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Project Manager
Energy market investigation
Competition and Markets Authority
Victoria House
Southampton Row
London WC1B 4AD

CMA Energy Market Investigation - provisional findings and possible remedies

The CMA's provisional findings are a clear indictment of how the energy market is failing consumers. The inquiry provides an authoritative assessment of how energy suppliers are exploiting their unilateral market power to price their standard variable tariffs above a level that can be justified. It also highlights key failings in the way government energy policy costs have impacted on consumer energy bills.

The CMA now has a unique opportunity to address features of the energy market that have an adverse effect on competition and cause significant consumer detriment. After years of scrutiny, it is critical that regulators take the necessary time to work with consumers, and consumer groups, to test the detail of possible remedies and to ensure that the final remedies will be effective this time.

This response focuses on the possible remedies to improve competition and consumer engagement in the market and the measures to protect consumers who do not engage in the market. Given the CMA's critique of the Retail Market Review remedies, this requires the CMA and Ofgem to use the final five months of this inquiry to conduct extensive behavioural testing with consumers to better understand the questions we set out concerning remedies 3, 4a, 9, 10 and 11. The CMA should also set out how such testing will continue beyond the inquiry's final remedies at the end of 2015 to ensure that measures put in place will deliver sustained engagement by consumers with the market.

The CMA should also be clear as to how the final remedies will be judged as successful. Which? would expect the CMA to review the market two years on from its final report to test whether the market is meeting these criteria, to assess whether consumer engagement has improved and the extent to which consumers are continuing to collectively overpay for their energy due to a lack of effective competition. The CMA should signal that if effective competition is not working at this point, then it will introduce ongoing cost-based price controls to protect appropriate segments of consumers.

Which? would welcome the opportunity to discuss our response with the CMA. We urge the CMA to ensure that its work to further consider possible remedies is transparent, firmly rooted in understanding real consumer behaviour, and not unduly dominated by engagement with representatives of the energy supply industry.

Which? is a consumer champion

We work to make things better for consumers. Our advice helps them make informed decisions. Our campaigns make people's lives fairer, simpler and safer. Our services and products put consumers' needs first to bring them better value.

Comments on possible remedies

Remedy 1 - Introduction of a new standard condition to electricity generators', suppliers', interconnectors', transmission, and distribution licences to require that variable transmission losses are priced on the basis of location in order to achieve technical efficiency

The absence of locational pricing for transmission losses is not an issue that Which? has previously considered in detail, but we note the CMA's finding that a more efficient outcome would lower total costs across all customers. Given the likely distributional effects, and in particular the modelling suggesting a transfer of approximately £40m a year from consumers in the South of England to those in Scotland and North England, there is a danger that this could adversely affect some groups through a sharp rise in energy prices. As a result, consideration should be given to transitional arrangements to ease this impact over a period of time. We expect the remedy to clearly state that inefficient implementation costs should not be passed on to consumers and the CMA and Ofgem should police this due to the lack of effective competition.

Remedy 2a - DECC to undertake and consult on a clear and thorough impact assessment before awarding any CfD outside the CfD auction mechanism

Which? agrees with the CMA's assertion that awarding contracts through the Final Investment Decision enabling process, rather than through a competitive process, may not have delivered the best value for consumers. Which? remains of the view that there should be a move to a fully competitive allocation process as soon as possible.

If CfDs are to be awarded outside a competitive auction, then Which? supports the CMA recommendation for DECC to undertake and consult on a clear and thorough impact assessment first. This impact assessment should be as transparent as possible, with data available to enable Which? and others to both comment on and potentially influence the decision to award a contract. As Which? regards this as current good practice for impact assessments, the CMA should set out how this measure will enhance scrutiny of the CfD process.

Remedy 2b - DECC to undertake and consult on a clear and thorough assessment before allocating technologies between pots and the CfD budget to the different pots

In our response to the CMA's Updated Issues Statement, Which? set out a proposal for an alternative method for allocating CfDs both within and between technologies. We believe that this proposal remains valid. Without such a change, there is merit in DECC regularly conducting assessments of the allocation process. As stated in our response to Remedy 2a, such impact assessments must be meaningful and transparent with background data published and a clear assessment on the impact on consumers' bills and prices, in order to enable Which? and others to assess any proposals and comment meaningfully.

Remedy 3 - Remove from domestic retail energy suppliers' licences the 'simpler choices' component of the RMR rules

Which? was unconvinced by the four tariff rule, instead believing that greater visibility of pricing, compelling offers and quicker switching would help to encourage more engagement. It is essential for consumers to have a choice of suppliers in a competitive energy market. However, the benefits of those suppliers offering a large number of

complex tariffs are less clear cut. Choice only has value if consumers can meaningfully differentiate between the offers available and move to the one that is best for them.

