consultation document.

<sup>152</sup> Insight Exchange (October 2012).

<sup>153</sup> Ibid.

they are mostly negative. Some consumers who have had a negative experience feel that if suppliers adopted the SOC, and changed their practices to ensure they were consistently met, it could lead to real improvements and increase levels of trust.<sup>154</sup>

8.150. There was a clear desire that someone – either ‘the government’ or Ofgem – ensures that suppliers are consistently meeting consumer needs and are treating them fairly and with empathy.

8.151. Some suppliers have taken some steps to try to address the issue of trust in the market. However, evidence shows that practices across the market are not universally conducive to promoting consumer trust and that consumer experiences with the same supplier can also vary.<sup>155</sup>

8.152. The current voluntary Standards cover a more narrow set of interactions – i.e. interactions such as sales and marketing or consumer complaints where consumers may face a trigger to engage with the market. They also cover interactions which were found to only represent a small part of the cause of negative interactions between consumers and their suppliers.<sup>156</sup> A recent review of consumer direct complaints data shows that the majority of issues raised related to marketing, billing, metering, transfers, debt/disconnection and transportation/distribution.<sup>157</sup> Of these, information and billing were the biggest source of complaints and these cover a large range of issues, which are not uniformly covered by existing licence conditions.<sup>158</sup>

### Options Considered

8.153. The alternative policy options which have been considered are summarised in the table below:

**Figure 10. Options for the SOC proposal**

Areas	Options
<b>Approach to Regulation</b>	<b>Option 1.</b> Principles based approach
	<b>Option 2.</b> Directive based approach
<b>Framing of the SOC</b>	<b>Option 1.</b> Binding license condition
	<b>Option 2.</b> Non binding condition
<b>Scope of the SOC</b>	<b>Option 1.</b> Covering all interactions
	<b>Option 2.</b> Limited interactions
<b>Enforcement</b>	<b>Option 1.</b> Bespoke approach
	<b>Option 2.</b> Two staged approach

<sup>154</sup> However, some remained sceptical about the ability of the Standards to affect this change.

<sup>155</sup> Insight Exchange (October 2012).

<sup>156</sup> Ibid.

<sup>157</sup> Ibid.

<sup>158</sup> Information includes information related to contact details, pricing information and meter type information.

### *Approach to regulation*

Options considered: Principles based approach vs. directive based approach

8.154. A principles based approach to regulation is a way to address key concerns within the market without taking a detailed directives based approach to addressing the range of issues identified. As outlined in our consultation document, the move to a principles based approach allows suppliers the ability and flexibility to focus on improving their relationship with consumers. This approach keeps the supplier's focus on the consumer and what consumer needs are rather than it being focussed on Ofgem and our definition of particular prescriptions. This will involve suppliers focusing their efforts on identifying and delivering what consumers need. It provides the opportunity for innovation and for suppliers to differentiate their services. This approach also allows suppliers the flexibility to change their services over time as consumer needs change. A more principles based approach to regulation is also consistent with Better Regulation Principles and we therefore are not proposing to introduce a directive based approach.

### *Framing and scope of the SOC*

Options considered: binding license condition vs. non binding condition

8.155. The option of non binding conditions provides no direct means of enforcement and limited incentive for suppliers to adhere to the principles of the Standards. Under this option it is unlikely that we would see the needed improvement in supplier interactions with consumers. Despite the introduction of the voluntary Standards, as part of the Energy Supply Probe, consumer engagement and trust remains an issue.<sup>159</sup> Experiences for consumers when engaging with their suppliers across the market have not consistently been positive, also leading to low levels of trust.<sup>160</sup> For this reason we are proposing to introduce the SOC as a legally binding licence condition.

8.156. Consumers have also outlined in qualitative research that they would be sceptical about how the SOC would be effective if introduced as voluntary measures.<sup>161</sup>

8.157. In developing our evidence base for the SOC, we examined other industries and countries where industry codes or SOC are used. This found that where comparative policies were successfully introduced, codes or standards were supported by enforceable rules, conditions or laws.

8.158. Examples include the energy regulator in Ireland, Ofcom's code of conduct, a dictated code set out by Australian state energy regulators and the Financial Services

---

<sup>159</sup> Ipsos MORI (January 2011).

<sup>160</sup> Insight Exchange (October 2012).

<sup>161</sup> Ibid.

Authority.<sup>162</sup> This evidence along with evidence illustrating the limited impact of the voluntary Standard has led us to propose the introduction of the SOC as enforceable standards.<sup>163</sup>

8.159. In response to our December consultation, we did receive some challenge to our proposal, especially from three of the previous incumbent suppliers. One of the large suppliers suggested that there has been significant progress in this policy area on supplier conduct and therefore the introduction of binding SOC are not needed. Two of the previous incumbent suggested that the SOC does not need to be enforceable as they replicate existing consumer protection regulations. However, as mentioned above the evidence suggests that the objectives of the original SOC have not been met with voluntary SOC. The introduction of our proposal will also help ensure that consumers are consistently being treated fairly across the market which is not occurring at present.<sup>164</sup>

8.160. Many stakeholders including consumer representatives support the need for enforceable SOC. In addition, three of the previous incumbent suppliers supported the need for the SOC to be enforceable. One of them also noted that they believed that non-binding SOC would not achieve the policy objectives and the SOC needs to be enforceable.<sup>165</sup>

Options considered: scope covering all interactions vs. limited interactions

8.161. Research shows there are a wide range of interactions between consumers and suppliers that can impact on consumer trust.<sup>166</sup> For this reason we propose to introduce the SOC to cover all interactions between consumers and suppliers (and their representatives).<sup>167</sup>

8.162. This will help ensure that a positive change will occur across interactions between suppliers and consumers. It will also provide protection for consumers on a range of issues where consumers currently have limited or no formal protection under the Standard Licence Conditions.

8.163. In the Retail Market Review December 2011 consultation responses, two of the previous incumbent suppliers did not feel that “all interactions between consumers and suppliers” needed to be covered by the SOC, with one of them suggesting that there were already existing legal rules that offered the protections the SOC would cover. Many responses supported the need for all interactions to be covered by the SOC. One of the previous incumbent suppliers suggested the SOC should be more widespread and cover all interactions, and any supplier who was found to be non compliant should face enforcement action. Some suppliers supported widening the scope of the SOC also. One supplier acknowledged the SOC should be widened but felt guidance was needed alongside the SOC.

---

<sup>162</sup> Ofgem (2011) Retail Market Review.

<sup>163</sup> Ofgem (2011) Retail Market Review.

<sup>164</sup> Insight Exchange (October 2012).

<sup>165</sup> Retail Market Review December 2011 consultation responses.

<sup>166</sup> Ipsos MORI (January 2012).

<sup>167</sup> Opinion Leader (December 2009).

### *Enforcement*

Options considered: approach to enforcement

8.164. It is important that we assure suppliers that we will take a fair and reasonable approach to enforcing the SOC. The consultation document outlines our proposed, bespoke approach to enforcement to achieve this, while at the same time assuring consumers that a clear regulatory “back-stop” is in place. We have a limited role in dealing with individual disputes between consumers and licence suppliers. We therefore see a role for the Ombudsman Services: Energy (Ombudsman) in applying the SOC when dealing with individual cases referred to it.<sup>168</sup>

8.165. We note our proposal differs from the proposal put forward by some stakeholders within their responses to the consultation, many of whom suggested a formalised two-stage process along the lines of that put in place for SLC25A. This process was one where we committed to engaging in dialogue before opening investigations and desisted from further action where suppliers put things right where we identify issues. As a result suppliers would be guaranteed an opportunity to avoid enforcement action even where there had been a past breach. This approach would reduce incentives for suppliers to take ownership of the implementation of the SOC and reduce our ability to take enforcement action in serious cases (e.g. where it appears the supplier had little or no regard to the requirement to treat customers fairly) or to address past breaches and the associated financial gain. Therefore, we do not propose taking this approach.

