

Energy market investigation

Provisional decision on remedies

17 March 2016

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The Competition and Markets Authority has excluded from this published version of the provisional decision on remedies information which the inquiry group considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [X]. Some numbers have been replaced by a range. These are shown in square brackets. Non-sensitive wording is also indicated in square brackets.

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Glossary

Summary

1. On 26 June 2014 the Gas and Electricity Markets Authority made a reference to the Competition and Markets Authority (CMA) for an investigation into the energy market in Great Britain.¹ The terms of reference for this investigation allow us to look at any competition issue connected with the supply or acquisition of gas and electricity in Great Britain, including both retail and wholesale markets, except that, in the case of retail markets, only the retail supply of households and microbusinesses are included within the reference.
2. In the provisional findings report, published in July 2015, and the addendum to provisional findings, published in December 2015, we provisionally found that there are features of the markets for the supply of energy in Great Britain that result in an adverse effect on competition (AEC).²
3. Where we find that there is an AEC, we have a duty to decide whether we should take action ourselves and/or whether we should recommend others to take action to remedy, mitigate or prevent the AEC or any resulting detrimental effects on customers. In deciding these questions we have a duty to achieve as comprehensive a solution as is reasonable and practicable to the AEC and any resulting detrimental effects on customers.
4. This document sets out our provisional decision on remedies from this investigation.

Wholesale electricity market remedies

5. The wholesale price of electricity represents just under half the total cost of supplying electricity to domestic customers, and it is therefore vital, in the interests of ensuring that the overall prices paid by customers are competitive, to ensure that competition operates well in the wholesale market.
6. In our provisional findings report, we provisionally found that two aspects of the regulatory regime governing wholesale market operation led to AECs:
 - (a) the mechanisms for allocating Contracts for Difference (CfDs); and
 - (b) the absence of locational charging for transmission losses.

¹ [Energy market investigation terms of reference](#).

² This is defined in section 134(2) of the Enterprise Act 2002.

Allocation of Contracts for Difference

7. In our provisional findings report we welcomed the introduction of CfDs as the main mechanism for incentivising investment in low carbon generation, partly because, by enabling a competitive process to set the level of subsidy to low carbon generators, CfDs should provide a more efficient means of providing support.
8. However, we expressed a concern that some elements of the CfD allocation process currently in place potentially restrict the use of competition in setting the level of support, which could result in higher bills for customers. Notably, the Energy Act 2013 gives the Department of Energy & Climate Change (DECC) powers to award CfDs directly to parties through a non-competitive process in the future. We therefore provisionally found that the mechanisms for allocating CfDs give rise to an AEC due to the absence of an obligation for DECC to:
 - (a) carry out, and disclose the outcome of, a clear and thorough impact assessment supporting a proposal to use its powers to allocate CfDs outside a competitive process; and
 - (b) monitor the division of technologies between different pots, which form the basis of CfD auctions, and provide a clear justification when deciding on the allocation of budgets between the pots for each auction.
9. The government is set to invest billions of pounds in decarbonising electricity generation over the next few years. The spending cap under the Levy Control Framework – which covers the Renewables Obligation (RO), Feed-in Tariffs and CfDs – will rise to £7.6 billion for the period 2020/21.
10. With such large sums of money at stake, suboptimal regulatory design can lead to substantial customer detriment. Indeed, we estimate that the cost of supporting an early form of CfDs (under the FIDeR framework³) allocated outside the context of a competitive auction is £250–£310 million per year higher than it likely would have been had the FIDeR projects been awarded CfDs through a competitive auction. This is roughly equivalent to 1% of all customers' electricity bills.
11. This evidence illustrates the significant impacts that DECC's decisions in this area can have on the costs faced by energy customers. It is essential, therefore, when DECC makes such decisions in the future, that they are based on rigorous analysis, and that the impacts are communicated in a

³ The Final Investment Decision enabling for Renewables scheme.

clear and transparent manner. We believe our remedies will help ensure that this happens.

