

ENERGY MARKET INVESTIGATION

Summary of response hearing with Ofgem on 30 July 2015

Response to provisional findings report

1. The Office of Gas and Electricity Markets (Ofgem) welcomed the provisional findings. It broadly agreed with the Competition & Markets Authority (CMA)'s analysis of the problems in the energy market and wanted to work closely with the CMA on remedies. Ofgem said the package of remedies should be effective, forward-looking, coherent and achievable.

Retail market adverse effects on competition (AECs) and remedies

2. In relation to remedy 11, Ofgem said it had considered there might be a need to introduce something similar to a transitional safeguard tariff for disengaged customers once smart metering was introduced. Ofgem said the two main issues for any safeguard tariff were scope (which customers received it) and exit strategy (removal of the tariff).
3. Ofgem identified three potential categories of customers for a safeguard tariff. First, all customers on standard variable tariff (SVT), approximately 70% of the market. Second, vulnerable customers, who could be defined in different ways (eg cold-weather-payment customers) and might account for 15 to 20% of the market. Third, customers who have never switched from their incumbent supplier, possibly 30 to 40% of the market.
4. Ofgem suggested that the safeguard tariff could be preceded by a period of intense marketing to encourage customers to engage and then the tariff could be applied to who was left on SVTs. Ofgem said the duration of such a marketing campaign could be less than one year. The government's marketing campaign in 2015 had lasted only four to six weeks but had resulted in significant switching by customers.
5. Ofgem said it would be important to establish criteria for the removal of any safeguard tariff. The criteria could include evidence that 'prompts' were encouraging customers to engage in the market.
6. Ofgem suggested potential issues in determining the level of any safeguard tariff. If set too low, the tariff could distort the market because it may prevent customers from seeking a better deal. If set too high, a safeguard tariff could

result in people that were supposedly being protected paying too much. Ofgem said it was difficult to address these issues on a lasting basis so it favoured any safeguard tariff having a set purpose and duration.

7. Ofgem said it would be hard to set the level of safeguard tariff for a microbusiness customer. Some of the CMA's other proposed remedies were more likely to address the concerns relating to microbusinesses (for example, in relation to price transparency). Ofgem's research showed better information on bills and longer timescales for terminating contracts had started to change microbusinesses' engagement in the market.
8. In relation to designing any safeguard tariff, Ofgem suggested it could be limited to the six large energy firms. Ofgem thought it would be possible to model wholesale costs for the tariff despite the hedging strategies employed by energy firms. The most difficult part would be identifying suppliers' operational costs.
9. Ofgem suggested it was important to make any safeguard tariff formulaic. This would limit the scope for arguments over whether the tariff should be increased or decrease and increase transparency. Ofgem warned of the scope for 'gaming' from energy firms if the safeguard tariff was indexed on costs derived from the energy industry.
10. Ofgem said it could understand the arguments for introducing a safeguard tariff providing there was a plan for removing the tariff in the future. While it could improve customers' trust and confidence, Ofgem noted that a safeguard tariff could have pros and cons for new firms' ability to gain entry into the energy market. Ofgem said it would be easier for the CMA to implement any safeguard tariff, and it was prepared to assist the CMA in this process.
11. In relation to remedy 10, Ofgem said being on a fixed term tariff was, in itself, a 'prompt' for customers to engage. Ofgem said there was limited space available on energy bills for 'prompts' and that marketing campaigns could increase customer engagement. The CMA might also want to think about ways in which third party intermediaries (TPIs) could be used to increase engagement.
12. Ofgem said suppliers were already required to provide annual statements to customers which contained critical pieces of information for engagement. Recent learning from the Department of Energy & Climate Change (DECC)'s Warm Home Discount payment scheme also showed potential value in putting information on envelopes rather than bills.