8.166. As we said in the consultation document, we will usually ask suppliers for contemporaneous documents so we can make an assessment of the seriousness of a potential breach before opening investigations. Our enforcement approach will focus on an assessment of whether the supplier has acted reasonably in the circumstances and has taken seriously its obligation to treat consumers fairly.

### *Guidance or clarification of our expectations*

Options considered: spectrum of options

8.167. It is important for suppliers to maintain responsibility for embedding the SOC in their organisation. We are keen that any potential clarification does not transfer responsibility for this from the suppliers to Ofgem. Given this, we have carefully considered the format and the level of detail included in our clarification and/or guidance that sits alongside the SOC.

8.168. As outlined in our consultation document this will involve providing guidance around existing legal definitions of key terms within the SOC.

---

<sup>168</sup> In line with the Ombudsman’s terms of reference we would expect disputes to be resolved on the basis of what is ‘fair and reasonable’ in each individual case.

8.169. Two suppliers voiced concerns over the definition of representatives in the Retail Market Review December 2011 consultation responses. These concerns were in relation to the potentially wide definition of representatives to include third parties that suppliers may not have a direct contract with.

8.170. An unintended consequence that may arise could be that suppliers are deterred from dealing with third parties where there is not a direct contract in place. Stakeholders noted that activities outside of contracts could still potentially expose suppliers to enforcement action; as a result they would cease all activities with such parties. The impact could be to cancel a significant sales and marketing channel which, amongst other results, could lead to decreased engagement levels by consumers. Another consequence may be that suppliers enter into contracts with all their third parties that may be costly to draw up and to impose to all relevant parties. These costs may ultimately be passed onto consumers.

8.171. In light of concerns over the term, we have considered the role of representatives and we have taken account of consultation responses in this consultation. Along with the guidance proposed we plan to provide further information about how the definition of representatives may be used in regard to compliance with the SOC. As set out in our consultation document without prejudice to other licence conditions that use the term, as a matter of policy, we would intend to focus the SOC on more direct and express relationships between a supplier and another person (including chains of sub-delegation arising from such a relationship), such as a person directly appointed as an agent.<sup>169</sup> On this basis, depending on the circumstances of the case, we do not generally envisage focusing on the relationships between a supplier and a broker or switching site, which may arise via the payment of commission or other direct arrangements.

#### *Communication of the SOC*

Options considered: mandating requirements vs. non mandating requirements

Options considered: high level communications vs. detailed communications

8.172. We hope that communication of the SOC to consumers will raise consumer awareness of the new Standards that apply in the industry, and in turn this should help build consumer trust. The consultation document outlines the requirements on suppliers and Ofgem's role in communicating the Standards. Alternative options considered were more prescriptive and detailed in nature. We have proposed an option which allows suppliers some flexibility in deciding how and what they communicate with their consumers.

8.173. We are proposing to introduce minimum requirements on communication of the SOC, as outlined in the consultation document, to allow for a standardised understanding of the SOC to develop in the industry. The alternative approach would be to allow suppliers to label the SOC in their own way; however, we feel that it is

---

<sup>169</sup> For example, the marketing licence condition: SLC 25

important that there is a consistent understanding and label for the SOC which will allow familiarity of the SOC to develop with consumers more effectively.

8.174. Other requirements, as set out in the licence condition, allow for visibility of the SOC to consumers with regard to what they can expect from their supplier. If this requirement was not mandated we feel that it would limit the effectiveness of the Standards as consumers would not be aware of what they can expect from their supplier.

8.175. We feel that communication can be a powerful tool to help rebuild trust in the market. Information on the SOC, and what individual suppliers are doing to comply with them, should empower consumers by highlighting what they can hold suppliers accountable to. Through this communication consumers can also be reassured that suppliers are committed to meeting their needs.

8.176. Keeping in line with a principles based approach to regulation we feel that it is unnecessary to take a detailed prescriptive approach to requirements with regard to the communications of the SOC.

## **Protecting Consumers on Fixed Term Offers**

8.177. In our December 2011 domestic proposals, we set out our policy proposals regarding the rules to be applied to fixed term offers in the retail market. Following development of our December proposals, and with regard to the responses received to that consultation, our current proposals are focused on two main areas: automatic contract rollovers ('auto-rollovers') and price increases and other adverse unilateral variations.

### **Automatic contract rollovers – developments since December 2011 proposals**

8.178. In our December 2011 domestic proposals we consulted on a ban on automatic contract rollovers. Stakeholders were concerned that our proposals could increase the cost of providing fixed term offers, impact negatively on the development of ToU tariffs and/or result in suppliers engaging in strategies that could undermine consumer engagement.

8.179. We have updated our 2011 RMR policy proposal in light of stakeholders' concerns and further developments in other RMR policy areas.

### **Options considered**

8.180. We have considered the following options in the development of our policy on automatic contract rollovers:



8.181. **Option 1 ('A prohibition on auto-rollovers to fixed term offers')**: This option involves prohibiting automatic contract rollovers to subsequent fixed term tariff offers.

8.182. **Option 2 ('Not prohibiting auto-rollovers to fixed term offers')**: This option involves not prohibiting automatic rollovers to subsequent fixed term offers. This could involve either:

- drawing on existing licence conditions and consumer protection law<sup>170</sup>; or
- restricting the length of time a tariff could be automatically rolled over for and/or include an 'opt-in' clause to auto-rollovers.

8.183. We note that some of the other measures we are proposing related to the end of fixed term offers (notification periods, switching windows and price protection) could be introduced under either of these options and so assess these separately below.

#### *Assessment of options*

8.184. Option 1 would ensure that consumers are not 'locked in' to subsequent contracts which could be more expensive or do not fit consumers' needs. Indeed, it is important to ensure that when customers do not give positive assent to be rolled onto another contract, whatever contract they do move to, does not permit termination fees. It is for this reason we are proposing that if no positive assent is given customers would default onto an evergreen tariff (which we are proposing is the cheapest equivalent evergreen tariff), enabling them to exit the contract at any point without fear of penalty if they identify a better deal for them. We expect that prohibiting auto-rollovers to fixed term offers would impact positively on consumer engagement by eliminating barriers to switching and creating a trigger point for consumers' decision-making. The advantage of Option 1 is that it directly addresses these key reasons driving consumer disengagement and lack of trust.<sup>171</sup>

8.185. In our view, prohibiting auto-rollovers to fixed term offers would reduce suppliers' ability to take advantage of consumers' behavioural biases, and allows for greater competitive pressures to emerge in the fixed term market driven by an increase in consumer engagement and trust in the market.

8.186. Given our analysis, our recommendation is to implement Option 1: A prohibition on automatic contract rollovers to fixed term offers.<sup>172</sup>

---

<sup>170</sup> For example, we could issue clarification or guidance to suppliers on their application of: (1) Standard Licence Condition (SLC) 23: Notification of Domestic Supply Terms; (2) SLC 25: Marketing to Domestic customers; (3) The Unfair Terms in Consumer Contracts Regulations 1999; and (4) Consumer Protection from Unfair Trading Regulations 2008.

<sup>171</sup> We explore the full default tariff options later in this chapter.

<sup>172</sup> More details on implementation costs and unintended consequences can be found in Chapter 4 and 7 of

### *Implementation options*

8.187. In implementing the prohibition on auto-rollovers to fixed term offers we also sought to address concerns relating to current practices around fixed term offers<sup>173</sup> and ensure that the consumer switching experience is not negatively impacted upon.

8.188. This section explains the specific implementation options considered to implement a prohibition on auto-rollovers to fixed term offers, including how we have considered:

- Options for the default tariff when consumers do not take appropriate action by the end of the contract period;
- Options for a consumer notification period for consumers to receive a written statement before the contract end date;
- Options for switching window arrangements before the contract end date; and
- Options for price protection arrangements for consumers whose switching process ends after the contract period.