Should it proceed with this remedy, the CMA should set out the extent to which it considers it might be effective in increasing competition between domestic retail energy suppliers and/or between PCWs, and what additional tariffs it believes energy suppliers would be likely to offer that they currently do not due to the RMR restrictions.

Ofgem's Energy Supply Probe and RMR were major interventions by the regulator and resulted in some improvements to the retail market, mainly in the area of customer communications. While Which? did not support all of the remedies introduced by the RMR, it is important to note that the market was far from competitive before the restrictions were introduced. Which? research repeatedly found that consumer understanding of energy pricing and the extensive, complex array of tariffs was poor. Most consumers were on expensive SVTs and competition was focused, as at present, on a small group of more active consumers. This situation also did not appear to put downward pressure on prices for all consumers.

It is therefore vital that, if the CMA is minded to remove the simpler choices element of RMR, it thoroughly tests ways of better engaging consumers with the market in the context of a larger number of tariffs. This should include testing which elements of the RMR have proved successful, particularly for customer communications. The CMA must guard against a return to the pre-RMR situation of consumers faced with a bewildering array of tariffs that undermine rather than enhance their ability to make informed choices about the best deal for them.

Previous experience before the four-tariff rule was introduced was that there was little innovation in the tariffs offered by most suppliers. There is therefore a risk that additional tariffs introduced when the four-tariff rule is removed would not encourage those previously unengaged consumers to move from SVTs. However, we recognise that the CMA found this lack of innovation may have been due to the perception of the energy suppliers that Ofgem's 'non-discrimination' rule, although repealed, might still be enforced in principle.

Given the importance that the CMA is placing on the role of PCWs in enhancing competition in this market, consumer testing is also needed to better understand how people use them to choose tariffs, and what impact remedy 3 might have on the PCW market.

For example, if this remedy were to be imposed, Ofgem's Confidence Code requirement for PCWs to provide coverage of the whole market could become impractical as the number of tariffs offered increases and PCWs agree different tariff levels and commissions with energy suppliers. Alternative measures to increase confidence in PCWs may therefore be necessary. For example, in order to maintain transparency and trust, PCWs could be required to provide information to customers about the suppliers with which they have agreements and those with which they do not.

That said, Which? does not agree that it is not possible for PCWs to show all of the deals on the market. Which?'s own energy switching site, Which? Switch, entered the energy PCW market long before the RMR to provide this whole of market comparison, whether we could switch customers to all deals or not. There is therefore no reason why this approach could not return after the four-tariff rule is removed. If this whole of market comparison is not to be retained, then the CMA should ensure there is evidence through consumer

testing of people's willingness to use multiple PCWs to find the best deals, or introduce further remedies to enable this.

Rather than removing all limits on tariff numbers and structures, the CMA should consider whether it would be more effective to increase the number of permitted tariffs while ensuring that the presentation of prices is engaging for consumers. For example, requiring domestic energy suppliers to structure all tariffs as a single unit rate in pence per kWh, rather than as a combination of a standing charge and a unit rate, could reduce complexity for customers without restricting competition between PCWs or requiring a tight control on the number of tariffs. Which? therefore believes that the CMA and Ofgem should also conduct consumer testing on tariff structures, particularly the role that price presentation can play in engaging consumers with the market.

Which? has submitted evidence in our previous inquiry responses on the role that a single unit rate could play in reducing complexity and enhancing price competition for customers. The annex to our response to the Update Issues Statement included behavioural research conducted with EDF Energy that explored this in more detail and providing evidence about increased consumer understanding and likelihood to switch using a single unit rate as well as standing charge plus unit rate. The CMA and Ofgem should build on this research and conduct wider consumer testing to understand whether these pricing structures and other options, such as a regulated standing charge, would improve engagement and propensity to switch.

Remedy 4a - Measures to address barriers to switching by domestic customers

Given the importance that the CMA is placing on PCWs to improve switching levels, action should be taken to significantly improve the switching process. The process of consumer switching is undermined by consumers' inability to find the correct information to input into PCW online forms. Which? therefore supports remedies that would improve this process and does not believe that this should necessarily be delayed until the introduction of smart meters.

Alongside such remedies, the CMA should explore more innovative and significant measures to improve switching. Given that PCWs themselves are unlikely to deliver the necessary increase in engagement, other ideas should be explored, such as the creation of a central agency with a mandate to achieve a certain level of switching in the market, and an obligation on suppliers to co-operate.

The CMA should shift the focus from penalties to redress and compensation for consumers when switching is not processed smoothly. With fines for firms no longer going to the Treasury but being returned to consumers, either directly or through the funding of consumer focused schemes, this should extend to redress for consumers whose switch fails to be completed during the set time.