DECC to undertake and consult on an impact assessment before awarding CfDs outside the auction mechanism

12. The aim of this proposed remedy is to ensure that, in the future, if DECC is considering allocating a CfD outside the competitive auction process, it undertakes a clear and rigorous analysis of the impact of doing so and consults on this basis before reaching a final decision.
13. We note that, in principle, there may be circumstances under which allocating CfDs outside the competitive auction process could result in lower costs to customers. For example, there may be cheap projects with a lifespan and other operating characteristics that are so different to the characteristics of potentially competing projects that it is difficult to compare them within an auction framework. Since an element of judgement will be required in making these assessments we have not considered it appropriate to recommend imposing absolute rules determining the situations in which non-competitive allocation would be allowed.
14. Before deciding to allocate support on a non-competitive basis, however, we recommend that DECC set out clearly in an impact assessment why it considers that it is not feasible for the project to compete in the competitive auction process and why the benefits to customers of non-competitive allocation are likely to exceed the costs.⁴
15. We recommend that DECC consult on the basis of impact assessments at two stages: before entering into negotiations with prospective generators, in order to identify the possible costs and the benefits that may arise from supporting a given technology; and after the negotiations with prospective generators and the provisional agreement of a strike price, to expose the specific impacts on customers expected to arise from the proposed contract.

DECC to undertake and consult on an impact assessment before allocating technologies between 'pots' and the CfD budget to the different pots

16. In allocating CfDs on a competitive basis, DECC separates technology into separate 'pots', to which it assigns separate budgets. Since only technologies within the same pot compete against each other, decisions on

⁴ We note that no such assessment was carried out in relation to the FIDeR projects. If any such assessment had been carried out, we do not believe that it would have led to the conclusion that it was in customers' interests to allocate the FIDeR projects outside of the auction.

these parameters influence the intensity of competition and the level of support provided through the scheme.

17. We recommend that DECC undertake an impact assessment and consult before allocating technologies between pots and the CfD budget to the different pots. As part of its analysis and consultation, DECC should estimate the extent to which the short-run costs of supporting low carbon generation are affected by its decision. This can then be weighed against any long-run benefits (eg cost reductions of future projects), to assess overall impacts on customers.
18. We recommend that DECC should undertake an assessment of the appropriate allocation of technologies and budgets to pots prior to each CfD auction and consult on this basis. To ensure that potential bidders are able to make informed decisions about whether to progress a project in advance of the auction, DECC should finalise its proposals for the allocation of technologies and budgets at least one year ahead of the auction.

Locational adjustments for transmission losses

19. Energy is lost when electricity is transported from one part of the country to another, and the greater the distance travelled, the higher the losses. The costs of these transmission losses therefore vary considerably by geographical location – in an area with relatively low levels of demand and high levels of generation, for example, consuming electricity will be associated with low losses and generating electricity will be associated with high losses. However, despite this locational variation in the costs of losses, under the current regulatory regime, these costs are allocated to generators and customers in a way that takes no account of their geographical location.
20. We have provisionally found that the absence of locational pricing for transmission losses is a feature of the wholesale electricity market in Great Britain that gives rise to an AEC, as it is likely to distort competition between generators, raise bills to customers and to have both short- and long-run effects on generation and demand:
 - (a) In the short run, costs will be higher than would otherwise be the case, because cross-subsidisation will lead to some plants generating when it would be less costly for them not to generate, and other plants, which it would be more efficient to use, not generating.
 - (b) In the long run, the absence of locational pricing may lead to inefficient investment in generation, including inefficient decisions over the

extension or closure of plant. There could also be inefficiency in the location of demand.

21. Our proposed remedy is to require that variable transmission losses are priced on the basis of location, and to assign 100% of losses to generators, rather than 45% as under current charging arrangements.
22. We have conducted a modelling exercise to assess the benefits that might be expected to arise from the introduction of locational charges for losses. The model results suggest that the total cost of meeting the electricity demand of customers in Great Britain will fall by between £158 million and £190 million over the period 2017 to 2026 due to the proposed remedy, depending on the future level of fossil fuel prices. The additional efficiency gain of requiring generators to bear 100% of transmission losses is estimated to be worth between £14 million and £31 million. The model also estimates that there will be a moderate additional environmental benefit from the reduction in SO₂ and NO_x emissions from the proposed remedy, valued at between £0.4 million and £14.4 million over the period.
23. The results of our modelling are similar, overall, to those from previous modelling exercises conducted in support of previous proposals to introduce locational charging for transmission losses. We have not attempted to model the dynamic benefits from the proposed remedy, in terms of more efficient investment, due to the complications and uncertainties of such modelling. All in all, expected benefits from the remedy – considering both benefits we have modelled and those we have not – exceed by far expected implementation costs, which are less than £10 million.
24. In summary, based on the modelling work we have conducted and other analysis, our provisional conclusion is that introducing locational charging for transmission losses will reduce costs and be in the long-term interests of customers. We propose to implement the remedy by means of an order imposed on National Grid, as system operator, to calculate imbalance charges taking into account transmission losses calculated on a locational basis and according to which 100% of losses would be borne by generators.