8.189. In the remainder of this section we assess the above policy implementation options.

### *Default tariff options*

8.190. Our proposal is that at the end of a fixed term offer, consumers must transfer to the supplier's cheapest equivalent evergreen tariff<sup>174</sup>. We considered whether suppliers ought to have discretion regarding the evergreen tariff to which the consumer should transfer, for example by choosing which evergreen (if a supplier offers more than one) the customer would default to. Whilst we recognise this alternative might involve fewer implementation issues and might allow suppliers to tailor the default tariff to the supplier's perception of their customers' needs, we consider there is a risk that consumers would end up on a evergreen tariff that is not competitively priced and would increase the risk of deliberate use of 'bait and switch' strategies<sup>175</sup> which some consultation respondents were concerned about. We therefore consider our proposal is an appropriate requirement.

---

the IA, respectively.

<sup>173</sup> For a more detailed description of these practices please refer to Ofgem (January 2011), 'Consultation on practices concerning Fixed Term Offers', Reference (09/11).

<sup>174</sup> For the avoidance of doubt a supplier's tariffs include those of any tariffs of a related 'white label' provider and vice versa.

<sup>175</sup> In this context, a 'bait and switch' strategy consists of a supplier providing a low profitable fixed term offer with the expectation that profits will be recouped on inactive consumers that default to higher priced evergreen tariff at the end of the initial contract term.

8.191. Some stakeholders have expressed concerns that consumers on ToU tariffs might lose their ToU benefits under both options. Our proposals have evolved so that for consumers on ToU tariffs, consumers default to the cheapest equivalent evergreen tariff for their meter type. This ensures that consumers need not lose the benefits of their ToU tariff as a result of our proposals.

*Switching window and consumer notification options*

8.192. We considered whether providing consumers with a switching window before the contract end date where no termination fees or notification periods applied was an appropriate implementation measure.

8.193. As already noted in this section, evidence suggests that termination fees have the ability to distort switching incentives. Hence, a switching window will bypass this negative effect. In addition, the lack of a notice period eliminates potential hurdles and makes the switching process easier for consumers. To make the process as transparent as possible to consumers, the switching window and the notification period should be aligned providing sufficient time for consumers to switch if they so wished.

8.194. As a result, we expect that a switching window will create an appropriate space for consumers to engage in the market, assess their options and switch without incurring any additional costs.

8.195. In determining the length of the switching window and when the consumer notification should occur, we took account of the following factors:

- It should allow for sufficient time for a consumer to consider switching and to assess their options;
- It should ensure that a customer receives the latest bill possible and is able to make informed decisions regarding budgeting and consumption, in order to manage and pay off debt;
- It should provide sufficient time for the customer to actually complete a switch before the end of the contract period; and
- It should account for industry best practice. From our 2010 information request into suppliers' practices regarding fixed term contracts<sup>176</sup>, best practice was to provide an end of contract notification six weeks before the contract ended.

8.196. Having considered these factors, we recommend 42 calendar days (six weeks) as an appropriate switching window and notification period before the contract end date.

---

<sup>176</sup> Ofgem (January 2011).

8.197. We note that depending on when the switching process takes place, in exceptional circumstances a 42 calendar day notification window will not ensure that the switch completes before the contract end date. We are incorporating additional measures to ensure that these consumers are not left worse off in these circumstances. These measures are discussed immediately below.

*Options for price protection arrangements for consumers whose switching process ends after their contract period*

8.198. A price protection window ensures that a homogeneous set of rules apply across the energy market reducing complexity and ensuring that consumers pay a 'protected' price for their energy during the switching process. We agree with stakeholders that a price protection window might potentially impose price risk upon suppliers. However, we expect that suppliers will be able to adapt their hedging strategies to minimise this impact. Furthermore, there is a risk that without a price protection window consumers could be subject to price shocks during the switching process and in addition provide a disincentive for consumers to switch. We therefore consider price protection arrangements to be appropriate.

8.199. Our new proposal is that consumers should benefit from price protection conditional on the existing supplier receiving notification under industry processes that the consumer intends to switch within 20 working days of the contract end date.

8.200. This is an alteration to our 2011 December proposals where this protection was conditional on the consumer informing their current supplier of their intention to switch on or before the date the fixed term period ends and the switch actually being completed within 42 days of the date they informed their supplier. We do not expect that removing the consumer requirement to notify their intentions to switch will add significant uncertainty to suppliers' processes to bill customers at end of their contract period.

8.201. We consider that our updated proposals are appropriate and have the advantage that they reduce complexity for consumers, and mitigate the risk that they do not benefit from price protection in the case they engaged late in the switching process.

**Price increases and other adverse unilateral variations – developments since December 2011 proposals**

8.202. In December 2011, we noted concerns regarding consumers' lack of understanding of fixed term tariffs, as well as concerns regarding tracker tariffs. Our December proposals sought to resolve these key issues through prohibiting price increases and other adverse unilateral variations (subject to exceptions). In addition, we proposed provisions to regulate the way in which consumers are notified of, and consent to, any mutual variations to the terms and conditions of their contracts.

8.203. With regard to our original proposals, responses to our December consultation were varied:

- Consumer groups and some suppliers were broadly in favour of our proposals (detailed reasoning was not provided).
- Some suppliers were opposed to our proposals, highlighting concerns around potential lack of evidence of consumer harm, loss of preferred tariffs for certain consumers, and that limitations in the fixed term market may push consumers into the evergreen market, potentially leading to higher prices for those consumers.
- Some additional exceptions to a prohibition were suggested (e.g. market trackers) – these could potentially fall within the scope of our exemptions if industry developed a transparent and published index.

### Options considered

8.204. We have considered the two following options in the development of our proposals for price increases and other adverse unilateral variations:

8.205. **Option 1 ('Prohibition of price increases and other adverse unilateral variations to fixed term tariffs (subject to exceptions)')**: This would implement our December proposals, including our proposed provisions to clarify and tighten the rules for mutual variations (which would not be prohibited). Under this option, there would be exceptions for certain mechanisms for automatic variations. These are set out in more detail in our consultation document.

8.206. **Option 2 ('Ensuring alignment of fixed term tariffs with relevant consumer protection legislation and SLC 23')**: In this option there would be tightening of practices regarding communication of contract terms and variations for fixed term tariffs, as well as guidance regarding tracker tariffs<sup>177</sup> (to restrict tariffs which track a supplier's standard tariff, or other suppliers' tariffs). This would not include a full prohibition.

### *Assessment of options*

8.207. In our view, only a full prohibition (Option 1) would provide the improved clarity to consumers when signing up to a fixed term tariff, with respect to the principal terms of the contract, and predictability in view of price increases and other adverse variations. This should simplify tariffs and improve comparability. Those allowed exceptions would not be subject to the supplier's discretion and would be clearly set out in advance of contract agreement (or through mutual variation).

---

<sup>177</sup> This could take various forms, e.g. non-binding guidance, provisions within licence conditions.

8.208. This option should align consumer understanding with available tariffs, as well as providing additional protection for consumers through prohibition of non-exempted tracker tariffs and through provisions for mutual variations.

8.209. The disadvantage of Option 2 would be that, whenever there is a price increase or adverse unilateral variation (which would not be prohibited), suppliers would be required to comply with the relevant requirements of SLC 23 with regards to notification of this variation. This could lead to situations where consumers picked a fixed term offer and part way through the contract would need to switch to a new contract if they wished to avoid one or more price increases or other adverse unilateral variations. This risks confusion for consumers, if they had not fully understood the variability of their fixed term contract, as well as adding to switching costs. Given that suppliers could see a large proportion of their consumers switch from the offer in such a circumstance, it may be that such fixed term offers would cease to be offered by suppliers in future; if this was the case this might lead to the same effect of the ban.