13. Ofgem said that for some of the most disengaged customers, face-to-face communication was most effective. Ofgem was working with Citizens Advice to deliver advice to people with financial difficulties on how to switch supplier.
14. Ofgem said any measures to increase customer engagement should be tested. Following evaluation of its Retail Market Review (RMR), Ofgem had evidence of some customers engaging with the cheapest tariff message on the bill. About 30 to 40% of customers who read the message took action in response to this message.
15. In relation to remedy 6, Ofgem said it could see the need for a trusted source of information for customers if the four-tariff rule was removed and there were many more tariffs. However, there might be alternative options to an Ofgem-run price comparison website (PCW). One alternative was a market response similar to Skyscanner or other websites that covered a range of PCWs. Another option was more regulation of PCWs eg they could be rated on their ease of use or representativeness of tariffs.
16. Ofgem expressed concern about the cost of running its own PCW. It suggested it would cost multiple millions and queried how this would be funded. While Ofgem acknowledged the cost could be lower, it would want to provide a high quality service and ensure customers were not misled.
17. In relation to remedy 3, Ofgem said the CMA's proposal to remove 'the simpler choices' component of the RMR rules raised issues about how to deal with tariff complexity. Complexity had driven much of the RMR. Ofgem was interested in exploring the CMA's views on this including on potential changes to other elements of the 'simpler choices' component such as prohibition on block tariffs and banded tariffs.¹
18. Ofgem agreed that the 'treating customers fairly' obligation could in theory apply to PCWs and all TPIs. This could be achieved through general principles rather than extending licensing. Under the existing licensing arrangements, suppliers were already required to ensure any TPIs that sold products on their behalf for commission met this obligation.
19. In relation to remedy 7a, Ofgem welcomed the proposal, which it saw as transformative. Ofgem extended its definition of microbusinesses when implementing the RMR for microbusinesses, but this is something that could be reconsidered. Ofgem said it would expect any price information published by suppliers for microbusinesses to be the starting point for negotiation.

¹ A tariff where different unit rates apply to different volumes of gas/electricity consumption (sometimes referred to as consumption 'blocks' or 'bands') irrespective of the time period in which consumption occurred.

Alongside remedy 7a, Ofgem thought additional information and 'prompts' were necessary to increase microbusinesses' engagement. It reported businesses were already trying to create PCWs for microbusinesses.

20. In relation to remedy 7b, Ofgem expressed interest in addressing the conduct of TPIs working with microbusinesses. It preferred a 'light touch' approach and had been thinking about ways other than licensing to make any rules obligatory for TPIs and PCWs for microbusinesses. These alternatives could be more effective than licensing TPIs.
21. In relation to remedy 8, Ofgem advised that there was now a much wider window of notification for microbusinesses on auto-rollover contracts to switch supplier and/or tariff. Ofgem said there were two issues to consider in relation to any removal of auto-rollover. First, the potential impact on independent suppliers if they were not able to recover the cost of serving customers that had auto-rolled onto them or had not renewed their contracts. Second, if removing auto-rollover would benefit customers. Ofgem had some evidence it could result in customers ending up on punitive out-of-contract rates.
22. In relation to remedy 4a, Ofgem said PCWs could already access the meter point reference database if they were given access by the supplier for whom they were acting. Ofgem said ways of making access easier for PCWs should be explored – for example, by considering the limits that suppliers place on PCWs to prevent them recontacting consumers. This could address the issue raised by some customers that they would like some 'hand-holding' through the switching process.
23. In relation to remedy 5, Ofgem said this was an attractive proposal but there might be some technical issues to address.
24. In relation to remedy 9, Ofgem said the switching guarantee, which industry are currently working on, could be hugely helpful. Ofgem said they would give further thought to all the ideas set out as part of this remedy.

Broader regulatory framework and code governance AECs and remedies

25. In relation to remedy 13, Ofgem said one of the ways of capturing the benefits of smart metering would be through moving to half-hourly settlement. Ofgem said it was already in active discussions with DECC about the timescales for a half-hourly settlement programme of work. There were some timing, policy and technical issues to resolve but Ofgem was not waiting until the smart meter roll out to progress this work.