Updated assessment of AECs and detriment affecting domestic customers

25. In our provisional findings report, we provisionally found four AECs concerning domestic retail energy markets. We provisionally found: one AEC relating to weak customer response (the Domestic Weak Customer Response AEC); and three AECs relating to aspects of the regulatory framework – the electricity and gas settlement systems and elements of the ‘simpler choices’ component of the Retail Market Reform (RMR) rules.

26. In addition, in the addendum to provisional findings we set out features that in our provisional view give rise to a fifth AEC in the domestic retail markets, relating specifically to prepayment customers (the Prepayment AEC). We provisionally found that these features, in combination, reduce retail suppliers' incentives (and, for some, their ability) to compete to acquire prepayment meter customers (in particular, customers with an outstanding debt or a poor credit history) and to offer tariffs that meet customers' demand. As a result, the tariffs available in the prepayment meter segments are not competitively priced compared with the direct debit segments.
27. We have conducted updated analysis of the relative strength of these provisional AECs and the features contributing to them, including: an update of analysis of the gains available to customers from switching; an updated analysis of the provisional AECs and features affecting customers on prepayment meters; and an analysis of the provisional AECs and features affecting customers on restricted meters.

Updated analysis of gains from switching

28. In the provisional findings report, we reviewed a number of pieces of evidence that showed that domestic customers exhibited weak customer response, including: our customer survey, in which 34% of respondents said they had never considered switching; the numbers of customers on default tariffs; and the existence of material, persistent gains from switching supplier, tariff and/or payment method that go unexploited by such customers.
29. We have updated our gains from switching analysis, extending the period of the analysis from Q1 2012 to Q2 2015, extending the calculations of annual potential savings to customers of the four Mid-tier Suppliers⁵ and making certain methodological improvements.
30. The gains available to customers differ quite substantially according to the scenario chosen and category of customer concerned (and in particular, the supplier they are with, the type of tariff they are on and the payment method they employ). Overall, the results demonstrate that:
- (a) there were material, persistent savings available to customers of the Six Large Energy Firms⁶ over the period;

⁵ Co-operative Energy, First Utility, Ovo Energy and Utility Warehouse.

⁶ The Six Large Energy Firms are Centrica plc (Centrica), EDF Energy plc (EDF Energy), E.ON UK plc (E.ON), RWE npower plc (RWE), Scottish and Southern Energy plc (SSE) and Scottish Power. These firms are the former monopoly suppliers of gas (Centrica) and electricity (EDF Energy, E.ON, RWE, SSE and Scottish Power) to GB customers.

- (b) the savings available to customers on standard variable tariffs were, on average, larger than savings available to non-standard tariff customers; and
- (c) the savings available to standard credit customers were, on average, higher than those available to customers on other payment methods.
31. We also note that the savings available to customers on prepayment meters were, on average, substantially lower than those available to other customers, reflecting the more restricted range of tariffs available to them. This is discussed further below.
32. The table below shows average period results for the domestic customers of the Six Large Energy Firms under the most liberal scenario for customer choice (scenario 5x).⁷ Overall, we calculated that the weighted average gains to all the dual fuel customers of the Six Large Energy Firms over the entire period was £164 under this scenario.

Table1: Weighted average savings under scenario 5x for domestic customers of the Six Large Energy Firms on different tariffs and payment methods, Q1 2012 to Q2 2015

<i>Dual or single fuel</i>	<i>Tariff type</i>	<i>Payment type</i>	<i>Average savings (£)</i>	<i>Average savings (%)</i>
Dual	Non-standard	All	109	9
Dual	SVT	Direct debit	205	16
Dual	SVT	Standard credit	245	23
Dual	SVT	Prepayment	70	8
Single gas	Non-standard	All	96	14
Single gas	SVT	Direct debit	132	19
Single gas	SVT	Standard credit	142	24
Single gas	SVT	Prepayment	48	13
Single electricity	Non-standard	All	55	9
Single electricity	SVT	Direct debit	95	15
Single electricity	SVT	Standard credit	118	23
Single electricity	SVT	Prepayment	45	8