8.210. We also note that by limiting the types of tariff available in the market, this will reduce tariff proliferation, thereby improving engagement and trust in the market. We recognise that under Option 1 there may be implementation issues and costs for suppliers associated with implementing this prohibition, particularly in terms of altering the fixed term offers they present to the market.

## Appendices

---

### Index

<b>Appendix</b>	<b>Name of Appendix</b>	<b>Page Number</b>
1	Consultation Questions	112
2	Evidence on barriers	113
3	Bibliography	126

## Appendix 1 - Consultation questions

---

### **CHAPTER: Three**

**Question 1:** Do you agree with our assessment of the impacts of our proposed package of measures on consumers? Please explain your views.

### **CHAPTER: Four**

**Question 2:** Do you agree with our assessment of the impacts of our proposed package of measures on competition? Please explain your views.

**Question 3:** How much incremental cost would you incur to implement our proposed package of measures?

**Question 4:** How much incremental cost would you incur to implement our proposed package of measures?

### **CHAPTER: Five**

**Question 5:** Do you agree with our assessment of the impacts of our proposed package of measures on sustainable development? Please explain your views.

### **CHAPTER: Six**

**Question 6:** In your view, what would be the health and safety impacts resulting from the implementation of our proposal? Please explain.

### **CHAPTER: Seven**

**Question 7:** Do you agree with our assessment of the risks and unintended consequences that could result from our proposal? Please explain your views.

### **CHAPTER: Eight**

**Question 8:** Do stakeholders agree with our assessment of the alternative options to our proposed package of measures? Are there any alternative options we have not considered? Please explain your views.



## Appendix 2 – Evidence on barriers

---

1.1. This appendix sets out the evidence and the causes for the barriers to consumer engagement that we have identified: tariff complexity, poor information and lack of consumer trust. We also set out our evidence base on consumers' level of engagement and switching in the energy market.

### Tariff complexity

1.1. Many consumers perceive that the domestic energy market is too complex for them to engage with. A high number of tariffs and different price structures add complexity to energy tariffs, and consumer perception of it as such. For these reasons, many consumers choose not to engage, and if they do they are likely to have difficulties in assessing their current circumstances against the options that are available in the market.

#### Evidence of tariff complexity

1.2. At present, the energy retail market in GB is characterised by a small number of suppliers that offer a large number of tariffs.

1.3. The complexity of current tariff structure is considered by many consumers to be too complex for the average consumer to understand. In particular, consumers dislike two tier tariffs. These type of tariffs cause confusion because consumers report there is no clear point at which energy units become more expensive.<sup>178</sup> Evidence about confusion and complexity in relation to tariff structure is further underlined by research published by Which?.<sup>179</sup>

1.4. Seven out of ten consumers agree that they find the number of tariffs available in the energy markets confusing.<sup>180</sup> Our analysis supports this finding, and suggests there are currently around 900 tariffs available in the market. The evidence suggests not all consumers are aware of the range of tariffs and choices available to them, e.g. some are not aware that their supplier may offer tariffs different to their own.<sup>181</sup> However, for those who do attempt to engage in the market, a large number of choices is perceived as overwhelming rather than beneficial for consumers (especially given that they find tariffs difficult to understand and compare in the first place).<sup>182, 183</sup>

---

<sup>178</sup> Opinion Leader (March 2009), Opinion Leader (March 2011) and Creative Research (October 2011).

<sup>179</sup> Which?, (October 2009), 'Energy Campaign, Bambooing bills & tariffs'.

<sup>180</sup> Ipsos MORI (August 2008), 'Customer Engagement Survey Report prepared for Ofgem'.

<sup>181</sup> SPA Futurethinking (October 2012b).

<sup>182</sup> Opinion Leader (March 2011). Qualitative evidence on this issue is mixed, indicating that consumers find choice favourable, but hard to take advantage from, given the confusion and lack of transparency or a

1.5. Current industry practices in terms of discounts and bundling offerings increase the range of information consumers are faced with. These practices increase the number of variables that consumers have to consider, making comparisons more difficult. The introduction of bundled services, in particular, has increased the different types of energy tariffs on offer, and also the total number of different products available in the energy market. Research from Ofcom suggests that the bundled market has the highest level of stated difficulty in switching.<sup>184</sup>

#### *Effects of tariff complexity*

1.6. Consumers' perception that the energy market is complex has led to a loss of interest in looking for information and, more generally, to engage with the market. This has also contributed to a low awareness and understanding about tariffs.<sup>185</sup> Some Panellists, particularly those who are not active, were unaware of the tariff that they are on.<sup>186</sup> The perception that there is a lack of differentiation between suppliers contributes to the fact that consumers have little inclination or interest in spending time shopping around for a better deal.

#### **Causes of tariff complexity**

1.7. We have identified a number of causes of tariff complexity in the GB energy markets. These include:

- Number of tariffs
- Structure of tariffs
- Discounts and bundles
- Exploitation of limited consumer capacity

#### *Number of tariffs*

1.8. Analysis for the March 2011 RMR consultation document suggested that the number of tariffs open to domestic consumers increased by over 70% between 2008 and 2011 to around 400.<sup>187</sup> Using the same methodology, our analysis suggests that there are still around 400 tariffs in the market. However, this may be significantly

---

simple mechanism for comparison in the marketplace.

<sup>183</sup> We aim to explore this further through academic research. Behavioural experiments will show whether the effectiveness of their choices is affected by the number of options they have to assess.

<sup>184</sup> Ofcom (December 2011), 'The Consumer Experience 2011'. Ofcom suggest that this may be explained by the fact that switchers have to manage multiple processes at the same time.

<sup>185</sup> Opinion Leader (March 2011), p.26.

<sup>186</sup> Ibid.

<sup>187</sup> The RMR methodology only counted the number of offers available and did not differentiate between payment methods for example.

underestimated. Recent analysis based on an information request to suppliers suggests that there were 900 tariffs open for customer sign up as of 28 August 2012.

1.9. Due to the high number of tariffs, consumers are likely to encounter a large range of choices when looking for a new tariff.<sup>188</sup> This is particularly an issue for those consumers unable or unwilling to use online comparison sites which can filter options. A related issue applies when using comparison websites consumers have to input their current tariff to make a price comparison.<sup>189</sup> Such a high number of choices are complex for consumers to navigate through, especially given the likelihood that they will have differing price structures.

1.10. Dead tariffs also contribute to tariff complexity. According to information provided by suppliers, there are around 700 evergreen tariffs that have current customers but are not open to new customers.<sup>190</sup> These tariffs make it harder for consumers to identify their own tariff (for example, on a switching site list). They therefore contribute towards making tariff comparisons harder. Evergreen variable price dead tariffs also enable suppliers to price discriminate against inactive consumers. We have found that a significant number of dead tariffs are more expensive than suppliers' standard tariffs.

#### *Structure of tariffs*

1.11. One source of the current tariff complexity is the wide range of price structures used in tariffs. At present, tariff structures include tariffs with a standing charge and single unit rate, a single unit rate, two-tiers of unit rate (typically, the first unit rate being very high but spanning a small amount of consumption with the impact that it replicates a standing charge) and (less frequently) more complex tariff structures such as multi-tiered unit rates.

1.12. Complexity in tariff price structures constrains tariff comparisons. It also prevents consumers from understanding their tariff and how its bill relates to the amount of energy consumed.

#### *Discounts and bundles*

1.13. Discounts and bundling practices add further complexity to energy tariffs, as they increase the number of variables that consumers have to consider. At present, suppliers apply discounts in different and sometimes complex ways. For example, discounts can be applied in terms of a fixed reduction, a percentage reduction in the

---

<sup>188</sup> Looking at each of the previous incumbent suppliers' websites we found there to be between 4 and 11 high level tariff options presented for five of the suppliers and for another no high level option was presented and instead consumers were lead through the process (internet research, September 2012).

<sup>189</sup> Anecdotal evidence using one of such websites as an example indicates that a consumer on a dual fuel, direct debit tariff would have to find their tariff name from a list of between 14 to 150 options (internet research, September 2012).