The CMA should consider the role of consumers within this penalty or redress regime. Would consumers be expected to inform their energy company, the Ombudsman or regulator about this failure? Or should measures be put in place that provide this compensation for consumers, whether they are aware of the redress rules or not? Which? favours an automatic entitlement approach where firms have an obligation to directly provide redress with no need for consumers to identify or notify them and no requirement to go through the Ombudsman.

When next-day switching is introduced, the ‘cooling-off’ period should be retained and we expect the CMA to propose remedies that enable this to take place.

Introduction of smart meters - Midata

At present, Midata is not being introduced in a meaningful way within the energy sector and this should be addressed by the CMA in its final remedies. The CMA should look at the lessons of the roll out of Midata in the Personal Current Account (PCA) market, where the application of Midata still requires consumers to go through a lengthy process of downloading a CSV file and where only one PCW is engaged in the process. Without the PCWs having greater access to customer data through Midata, it is likely that its application will not reduce the friction in the current switching process. Furthermore, the practice of energy companies restricting PCWs ability to return to recent customers with new energy deals should also be addressed.

Introduction of smart meters - better information

Given that the smart meter roll out is in its early stages, it is unlikely at present that consumers need more information about how their smart meters will work. Without full interoperability, there is a danger that such information would raise consumer expectations, which could then be undermined when people find that they are unable to switch supplier.

Once the roll out is fully underway next year and the issues with interoperability are resolved, then a significant amount of effort should be given to engaging consumers with their smart meter. This needs to go beyond traditional energy supplier attempts to add additional information to bills. While there will be many benefits from the roll out of the new meters, it is possible that the programme will face criticism due to issues with the costs added to consumers bills, problems with installations and confusion about new tariffs. The experience in other countries of smart meters has not always been positive and the Government, Ofgem and the energy industry must learn from these experiences to ensure the programme puts consumer engagement at its centre.

Remedy 5 - Requirement that energy firms prioritise the roll-out of smart meters to domestic customers who currently have a prepayment meter

There must be a clear plan for how prepayment customers will benefit from the roll out of smart meters. However, Which? is concerned that option (b) could add undue costs to the roll out, thereby increasing overall costs to the programme and ultimately to consumers. Which? therefore favours option (a) but we would like to see quicker progress to the full interoperability provided by SMETS 2 meters and a faster transition to the Data Communications Company.

The cost of the smart meter roll out to consumers is considerable and while there are ultimately benefits to consumers, there are significant concerns about whether the current timetable for the roll out is realistic. There would therefore need to be a strong economic case for accelerating the roll-out. Indeed, there may be a stronger case for pushing back the deadlines for all households to have smart meters to reduce costs, particularly given the issues with multi-occupancy dwellings, such as flats.

The CMA should be cautious about putting too much faith in the smart meter roll out to deliver gains for consumers immediately following the inquiry. It is entirely possible that

many consumers will not have a smart meter for up to two or three years after the inquiry has finished.

Remedy 6 - Ofgem to provide an independent price comparison service for domestic (and microbusiness) customers

Which? does not support this provisional remedy. While consumers may state in market research that they would be more likely to trust and use a PCW provided by Ofgem, in practice it is unlikely that this would be the case given the significant marketing budgets of the biggest PCW providers. Given the experience of other prompts on bills following RMR, it is also unlikely that information on suppliers' bills or during telephone calls would change this. It is therefore likely that this proposal would have little impact on restoring consumer trust in PCWs or increase engagement in switching.

There is also a danger that this role would be inappropriate for Ofgem. This proposal risks both focusing Ofgem's time and resources on a non-core element of its duties and Ofgem failing to deliver a PCW that can compete with the best offerings in the market. Furthermore, the existence of a regulator-delivered PCW has the potential to undermine the competitive PCW market thus leaving consumers with less choice.

Remedy 9 - Measures to provide either domestic and/or microbusiness customers with different or additional information to reduce actual or perceived barriers to accessing and assessing information

Which? believes that the key task for the CMA is to now test each of the potential information remedies directly with consumers, and to prioritise those likely to be most effective.

To this end, it should be recognised that many of the CMA's suggestions, such as prompting customers to read their meters, are already undertaken by energy suppliers. Furthermore, many of these questions were explored in detail through the RMR and new measures were put in place try and address the issues that consumers face with understanding billing and prices. We are also aware that at least one energy supplier has sought a derogation from Ofgem to revisit simpler bills.

It is therefore important that the CMA engages directly with Ofgem and the suppliers to understand the lessons from these previous attempts and devotes significantly more time to testing new engagement mechanisms. It is also important to recognise there will be no simple answer to these questions in the five months before the inquiry concludes. Consumer testing should therefore continue beyond the end of 2015 and should provide the means by which the CMA and Ofgem can judge whether consumers are able to engage in the market and the necessity or otherwise of interventions such as the safeguard tariff.