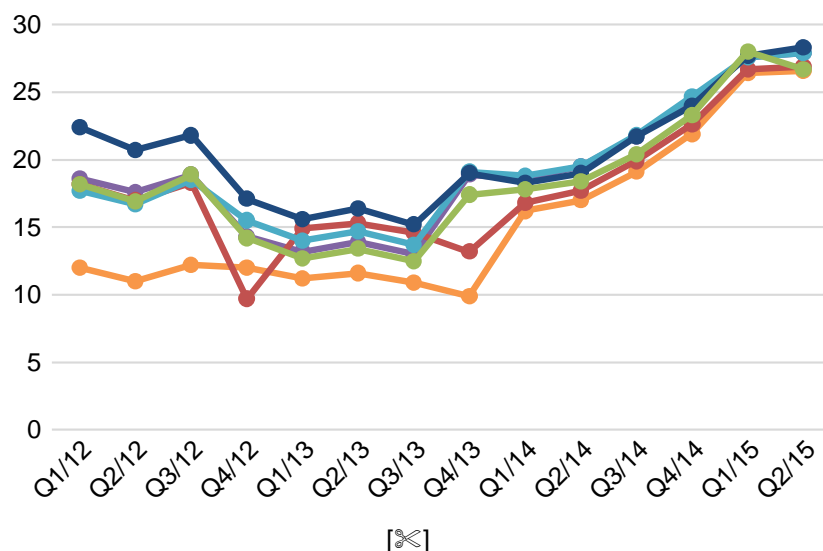
Source: CMA analysis. Scenario 5x.
Note: SVT = standard variable tariff.

33. We have also assessed how the potential savings to customers have evolved over time. The figure below shows the annual potential savings from switching (% of the bill) available to the dual fuel standard variable tariff customers (excluding those on prepayment meters) of each of the Six Large Energy Firms over time under scenario 5x. It shows that annual potential savings for these customers have risen substantially over the past two years, and have reached their highest level in the most recent period of the

⁷ In this scenario, customers are able to switch supplier, tariff, payment method (except for prepayment customers, reflecting the greater barriers they face in using other payment methods), and gains are reduced to reflect the exit fees a customer may incur in moving from a non-standard tariff. Appendix 3.2 presents the results of a broad range of scenarios, which differ according to the parameters of choice available to the customer.

analysis, Q2 2015, reaching an equivalent of between £310 and £360. There is a similar trend for the standard variable tariff customers of the Mid-tier Suppliers, although there is a bigger disparity in the positions of individual suppliers.

Figure 1: Weighted average potential savings (% of bill) available to the dual fuel SVT customers (excluding prepayment) of the Six Large Energy Firms under scenario 5x



Source: CMA analysis.

Notes:

1. Within each quarter the weighted average is calculated using data on the distribution of consumption and the weights reflect the number of accounts that belong to each tariff.
2. Base: all dual fuel SVT customers (excluding prepayment).

34. We note that in February 2016, the Six Large Energy Firms announced a reduction in the price of their standard variable gas tariffs, ranging from 5 to 5.4%, and expected to come into effect from February to March 2016.⁸ However, we do not believe this will materially change the pattern of results seen in the chart above. Indeed, gains may even have increased further, since we would expect the acquisition tariffs to follow more closely the reduction in wholesale gas and electricity prices, which comprise roughly 50% of the total costs incurred in supplying gas and electricity and have fallen around 33% and 20% since Q2 2015, respectively.

Customers on prepayment meters

35. The proportion of customers on prepayment meters has increased steadily over the last 20 years, from 7% in 1996 to 16% currently. Unlike the choice of whether to pay by direct debit or standard credit, prepayment is not

⁸ EDF Energy announced a price cut of 5%; British Gas announced a price cut of 5.1%; E.ON announced a price cut of 5.1%; RWE npower announced a price cut of 5.2%; SSE announced a price cut of 5.3% and Scottish Power announced a price cut of 5.4%.

generally a choice on the part of the customer. Prepayment meters are generally installed where a customer has had a poor payment history or in certain types of accommodation such as student accommodation. Nearly all prepayment customers are on standard variable tariffs, reflecting the limited choice of non-standard tariffs they face.