<sup>190</sup> It should be noted that this tariff definition includes all meter and payment types and is therefore wider than the tariff definition used to generate tariff numbers for the original RMR March 2011 analysis.

p/kWh unit rate, or a percentage reduction in the total bill. This range of different discounting practices adds undue complexity to the domestic market.

1.14. Bundling can add significant additional complexities in the choices consumers face. Bundling practices have multiple forms, with energy products combined with other utilities, other products and insurance premiums such as heating maintenance. Linking energy supply with a range of affinity offers, loyalty schemes and charities has also been introduced in GB's energy retail market. These practices increase the number of variations consumers are offered with their energy tariff. Comparisons across the market become more difficult due to the increase in the number of variations, but also because product offerings are often different across suppliers.

#### *Exploitation of limited consumer capacity*

1.15. Behavioural biases can explain, at least in part, why consumers find it challenging to engage in the domestic energy market and to assess and compare their options. Our research suggests that consumers in the energy market exhibit these behavioural biases. These biases influence how they engage with the market, their ability to understand their current circumstances, assess alternative options, and make decisions that best suit their preferences. Research with vulnerable consumers also supports this finding, indicating that those with limited numeracy/literacy want less choice.<sup>191</sup>

1.16. The economic literature also suggests that firms may have an incentive to take advantage of behavioural economics biases. In a recent report, the OFT identifies that firms can make it more difficult for consumers to assess the best deal by obfuscating prices, or increasing choice or complexity.<sup>192</sup> They may also use price promotions and framing to distract and distort decision-making.

1.17. Firms may also make it more difficult for consumers to act to get the best deals. Behavioural economics indicates that consumers may display more inertia than traditionally suggested, perhaps due to overconfidence in their capacity to improve things at a later time. Firms, knowing that consumers display this inertia, can increase switching costs (for example, making consumers use registered post to cancel). Firms can also use defaults and automatic enrolments, or use time limited offers to inhibit switching. The same OFT report cites a study which suggests that all firms may have an incentive to exploit consumer biases, without any of them having a unilateral incentive to deviate from this behaviour.<sup>193</sup>

## **Poor information**

1.18. Unclear or incomplete information is a significant barrier to consumers' effective engagement. Even once engaged with the market, consumers require key

<sup>191</sup> FDS International (February 2011), p.38.

<sup>192</sup> Office of Fair Trading (March 2010), "What does behavioural economics mean for competition policy?", p.16.

<sup>193</sup> Gabaix, X. and Laibson, D. (2006), 'Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets', Q.J. Econ., 121(2), 505-40.

information, such as consumption levels, in order for that engagement to be effective through well-informed switching decisions.

### **Evidence of poor information**

#### *Information provided by suppliers is unsatisfactory*

1.19. Suppliers are in most cases the only source for key energy information for consumers. However, a review of the information currently provided by suppliers to domestic consumers showed that important information is often generic or incomplete.<sup>194</sup>

1.20. Our review showed that some suppliers provided information in a way that did not appear to be compliant, or was not consistent with the spirit of the SLCs we introduced with the Probe.<sup>195</sup> In some cases key information was not being provided on communications.<sup>196</sup> Further evidence on the lack of key information in suppliers' communications and marketing materials is available in our January 2011 consultation on fixed term offers.<sup>197</sup>

1.21. A review conducted by linguistic experts concluded that while information is important to consumers, it is of equal importance that they understand what action to take with it.<sup>198</sup> After also examining supplier communications they noted that key messages about consumers' tariffs and switching were not presented clearly. For instance, information was at times presented in a piecemeal way or given without sufficient context to ensure consumers could understand the key details.<sup>199</sup>

1.22. Our consumer research suggests consumers do not find communications from suppliers, such as Bills, Annual Statements and Price Increase Notifications, particularly user-friendly or easy to understand which can deter further engagement.<sup>200</sup> They are perceived as being unnecessarily complicated and many consumers are confused by their purpose and content.

1.23. Panellists note that energy market language tends to confuse them and terms are not well understood. As a result, very few read their supplier communications in any detail and those who do read them do not fully understand them.<sup>201</sup> In addition,

---

<sup>194</sup> Ofgem's internal evaluation of communications undertaken in 2010 and 2011. For SLC 23 and 31A we gathered evidence from the suppliers of the materials they were using for compliance to the conditions, and assessed them against the requirements of the licence conditions.

<sup>195</sup> Since our proposals in the Probe, only half of consumers recently surveyed reported awareness of (i) clearer information on the name of their tariff, (ii) any changes to it and/or (iii) the forecast cost of their energy consumption. Ipsos MORI, 2011.

<sup>196</sup> Ofgem's internal evaluation of communications undertaken in 2010 and 2011.

<sup>197</sup> Examples include lack of information on termination fees, unclear information about what would happen at the end of the term, and incomplete or unclear information regarding automatic rollovers. See 'Consultation on practices concerning Fixed Term Offers', January 2011, Reference (09/11):

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=110&refer=Markets/RetMkts/Compet>

<sup>198</sup> Lawes Consulting and Lawes Gadsby Semiotics (November 2011a).

<sup>199</sup> Ibid.

<sup>200</sup> Opinion Leader (January 2009 and March 2009).

<sup>201</sup> Ipsos MORI (January 2012).

research commissioned by DECC showed that consumers did not tend to engage with their bill in its present form (they only checked the bill to see how much they have paid, or have to pay, and to confirm the accuracy of meter readings).<sup>202</sup>

1.24. Further consumer research also indicates that many consumers agree there is much scope to improve key customer communications to make them clearer, easier to understand and more relevant to them personally.<sup>203</sup> The December 2011 consultation responses from suppliers also recognised that communications could be improved and were currently not as effective as they could be.

#### *Satisfaction with current supplier*

1.25. Our quantitative research suggests that a majority of people who do not switch report being 'happy with their current supplier'.<sup>204</sup> However, qualitative research shows that there are many and more varied reasons for not switching. When noting their satisfaction with their current supplier, consumers' comments primarily related to the satisfactory level of service (i.e. no issues experienced) and/or their current energy bills being within budget.<sup>205</sup> When considering the industry more broadly, the overall perception of the energy industry is fairly negative and rarely rises above neutral.

1.26. Meanwhile, some consumers (some of whom had experienced switching suppliers) believed that their supplier was no better or worse than others in the market and there was therefore no reason to switch again.<sup>206</sup> Some consumers assume that their suppliers would automatically put them on the best tariff available to them.<sup>207</sup> This indicates that they may express satisfaction without being fully aware of the facts, and that they lack appropriate information about their tariff and the options available to them.

#### *Lack of understanding of the fixed term market*

1.27. Many consumers misunderstand fixed term tariffs. For example, they assume that these types of tariffs have a fixed price, whilst in reality fixed term tariffs may also include, for example, variable prices or prices that track a specific index. This lack of understanding may arise from a lack of clarity when communicating the terms of these tariffs to consumers, but also relates to inferred expectations of consumers (of the implications of 'fixed term').<sup>208</sup>

---

<sup>202</sup> Ipsos MORI (July 2011), 'DECC, Empowering Households - Research on presenting energy consumption benchmarks on energy bills'.

<sup>203</sup> SPA Futurethinking (October 2012a).

<sup>204</sup> Note: respondents chose from a list of options and could pick more than one answer to this question. Ipsos MORI (April 2012).

<sup>205</sup> Ibid.

<sup>206</sup> Opinion Leader (March 2011), p.248.

<sup>207</sup> Opinion Leader (March 2011) and SPA Futurethinking October (2012b).

<sup>208</sup> Evidence on the misunderstanding of fixed term tariffs is available in qualitative and quantitative research. See Creative Research (October 2011) and Ipsos MORI (October 2011).