26. Ofgem had not done any cost-benefit analysis on half-hourly settlement for domestic customers. It had, though, done an impact assessment in relation to P272 and made an estimate on the cost to suppliers of mandating half-hourly settlement for their profile classes 5–8. This showed a cost of about £45 per year per non-domestic meter. Ofgem said it would provide more information on this issue to the CMA.
27. In relation to remedies 18a and 18b, Ofgem expressed its support for the CMA's focus on the system of industry code governance. Ofgem had identified various issues with code governance and provided more details of its views in a handout. The issues included new suppliers finding the system a barrier to entry and Ofgem having little scope to influence the development and implementation phases of codes. Ofgem said Project Nexus (to upgrade the gas settlement system) was a source of constant frustration because it could not specify who should do something and the consequences if they did not.
28. Ofgem had developed a straw man model which could address the issues which the CMA had identified. This model could involve the development of a single licensed body for retail codes that could develop and administer codes. Ofgem said this body could bring together all the existing disparate bodies with overlapping responsibilities and would be accountable to Ofgem. Ofgem would regulate this body, retaining its current adjudicator role. Ofgem said its proposal focused on the retail related codes in the first instance, but it might be possible to extend the model to other codes in the long run. Further work was required to identify funding for this body and to consider other aspects of its detailed design, but it might deliver strategic change in the industry in a more timely and streamlined way than is possible at present. Change would be driven by the retail code body and based on a work plan developed by the body. Over time, this proposal could result in a simplification and consolidation of the codes.
29. In relation to remedy 15, Ofgem said it concurred with the CMA's findings on the need for more effective assessment of trade-offs between policy objectives and the communication of the impact of policies on prices and bills. Ofgem said this was largely a matter for DECC, and it was neutral on whether it or a separate body undertook impact assessments of policies. Ofgem said there would be some benefit in bringing together DECC's work on impact of bills with its work through a framework.
30. In relation to remedy 16, Ofgem said revision of its statutory objectives to promote effective competition could be achieved through the removal of certain wording that was added as part of the Energy Act 2010. More

extensive action to produce a simpler objective could be tricky because Ofgem's legal framework was both enshrined in UK and European law.

31. In relation to remedy 17, Ofgem said it did not need a mechanism to resolve disagreement with DECC. Ofgem said that if such a mechanism resulted in the government view prevailing, this would conflict with Ofgem's European legal duty not to take direction from anyone. Ofgem said this was quite a contentious remedy to address a problem that did not currently exist.
32. Ofgem said there might be a case for greater clarity and transparency when Ofgem and DECC were working together because they had a shared agenda and complementary skills and powers to bring. Ofgem said that the working relationship with DECC was generally good. Ofgem currently had the opportunity to say 'no' to the government, although it was not always appropriate to do so in public. However, it had been quite public in its disagreement with DECC on some policy design issues, for example in relation to aspects of EMR. Ofgem noted that where Government takes powers in areas that Ofgem is active in, it can create the perception that regulatory independence is being undermined unless it is absolutely clear that the two parties are working in concert. Ofgem said that, in general, all its regulatory decisions and functions as a national regulatory authority were independent of government, as required by EU law.
33. Ofgem said the current situation was best addressed by a coherent strategy and policy statement (SPS) setting out the decisions to be taken by each body. Ofgem said there was a risk that any SPS could be too high level but it needed to establish a framework. Ofgem said it thought that DECC was now drafting the SPS.
34. In relation to remedy 14, Ofgem suggested the introduction of the Consolidated Segmental Statements (CSS) had resulted in consistent information from energy companies. Ofgem said it was constantly being pressed to obtain more information from suppliers but it thought information in the CSS was sufficient. However, Ofgem was happy to have further discussions with the CMA about how best to answer the question 'why have retail prices not fallen if wholesale prices have fallen?'. There might be scope to improve transparency by publishing more trading data for companies.

Market rules and regulatory framework distortions of competition in wholesale electricity markets AECs and remedies

35. In relation to remedy 1, Ofgem said it agreed with variable transmission losses being priced on the basis of location. This had not happened before because of the distributional impacts on different players in the market and

the opposition from industry that arises from this. Ofgem said it could discuss this further with the CMA.

36. In relation to remedy 2b, Ofgem said it had a longstanding position of favouring one funding pot for technologies. Ofgem also suggested there were alternative ways of helping less mature technologies eg industrial policy.

Remedies that the CMA is not minded to consider further

37. In relation to the possibility of requiring energy firms to inform customers about the cheapest tariff on the market, Ofgem said a similar outcome could be achieved through 'beefed-up' TPIs.

Concluding remarks

38. Ofgem said it wanted to be as helpful as possible for the CMA's work on remedies. In this regard, Ofgem stressed the importance of knowing the CMA's reasons for proposed remedies and what it hoped they would achieve.