36. In our addendum to provisional findings, we identified particular supply-side constraints affecting customers on 'dumb' (ie non-smart) prepayment meters and which limit the extent of competition in the segments. These constraints, arising from the dumb prepayment infrastructure, take the form of limitations on the numbers of tariffs that suppliers can offer due to the limited number of gas and electricity tariff 'slots'. We found these constraints to be particularly binding for new entrants in gas on account of the low availability of gas tariff slots – over 85% of which were held by the Six Large Energy Firms, including a large proportion that they were not using.
37. We also provisionally found softened incentives for all suppliers, and in particular new entrants, to compete to acquire all prepayment customers, whether on smart or dumb prepayment meters. This was due to actual and perceived higher costs to engage with, and acquire, these customers compared with other customers, and the low prospect of successfully completing the switch of indebted customers (who represent about 15% of prepayment customers).
38. Our provisional analysis of the prepayment segments suggested that competition is significantly weaker than in the wider GB domestic retail energy markets. We found that entry and expansion by suppliers other than the Six Large Energy Firms in the prepayment segments is slower, and that entry is limited to fewer suppliers, than we have observed in the broader domestic markets. We also found that the range of tariffs available to prepayment customers is significantly more limited than those available in the credit meter segments, and that the cheapest tariffs that are offered by suppliers to prepayment customers are significantly higher (even accounting for differentials in the costs to serve) than the cheapest tariffs in the direct debit segments.
39. We have examined more recent data to assess, as was put to us by some of the respondents, whether competition in the prepayment segments has recently intensified.
40. We first looked at our extended gains from switching data set which covers the period from Q1 2012 to Q2 2015. We observed that the gains from switching available to dual fuel customers on prepayment meters have been fairly static, with gains available as of Q2 2015 of between £70 and £120,

depending on the customer's supplier. This is in contrast with a sharp increase in the gains available to prepayment customers if they were to switch to a credit meter, which doubled between 2013 and 2015, reaching between £290 and £370 as of Q2 2015, depending on the supplier.

41. We also conducted a search on a price comparison website (PCW) in order to look at the most recent pricing data. We found that, as of 1 March 2016, there were large differences between the cheapest prepayment and direct debit tariffs, between £260 and £330, depending on the region. This is well in excess of our estimate of the cost differential between the two payment methods of £54.
42. We also looked at the customer numbers in the prepayment segments, and how they changed over time, for both the independent suppliers and the Six Large Energy Firms. We observed an increase in the share of independent suppliers in the prepayment segments over time, reaching 8% for gas and 7% for electricity as of Q2 2015.
43. Overall, while there has been an increase in the share of independent suppliers, we have seen no evidence of improving outcomes for prepayment customers relative to the position we documented in the addendum to provisional findings.
44. We have also reviewed the available evidence on the extent to which the Domestic Weak Customer Response AEC applies to customers on prepayment meters. The evidence suggests that a higher proportion of prepayment customers are less engaged than direct debit customers (but not less engaged than standard credit customers), particularly in terms of whether they have ever considered switching or are likely to consider switching in the next three years, and their awareness of their ability to switch.
45. There are a number of factors that may explain this:
 - (a) Prepayment customers face particular restrictions on accessing and assessing information about switching (including relatively low access to the internet and confidence in using PCWs).
 - (b) Prepayment customers include higher proportions of individuals: with low levels of income; with low levels of education; living in social rented housing; and having a disability – demographic characteristics that we have found to be associated with low levels of engagement in retail energy markets.

- (c) While the need to top up prepayment cards regularly is likely to increase awareness of retail energy markets among prepayment customers, low levels of engagement may have in part been influenced by the outcomes we have observed arising from the Prepayment AEC – notably the lower gains from switching and the confusion surrounding rights to switch when the customer has outstanding debt.
46. The overall weight of evidence supports a provisional finding that disengagement and weak customer response is a more significant problem among prepayment customers compared with domestic customers on direct debit.

Customers on restricted meters

47. Restricted meters include any metering arrangement whereby a domestic customer's consumption at certain times and, in some cases, for certain purposes (for example, heating) is separately recorded. These meters allow for customers to be charged lower rates for electricity used at times when overall demand is lower.
48. There are currently over 4 million restricted meters (around 17% of all customer accounts) of which around 700,000 (about 2% of all customer accounts) are non-Economy 7 restricted meters.⁹ Our analysis has focused on the position of non-Economy 7 restricted meters, about which we have heard specific concerns (and henceforth refer to this group as 'customers on restricted meters' unless otherwise specified).
49. Our further analysis shows that customers on restricted meters face particularly strong barriers to accessing and assessing information and barriers to switching supplier and/or tariff.
50. As regards facing specific barriers to accessing and assessing information, we have found that this is partly because restricted meter tariffs are not supported by PCWs or suppliers' online search tools. As regards facing barriers to switching supplier and/or tariff, we have been told that many restricted meter customers do not have a choice of supplier offering bespoke tariffs. They can in principle switch to a single-rate or an Economy 7 tariff offered by their supplier or rival suppliers, but some suppliers would require their existing meter to be replaced at a cost to the customer and loss of functionality. Changing meters might also involve some rewiring in the home.