### *Effects of poor information*

1.28. Without the provision of sufficient relevant information, consumers are unable to engage effectively with the market and make well-informed switching decisions. For instance, research by Consumer Focus notes that consumers' overall understanding of their energy bills is relatively poor, with 35% of consumers not understanding their energy bills.<sup>209, 210</sup> Consumers want a good, efficient service from their energy supplier. They are not expecting excellence, but they do expect information they receive from suppliers to be accurate and informative.<sup>211</sup>

1.29. The same research shows that when dealing with suppliers consumers often feel powerless and frustrated. They feel that suppliers could do more to help them, including helping them to understand their rights and options. The lack of complete, relevant information in current communications from suppliers to consumers has resulted in information asymmetry on the consumers' side, and constrained their ability to engage effectively with the market.<sup>212</sup>

### **Causes of poor information**

1.30. We have identified three main causes for the lack of consumer knowledge about the energy market:

- The quality of information suppliers provide to consumers is unsatisfactory;
- Consumers misconceptions about suppliers and the energy market; and,
- Lack of trigger points for consumers to engage with the energy market.

1.31. In some instances, suppliers' communications to consumers have been found to be generic, incomplete, or lacking clarity in the communication of the principal terms of energy contracts. This has contributed to consumers' limited understanding of tariffs, and more generally it has led to an overall lack of understanding of the energy market.

1.32. Consumers' misconceptions about the energy market can be both a cause and a consequence of their lack of knowledge. Some consumers believe that suppliers have put them on the best tariff for them. They are unaware of how different tariff features work, and they feel powerless when faced with price increases and other

---

<sup>209</sup> Ipsos MORI (January 2011).

<sup>210</sup> Consumer Focus (October 2010), 'Informing choices – consumer views of energy bills'.

<sup>211</sup> Insight Exchange (October 2012).

<sup>212</sup> Anecdotal complaints/contacts information to Ofgem, Consumer Direct and Ombudsmen also indicated that some consumers received mis-information or insufficient information from suppliers (e.g. unclear information, price increase information was not personalised, etc.).

adverse changes made unilaterally by suppliers. This has led consumers to believe that suppliers are all the same and that there is little point in switching.<sup>213</sup>

1.33. Our previous evidence has also shown that the energy market has few trigger points at which consumers are prompted to explore the energy market and their options. Indeed some consumers, especially in Wales and Scotland show loyalty to what they perceive to be 'national brands'.<sup>214</sup> In the same research, consumers noted that in general they have limited interactions with suppliers and many consumers feel that they have 'no real relationship with their suppliers'. The behavioural economics concept of status quo bias suggests that consumers will not deviate from their current choices unless they face a strong reason for doing so.<sup>215</sup>

## Lack of consumer trust

1.34. Trust in the energy market is low and engagement levels have been falling for a number of years. In the Probe, we outlined that the energy market had the lowest consumer confidence of 50 surveyed sectors. A similar report for Consumer Focus in 2009 also found energy as the lowest ranked sector for customer service.<sup>216</sup>

### Evidence of lack of consumer trust

#### *Limited consumer interaction with suppliers*

1.35. Many consumers have limited interactions with their supplier and often they feel they have no real 'relationship' with them. Therefore interactions such as looking at marketing materials reading an energy bill, speaking with a company representative and/or raising an issue or complaint can become important 'touch-points'.<sup>217</sup> Each occurrence has the possibility of strongly influencing a consumer's impressions and views. When these interactions are negative, it can leave a consumer feeling generally negative towards the industry, especially if this is combined with exposure to negative stories in the media.<sup>218</sup>

1.36. The evidence suggests that such experiences can compound feelings of mistrust. These may also be driven from other views, such as a perception of excess profit making in the industry and the deliberate creation of an unnecessarily complex market. These negative views can proliferate and lead to large numbers of consumers no longer trusting energy suppliers, or more widely the energy market.

---

<sup>213</sup> 13% of those who have never switched report there is no difference between suppliers to make switching worthwhile. Qualitative research also indicates that consumers do not trust suppliers to keep prices low after they have switched. Ipsos MORI (April 2012) Opinion Leader (March 2011).

<sup>214</sup> Insight Exchange (October 2012).

<sup>215</sup> Ofgem (March 2011), 'What can behavioural economics say about GB energy consumers?'.  
<sup>216</sup> Ipsos MORI (August 2008), (March/April 2009), p.4.

<sup>217</sup> Insight Exchange (October 2012).

<sup>218</sup> Information from Consumer Direct indicates that in Q1 2012 alone there were over 11,000 complaints from energy consumers, covering a wide range of issues.



Consequently, consumers' negative experiences with suppliers can play a role in discouraging them from engaging proactively with the energy market.<sup>219</sup>

### *Energy market specific features*

1.37. We have identified a number of market features and conduct by suppliers that work against the interest of consumers. Evidence in the Probe confirmed that there are a number of structural features in the industry that are likely to have a cumulative effect of weakening competition. The greater the competitive pressure in an industry on suppliers, the greater the effort suppliers make to retain or win consumers. Both consumer engagement and switching levels in the energy market are generally low. The latest data outlines that switching fell for the third year in succession.<sup>220</sup>

1.38. As mentioned above it is also important to note that consumers in the energy market often respond to negative interactions with suppliers by disengaging from the market. According to economic theory it would be expected that consumers would respond to these negative interactions by looking for another services provider. However research shows that most consumers tend to feel that all companies within the sector are fairly similar in key respects and, unless there is a significant price saving, there is little point in changing supplier. They therefore tend not to engage with the market.<sup>221</sup>

1.39. This signals that the energy market has many challenges and appear to be unique compared to many other industries. Consumers feel they cannot 'opt out' of this market; therefore, there is an increased need to ensure service provisions are of an acceptable standard.<sup>222</sup> We consider that it is necessary to intervene in the market to remove the barriers which currently prevent it from delivering appropriate outcomes for consumers. Through our research there is a clear desire that a regulator (or 'government') back stop is in place to ensure these outcomes are achieved for consumers in the energy market.<sup>223</sup>

### *Switching issues*

1.40. Consumers concerns regarding lack of predictability of the market link to consumer views that suppliers are all the same, and that switching will not help.<sup>224</sup> Many consumers do not trust suppliers to keep prices low in the long-term after they have switched, which affects their attitude towards future engagement in the market.

---

<sup>219</sup> This highlights the need for these limited occurrences offering a positive experience for consumers. Research has shown that over a number of years prices have been the major area of concern for consumers. See Insight Exchange (October 2012) and Ipsos MORI (January 2012).

<sup>220</sup> Ipsos MORI (April 2012).

<sup>221</sup> Insight Exchange (October 2012).

<sup>222</sup> Ibid.

<sup>223</sup> Ipsos MORI (January 2012), pp2, 8, 18.

<sup>224</sup> Ipsos MORI (April 2012).

*Effects of lack of consumer trust*

1.41. Findings from the Consumer First Panel research, run on behalf of Ofgem since 2007, indicate that trust and engagement by consumers has not improved since its launch, and may even be getting worse.<sup>225</sup> Trust in energy suppliers and the information they provide is low amongst consumers and this covers a range of interactions including billing, marketing and general information provision.<sup>226</sup>

**Causes of lack of consumer trust**

1.42. The causes for lack of consumer trust that we have identified include:

- Consumers' perceptions of suppliers' excess profits;
- Consumer negative experiences in their interactions with suppliers;
- Poor information available to consumers; and
- Poor customer service.