Remedy 10 - Measures to prompt customers on default tariffs to engage in the market

As stated in our response to remedy 9, there is no simple answer to the questions about how to prompt consumers to engage. Numerous attempts have been made, both in energy and other markets, so it is important that the CMA both reviews the evidence from the RMR, energy suppliers and other markets (including the experiences of other regulators such as the FCA) as well as conducting new consumer behavioural testing to understand what would lead to a significant change in engagement.

This should include factors outlined above, and other issues such as terminology. For example, the term ‘safeguard tariff’ may itself act as a barrier to engagement, given that some consumers may see that as the best tariff for them. Previous research on energy efficiency suggests that more should be made of key moments in peoples’ lives, such as the home moving process. This should now be rigorously tested to examine whether consumers really would engage in the market at this moment and that it would lead to a significant increase in switching.

Remedy 11 - A transitional ‘safeguard regulated tariff’ for disengaged domestic and microbusiness customers

As Which? stated in our initial response to the provisional findings and possible remedies, we support strong extra protection for consumers who do not, for whatever reason, get a fair and competitive price, and in particular vulnerable consumers.

We recognise that the CMA’s preference is for a tariff that would include ‘headroom’ above the efficient cost to serve. However, this raises a number of questions. In particular, a regulated tariff with ‘headroom’ will effectively permit incumbents to make excess profits. If the market drifts to the regulated tariff, with more than 70 per cent moving to these tariffs over time, then excess profits for incumbents could grow further. If a regulated tariff with ‘headroom’ were to persist for any length of time in the market, then it would effectively legitimise a situation where a large number of consumers - those on the regulated tariff - are being charged a rate significantly above the efficient cost to serve.

With the CMA seeking to address both switching and engagement in the market as well as protecting consumers who do not switch, there is also a risk that the remedies act against each other. Which? would be concerned if a safeguard tariff was designed in such a way that it undermined the remedies for improving engagement.

The CMA should set out from what the safeguard tariff is transitioning, and to what it is transitioning to, and therefore in what circumstances it will disappear. This should include clear criteria for judging whether the remedies for engagement have worked. We believe extensive consumer testing is necessary to find the most appropriate mix of solutions for this market. The CMA should set out how a safeguard tariff would sit alongside testing new approaches to engagement and how the safeguard would be removed once it was deemed that the tests had worked.

An alternative approach that the CMA could consider would be to introduce stronger incentives to change consumer and energy company behaviour and to improve engagement in the market before introducing the safeguard tariff. These incentives should be drawn from the behavioural testing outlined above and given a limited, fixed period of time to achieve clear objectives, at which point the CMA should return to reassess the market. If the remedies have failed to achieve their objectives, then the CMA should be prepared to impose protection for appropriate segments of consumers, in the form of a social tariff with a cost-plus regulated price cap.

The behavioural remedies that should be tested in this scenario would have to go further than the information remedies that have been tried to date, and could include imposing new arrangements to promote switching with a central switching body that is incentivised to switch consumers, and obligations on suppliers to comply. Stronger incentives could also be placed on energy suppliers to encourage ‘sticky’ customers to switch, for example

by imposing penalties on incumbents where a given percentage of their customers who have never switched to a more competitive tariff remain on an SVT.

Remedy 14 - Remedy to improve the current regulatory framework for financial reporting

Which? welcomes this remedy particularly if it can deliver greater transparency of the level of profitability across energy suppliers. The CMA should ensure that this new reporting requirement does not involve significant costs on the part of the energy companies. It is important to ensure that these costs are efficient and proportionate, so that they do not have a negative impact on consumer bills.

Remedy 15 - More effective assessment of trade-offs between policy objectives and communication of impact of policies on prices and bills

Remedy 16 – Revision of Ofgem’s statutory objectives and duties in order to increase its ability to promote effective competition

Remedy 17 - Introduction of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making can be addressed transparently

These remedies are welcome. It is important that remedy 16 does not lead to any downgrading of Ofgem’s duty to protect consumers. Which? supports greater transparency and, as stated in our response to the remedies on CfDs, believes that all data should be published so that assessments can be assessed and challenged effectively.

Remedy 18a - Recommendation to DECC to make code administration and/or implementation of code changes a licensable activity

Remedy 18b - Granting Ofgem more powers to project-manage and/or control timetable of the process of developing and/or implementing code changes

Remedy 18c - Appointment of an independent code adjudicator to determine which code changes should be adopted in the case of dispute

Which? broadly welcomes the intention of these proposals to improve the governance of the market in a way that improves scope for innovation and better outcomes for consumers. The CMA should consider carefully the incentives of the various models of governance to ensure the best mechanisms are put in place.

**Which?
4 August 2015**