⁹ Economy 7 customers are included in our assessment of gains from switching discussed above.

51. All this means that, for customers on restricted meters, understanding the options available to them and switching supplier is substantially more difficult than it is for customers on other meter types. Reflecting this, we have found that, across Great Britain the historical incumbent supplier's share of supply in restricted meters is 79% which is significantly higher than the equivalent figure for all electricity (33%) and gas (37%) customers. For certain types of restricted meter, the incumbent supplier still supplies nearly 100% of customers on these meters.
52. Despite the cost advantages to suppliers of serving customers on restricted meters, we have found, using data from Q2 2015, that 69% of customers on restricted meters would have had lower bills if they were on the cheapest single-rate tariffs available on the market and that those who could have saved would have saved an amount equivalent to around 18% of their bill. We note that the results differ significantly depending on the supplier in question – for two of the Six Large Energy Firms, over 85% of their customers would have been better off on the cheapest single-rate tariff.

Updated analysis of detriment

53. To assist us in deciding on appropriate remedies, we have assessed the nature and extent of detrimental effects on domestic energy customers resulting from the AECs that we have provisionally identified.
54. Our approach to assessing the scale of detriment is to consider to what extent the outcomes that we have observed in the retail energy markets are worse than we would expect to see in well-functioning competitive markets, including the extent to which domestic energy customers are, on average, paying higher prices than they would do in well-functioning competitive markets and receiving poorer quality of service. Most of our analysis has focused on the first source of detriment – excessive prices – since we believe that this is likely to be the most significant form of detriment suffered by energy customers, given the homogenous nature of gas and electricity.
55. We have adopted two approaches to assessing the extent to which prices have exceeded those we would expect in a well-functioning market:
- (a) a 'direct' approach, which involves comparing the average prices charged by different suppliers, while controlling for those differences in each supplier's customer base that are likely to affect costs; and
 - (b) an indirect approach, which involves assessing both:
 - (i) suppliers' levels of profitability (and in particular whether the Return on Capital Employed by suppliers exceeds their cost of capital); and

- (ii) the extent to which suppliers have incurred costs inefficiently (ie whether costs are higher than we estimate an efficient supplier would incur).

- 56. The benefit of the direct approach is that it gives us a more direct measure of customer detriment based on actual market prices – and prices are ultimately what matter to a customer, rather than a supplier's level of profitability or cost efficiency. Further, the direct approach allows for a much more granular breakdown of detriment, not just by supplier but by customer type, including type of tariff and payment method.
- 57. The indirect approach provides information on profitability and cost efficiency which can be a useful proxy for customer detriment. It can therefore provide a useful independent cross check on our direct analysis, as it is based on a separate data set and methodology.

Direct approach

- 58. Our direct approach to assessing detriment involves calculating the average prices offered by different suppliers to their customers and comparing these to a 'competitive benchmark price', which is constructed as the average prices offered by the most competitive suppliers. In making this comparison, we adjusted for exogenous cost differences relating to network costs and the costs associated with different payment methods, to ensure the comparison is on a broad like-for-like basis.
- 59. Using this approach, we estimated the detriment from excessive prices to the domestic customers of the Six Large Energy Firms to be about £1.7 billion a year on average over 2012 to 2015, the entire period for which we had data, with a marked trend upwards year on year, reaching almost £2.5 billion in 2015. We consider this our headline estimate of the annual detriment arising from high domestic retail market prices.
- 60. We have also considered the extent to which the scale of excessive pricing by the Six Large Energy Firms varies between different payment methods. This is shown in the table below.