*Consumers' perceptions of suppliers excess profits*

1.43. The overall perception of the energy industry is fairly negative and rarely rises above neutral. The negativity on the whole is less about personal experience as an individual consumer and more as a result of perceptions of excess profits. This is seen as particularly unfair because suppliers are selling an essential service. Where consumers feel that their energy supplier has treated them poorly, this exacerbates their negative feelings over the profit issue.<sup>227</sup>

1.44. Similarly, Panellists are concerned about what they see as excessive profit-making in the energy market. When asked what they thought about the energy market overall, Panellists' spontaneous reaction was overwhelmingly negative. Many Panellists across various locations thought that gas and electricity were overpriced and that energy companies are making too much profit.<sup>228</sup>

*Consumer negative experiences*

1.45. Experiences that are not in line with consumer expectations with regard to their interactions with suppliers are a driver of lack of trust in the energy suppliers and market.<sup>229</sup> These negative experiences may lead to reduced engagement and

---

<sup>225</sup> This is based on a qualitative analysis of previous Consumer First Panel reports.

<sup>226</sup> Opinion Leader (March 2011), Ipsos MORI (January 2012).

<sup>227</sup> Insight Exchange (October 2012).

<sup>228</sup> Ipsos MORI (October 2011).

<sup>229</sup> Ipsos MORI (August 2008), March/April 2009 and January 2012).

ultimately lower competitive pressure. There are several reasons why consumers have not had the positive experiences in the market they expect. It is clear that:

- there are issues with regard to consistency in consumer experiences across the industry, and between approaches taken by different staff representing a given supplier;
- further action is needed to address the issue of fairness and consumer trust across the market.

1.46. The recent consumer testing of the SOC highlights that, to a degree, supplier actions have improved recently.<sup>230</sup> However, the reasons above suggest that supplier conduct has not gone far enough to meet the needs of consumers since the voluntary SOC was introduced as part of the Probe.

#### *Poor information available to consumers*

1.47. Consumers rely on suppliers to provide them with the information they need to understand their contract and options available to them. It can be difficult for consumers to understand (i) the industry systems, rules and procedures that may impact them; (ii) their rights and responsibilities; and (iii) what action they (or their suppliers) can take to help avoid or address issues that may arise.

1.48. This means, to a large extent, consumers rely on information provided by suppliers. This can place consumers at a disadvantage if the information they are given is not clear or appropriate to their circumstances or needs.<sup>231</sup> Consumers may therefore lose interest in the energy market, as the end product is viewed as 'all the same' across the market.<sup>232</sup>

#### *Customer service*

1.49. Many consumers cannot understand why suppliers do not improve customer service so that it is of a consistently high standard. These consumers feel that this should be a basic aspect of the energy service they provide. As noted in previous sections of this document this frustration on the part of consumers is closely linked to lack of trust in individual energy suppliers and with the industry more broadly. Again, such views can form from a consumers' own experience and/or experience of others that they are aware of.<sup>233</sup>

---

<sup>230</sup> Insight Exchange (2012).

<sup>231</sup> Insight Exchange (October 2012) and Ipsos MORI (January 2012).

<sup>232</sup> Insight Exchange (October 2012).

<sup>233</sup> Insight Exchange (October 2012) and Ipsos MORI (August 2008), March/April 2009 and January 2012).

## Switching and engagement: quantity and quality

### Hassle of switching: cause and evidence

1.50. One fifth (20%) of those who say they've never switched believe switching is a hassle.<sup>234</sup> Qualitative research suggests this is a commonly held belief among all but a minority of engaged consumers: many believe it will be a time consuming and potentially problematic experience, either because they have experienced this in the past, know others who have struggled or not gained, or just assume it will be difficult.<sup>235</sup>

1.51. Our evidence shows that many consumers find it difficult to assess whether they will gain financially from switching their supplier. Many believe that financial gains will be small or short lived and therefore do not investigate further. Many simply feel that the amount of time and effort required to navigate their energy options and potentially to decide to switch tariff or supplier is disproportionate to what they believe they would ultimately gain.<sup>236</sup>

1.52. Research with vulnerable groups supports these findings. When customers did switch they hoped to save money, but were not necessarily confident that they would do so. Many in this group regard energy as a low interest subject. For some there is a considerable gap between what they think they might save as a result of changing energy suppliers, and what kind of savings would actually persuade them to switch.<sup>237</sup>

1.53. Nevertheless, our quantitative evidence suggests that consumers could save money by switching suppliers. Our most recent pricing information shows that for the previous incumbent suppliers, on average, a consumer moving from the average priced supplier to the cheapest could save £54 per year. These potential savings would obviously be greater if consumers were with the most expensive supplier. We also published evidence on the benefits on savings in the appendix to our March document.<sup>238</sup>

### Lack of switching: evidence and cause

1.54. Our latest consumer engagement tracking survey shows that since privatisation 63% of gas and 65% of electricity consumers say that they have never switched supplier.<sup>239</sup>

---

<sup>234</sup> Ipsos MORI (January 2012).

<sup>235</sup> Opinion Leader (March 2011). Ipsos MORI (January 2012 and April 2012).

<sup>236</sup> Ipsos MORI (April 2012).

<sup>237</sup> FDS International (February 2011), p.11.

<sup>238</sup> [http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR\\_Appendices.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/RMR_Appendices.pdf).

<sup>239</sup> Ipsos MORI (April 2012). Also see The Retail Market Review - Findings and initial proposals, March 2011, Reference: (34/11). We recognise that these figures are reliant on the respondents' ability to recall their past behaviours, and our analysis of trends over time suggests the tendency to under-report previous switching behaviour is increasing. Nevertheless, it does suggest that a majority of consumers

1.55. The rate of switching has been in decline in recent years. This is shown in figures published by DECC on domestic electricity and gas transfers in GB.<sup>240</sup> Similarly, Ipsos MORI's consumer engagement tracking survey also shows that switching is in decline. The most recent survey, conducted in March 2012, shows that just 13% of gas consumers and 14% of electricity consumers switched their supplier during 2011; this compares with 20% (gas) and 19% (electricity) in 2007. Furthermore, our analysis included in the December 2011 consultation suggests that the number of passive consumers had increased and the number of active consumers decreased since the Probe.

1.56. Participants in our Consumer First Panel believed that the retail energy market contains a number of barriers which discourage them from engaging in the energy markets, and many spontaneously called for changes that they said would allow them to better understand and engage.<sup>241</sup>

1.57. We have found that complex tariff structures are contributing to consumer disengagement, and that quality of switching remains a concern. Over a quarter of those who have switched are not confident that they saved money by switching: this accounts for 28% of those who switched gas to save money and 27% of equivalent respondents who switched electricity. A significant majority of people who have switched say it was easy to decide which deal to choose. However there has been a significant increase in the number who disagree.<sup>242, 243</sup>

### **Costs of switching: evidence and cause**

1.58. The hassle of switching (which we mentioned above) represents a cost for consumers when they consider switching. Termination fees for switching from fixed term offers in response to a price increase would further limit appetite for switching. Additionally, lack of understanding of fixed term tariffs is likely to limit engagement in this market.

1.59. Evidence from our January 2011 consultation on fixed term offers shows that consumers are rolled over to contracts where termination fees and notice periods apply.

1.60. Evidence from behavioural economics suggests that individuals are 'loss averse'. In other words, a loss has a significantly greater impact on an individual than the equivalent gain.<sup>244</sup> As a result, financial losses to the consumer in the form of termination fees, applying to subsequent fixed term contracts, are likely to have a greater impact on switching than the same level of savings available from switching to a new deal. This is further supported by our consumer research. Consumers view termination fees as an effective barrier that discourages them from switching.

---

perceive themselves to have been largely inactive in the market.

<sup>240</sup> See DECC's Energy Trends and Quarterly prices. Dataset available at [www.decc.gov.uk/assets/decc/statistics/source/prices/sep271.xls](http://www.decc.gov.uk/assets/decc/statistics/source/prices/sep271.xls).

<sup>241</sup> Ipsos MORI (January 2012).

<sup>242</sup> Ipsos MORI (January 2011).

<sup>243</sup> DECC (March 2010), p 48, 49.

<sup>244</sup> Kahneman, D., Knetsch, J. And Thaler, R. (1990).