Table 2: Detriment of the domestic customers of the Six Large Energy Firms by customer category and fuel type, Q1 2012 to Q2 2015

<i>Dual or single fuel</i>	<i>Direct debit (% of bill)</i>	<i>Standard credit (% of bill)</i>	<i>Prepayment (% of bill)</i>	<i>All (% of bill)</i>
Dual fuel	10%	11%	15%	11%
Single fuel electricity	9%	11%	13%	10%
Single fuel gas	18%	16%	17%	17%

Source: CMA analysis. Analysis based on Ofgem's medium Typical Domestic Consumption Values. Bills are calculated net of network costs and adjusted for the costs of different payment methods.

61. For dual fuel customers (the majority of all the customers of the Six Large Energy Firms) and single fuel electricity customers (31% of their electricity customers), we found that the detriment across all of the Six Large Energy Firms is biggest for prepayment customers, followed by standard credit customers and then direct debit customers. We found no such difference for single fuel gas (19% of their gas customers), though we note that the observed detriment overall is higher for single fuel gas than for dual fuel and single fuel electricity customers.
62. We also note that there is considerable variation (both within the Six Large Energy Firms and the Mid-tier Suppliers) in the extent to which individual suppliers price above the competitive level. For the Six Large Energy Firms, for example, average detriment experienced by their dual fuel customers over the period ranges from between 5% and 13% of the bill depending on the supplier. At this stage we have not identified the suppliers concerned in order to give parties the opportunity to respond to our analysis first. We intend to do so in our final report.

Indirect approach

63. We have also estimated customer detriment from excessive prices indirectly from the financial results of the Six Large Energy Firms which involved assessing both suppliers' level of profitability and the extent to which suppliers have incurred costs inefficiently.
64. The analysis using the indirect approach yields a total estimate of customer detriment from excessive prices of between £660 million and £1.1 billion a year, depending on the choice of the efficiency benchmark. There are a number of reasons why the indirect approach gives a lower estimate of detriment than the direct approach, including that the indirect approach covers a longer time span which includes two years when several of the Six Large Energy Firms made losses, and that the indirect approach takes a conservative approach to identifying the level of economic profits made and the efficient indirect cost base of the Six Large Energy Firms. It also does not seek to identify the efficient level of wholesale energy costs.

65. Overall, we place greater weight on the direct approach, as it is a more relevant and granular measure of domestic customer detriment. We note, however, that detriment calculated under this approach is far in excess of the net profits earned by the Six Large Energy Firms from their sales to domestic customers (eg assessed detriment in 2014 is almost double the Earnings Before Interest and Tax from domestic sales of the Six Large Energy Firms in 2014). The implication is that there is a high degree of inefficiency in current prices.

Quality of service and innovation

66. In relation to quality of service, we observed that there are several metrics which suggest that energy customers receive a poorer quality of service from the Six Large Energy Firms than they would do in well-functioning competitive markets. Those include the data which shows that the smaller suppliers have achieved consistently higher net promoter scores than the Six Large Energy Firms, and that there has been a marked increase in recorded customer complaints since 2008 and 2013 which resulted in a number of enforcement actions brought by Ofgem against the Six Large Energy Firms.
67. We have also found that some regulatory interventions, in particular the recent RMR rules, have served to reduce innovation in recent years, and that the absence of an accurate settlement system has inhibited the development of time-of-use tariffs which could bring substantial benefits in terms of reduced costs.

Summary

68. Overall, we consider there to be a material customer detriment arising from the provisional AECs that we have identified in retail energy markets. We estimated that the customer detriment associated with high prices was about £1.7 billion a year on average for the period 2012 to 2015 with a marked upwards trend. We also found evidence which is indicative of harm to customers from poor quality of service and restrictions on innovation, but by its nature this type of harm is less readily quantifiable.

Domestic retail remedies

69. We have drawn on the above analysis in developing our remedies and in assessing the proportionality and effectiveness of the package of remedies as a whole. At a high level, our proposed package of remedies for domestic customers comprises three strategic components:

- (a) creating a framework for effective competition;
- (b) helping customers to engage to exploit the benefits of competition; and
- (c) protecting customers who are less able to engage to exploit the benefits of competition.

Creating a framework for effective competition

70. If competition in retail energy markets is to serve customers' interests, it is vital that the regulatory and technical framework allows suppliers to compete effectively. Provided customers are sufficiently engaged, this will help drive down prices and improve quality of service.
71. We have identified a number of aspects of the regulatory framework that we believe undermine effective and efficient competition and propose three categories of remedy that we believe will help improve this framework:
- (a) the withdrawal of the simpler choices component of the RMR;
 - (b) reform of the settlement systems for gas and electricity; and
 - (c) measures to address the technical and regulatory constraints impeding competition for prepayment meter customers.