## Appendix 3 - Bibliography

---

### C

Centre for Sustainable Energy (March 2011), 'Understanding High Use, Low Income Consumers'  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=43&refer=Sustainability/Cp/CF>

Consumer Focus (October 2010), 'Informing choices – consumer views of energy bills', <http://www.consumerfocus.org.uk/files/2011/03/Informing-choices.pdf>

Creative Research (October 2011), 'Tariff Comparability Models, Volume 1 - Consumer qualitative research findings'  
[http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Tariff\\_Comparability\\_Qualitative\\_Research.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Tariff_Comparability_Qualitative_Research.pdf)

### D

DECC's Energy Trends and Quarterly prices. Dataset available at [www.decc.gov.uk/assets/decc/statistics/source/prices/qep271.xls](http://www.decc.gov.uk/assets/decc/statistics/source/prices/qep271.xls)

DECC (March 2010), 'Quarterly Energy Trends'

### F

FDS International (February 2011), '2011 Vulnerable Customer Research'  
[http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Ofgem\\_vulnerable\\_customers\\_research\\_Final.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Ofgem_vulnerable_customers_research_Final.pdf)

### G

Gabaix, X. and Laibson, D. (2006), 'Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets', Q.J. Econ., 121(2), 505-40.

### I

Insight Exchange, (October 2012), 'Consumer research and collaborative engagement on the proposed Standards of Conduct – Domestic Customers, Full Report'

Ipsos MORI (August 2008), 'Customer Engagement Survey Report prepared for Ofgem'

[http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/Customer\\_Engagement\\_Survey\\_FINAL1.pdf](http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/Customer_Engagement_Survey_FINAL1.pdf)

Ipsos MORI (March/April 2009), 'Report on the 2009 Consumer Conditions Survey' p.4 <http://www.consumerfocus.org.uk/files/2010/12/Consumer-Conditions-Survey-2009.pdf>

Ipsos MORI (January 2011), 'Customer Engagement with the Energy Market - Tracking Survey', [http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/IpsosMori\\_switching\\_on\\_mnibus\\_2011.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/IpsosMori_switching_on_mnibus_2011.pdf)

Ipsos MORI (July 2011), 'DECC, Empowering Households - Research on presenting energy consumption benchmarks on energy bills' <http://www.decc.gov.uk/assets/decc/11/cutting-emissions/behaviour%20change/2136-empowering-households-research.pdf>

Ipsos MORI (October 2011), 'Consumer reactions to varying tariff comparability, Quantitative Research conducted for Ofgem', [http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Tariff\\_Comparability\\_Quantitative\\_Research.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Tariff_Comparability_Quantitative_Research.pdf)

Ipsos MORI (January 2012), 'Ofgem Consumer First Panel, Year 4 Findings from first workshops (held in October and November 2011)', <http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/Ofgem%20Consumer%20First%20Panel%20Year%204.pdf>

Ipsos MORI, (April 2012), 'Customer Engagement with the Energy Market Tracking Survey 2012'

Ipsos MORI, (August 2012), 'Consumer engagement with the energy market, information needs and perceptions of Ofgem, findings from the Ofgem Consumer First Panel Year 4: second workshops (held in March 2012)'

Ipsos MORI (September 2012), 'Consumers' views of price comparison guides and tariff structures'

Ipsos MORI (October 2012), 'Consumer views on Tariff Comparison Rates, Findings from the Ofgem Consumer First Panel workshops held August 2012'

## **K**

Kahneman, D., Knetsch, J. And Thaler, R. (1990) 'Experimental tests of the endowment effect and the Coase Theorem', *The Journal of Political Economy*, 98: 1325-1348.

## L

Lawes Consulting and Lawes Gadsby Semiotics (November 2011a), 'Retail Market Review: Energy bills, annual statements and price rise notification; advice on the use of layout and language'

[http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Lawes\\_Language\\_Report.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Lawes_Language_Report.pdf)

Lawes Consulting and Lawes Gadsby Semiotics (November 2011b), 'Notes on the Tariff Information Label' (currently unpublished)

## O

Ofcom (December 2011), 'The Consumer Experience 2011'

[http://stakeholders.ofcom.org.uk/binaries/research/consumer-experience/tce-11/research\\_report\\_of511a.pdf](http://stakeholders.ofcom.org.uk/binaries/research/consumer-experience/tce-11/research_report_of511a.pdf) .

Ofgem, Responses to the December 2011 Retail Market Review consultation

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=72&refer=Markets/RetMkts/rmr>

Ofgem (March 2011), 'The Retail Market Review - Findings and initial proposals', Reference: (34/11).

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Markets/RetMkts/rmr>

Ofgem (January 2011), 'Consultation on practices concerning Fixed Term Offers', Reference (09/11):

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=110&refer=Markets/RetMkts/Compet>

Ofgem (March 2011), 'What can behavioural economics say about GB energy consumers?'

[http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Behavioural\\_Economics\\_GBenergy.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Behavioural_Economics_GBenergy.pdf)

Ofgem (June 2012), 'Enforcement Guidelines on Complaints and Investigations'

<http://www.ofgem.gov.uk/About%20us/enforcement/Documents1/Enforcement%20guidelines%202012.pdf>

Ofgem (September 2012), 'Proposals for a new Consumer Vulnerability Strategy', Ref (124/12)

<http://www.ofgem.gov.uk/Sustainability/SocAction/Documents1/Proposals%20for%20a%20new%20Consumer%20Vulnerability%20Strategy.pdf>

Ofgem (October 2012), 'Decision on measures to mitigate network charging volatility arising from the price control settlement'

[http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=CV\\_Decision.pdf&refer=Networks/Policy](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=CV_Decision.pdf&refer=Networks/Policy)



Office for National Statistics, (August 2012), 'Internet Access - Households and Individuals' <http://www.ons.gov.uk/ons/rel/rdit2/internet-access---households-and-individuals/2012/stb-internet-access--households-and-individuals--2012.html>

Office for National Statistics (Q2 2012), 'Internet Access Quarterly Update Q2 2012', [http://www.ons.gov.uk/ons/dcp171778\\_276208.pdf](http://www.ons.gov.uk/ons/dcp171778_276208.pdf)

Office of Fair Trading (March 2010), "What does behavioural economics mean for competition policy?" [http://www.oft.gov.uk/shared\\_of/economic\\_research/oft1224.pdf](http://www.oft.gov.uk/shared_of/economic_research/oft1224.pdf)

Opinion Leader (January 2009) 'Ofgem Consumer First Panel: Research findings from first event', <http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/Ofgem%20Consumer%20Panel%20Event%20One%20Final%20Report%20January%202009.pdf>

Opinion Leader (March 2009), 'Ofgem Consumer First Panel: Research Finding from the Second Events – Billing Information and Price Metrics' <http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/billing%20information%20metrics%20FINAL090409.pdf>

Opinion Leader (October 2009), 'Ofgem Consumer First Panel: Research Finding from the Third Events' <http://www.ofgem.gov.uk/Sustainability/Cp/CF/Documents1/Ofgem%20panel%20third%20events%20report%20FINAL.pdf>

Opinion Leader (December 2009), 'Ofgem Consumer First Panel, Research findings from the First event (Year 2)' <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=26&refer=Sustainability/Cp/CF>

Opinion Leader (March 2011), 'Ofgem Consumer First Panel, Report from the second set of workshops' [http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Ofgem\\_OpinionLeader\\_Tariff\\_Report\\_Final.pdf](http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Ofgem_OpinionLeader_Tariff_Report_Final.pdf)

## **S**

SPA Futurethinking (October 2012a), 'Energy bills, annual statements, price increase notification letters and tariff information labels: proposals for consumer testing'

SPA Futurethinking (October 2012b), 'Options for cheapest tariff messaging on customer communications; Report of qualitative research'

## **W**

Which? (October 2009), 'Energy Campaign, Bamboozling bills & tariffs'. Available at <http://www.which.co.uk/documents/pdf/bamboozling-bills-203858.pdf>