Withdrawal of the simpler choices component of the RMR rules

72. In the provisional findings report we set out evidence on the impact that the 'simpler choices component' of the RMR rules has had on the ability and incentives of suppliers to compete on the range of tariffs and discounts offered to domestic customers. We also consider that the simpler choices component of RMR rules (in particular the four-tariff rule) limits the scope for competition between PCWs for customers switching energy suppliers to exert downward pressure on energy prices.
73. We are therefore proposing a remedy, the aim of which is to:
- (a) promote competition and innovation between retail energy suppliers in the retention and acquisition of domestic customers by allowing them to offer a wider range of tariffs than permitted by the 'simpler choices' component of the RMR rules, including tariffs designed to appeal to certain customer groups; and
 - (b) facilitate competition between PCWs by allowing them to negotiate exclusive tariffs with domestic energy suppliers and to offer discounts funded by the commissions they receive from suppliers.

74. The proposed remedy takes the form of a recommendation to Ofgem to remove a number of standard licence conditions relating to the simpler choices component of the RMR rules. These include: the ban on complex tariffs; the four-tariff rule; the ban on certain discounts; and the ban on certain bundled products.

Settlement reform

75. Energy suppliers generally attempt to purchase in advance the electricity and gas that they expect their customers to consume, to help them manage price and volume risks. But both gas and electricity demand are driven by a range of factors that are difficult to predict accurately, such that there will always be some disparity between the volumes of energy covered by suppliers' contracts and the volumes their customers actually use in real time. Settlement is the system by which such disparities are identified, reconciled and paid for.
76. Accurate and timely settlement is fundamental to well-functioning retail energy markets, since without this, suppliers will not have the right incentives to minimise the overall costs of energy – which are ultimately borne by customers. However, in our provisional findings report we expressed concerns that elements of the settlement systems of both gas and electricity lead to inaccuracies and delays that distort competition between energy suppliers.

Electricity settlement reform

77. Electricity settlement takes place every half hour but the majority of domestic and microbusiness customers do not have meters capable of recording half-hourly consumption. Therefore, their consumption must be estimated on an ex ante basis. This is done by assigning customers to one of eight profile classes, which are used to estimate a profile of consumption over time and allocate energy used to each half-hour period.
78. Our main concern in relation to electricity settlement is that such estimates fail to charge suppliers for the true cost of their customers' consumption. This means that suppliers are not incentivised to encourage their customers to change their consumption patterns, as the supplier will be charged in accordance with their customers' profile regardless of their actual consumption behaviour. This in turn distorts suppliers' incentives to innovate and bring in new products and services such as time-of-use tariffs, which reward customers for shifting consumption away from peak periods. Further, the Smart Energy Code currently prohibits suppliers from collecting consumption data with greater than daily granularity unless a customer has

given explicit consent to do so. We believe that this opt-in clause is a major barrier to the development of static and dynamic time-of-use tariffs.

79. Our proposed remedy package in relation to electricity settlement comprises recommendations: to DECC to consult on amending the provisions of the Smart Energy Code; to Ofgem that it conduct a full cost-benefit analysis of the move to mandatory half-hourly settlement and consider options for reducing the costs of elective half-hourly settlement; and to DECC and Ofgem that they publish and consult jointly on a plan setting out timescales and responsibilities relating to the introduction of half-hourly settlement.

Gas settlement reform

80. Our concern in relation to the current system of gas settlement is that it leads to an inefficient allocation of costs to parties and creates scope for gaming, which reduces the efficiency and, therefore, the competitiveness of domestic retail gas supply.
81. We note that a modification process currently underway – Project Nexus – is likely to address most of the current inefficiencies in the gas settlement system. However, we were concerned that even after implementation of Project Nexus, the gas settlement process would still be characterised by the presence of a (residual) amount of unidentified gas, inefficiencies in the allocation of the cost of this residual unidentified gas, as well as incentives that shippers face to place a higher priority on adjusting Annual Quantities (AQs) down.
82. Our proposed remedies in relation to gas settlement comprise: a recommendation to Ofgem to ensure implementation of Project Nexus by 1 October 2016; an order on gas suppliers to submit all meter readings for non-daily metered supply points in Great Britain to Xoserve as soon as they become available and at least once a year, except for smart meters where meter readings must be submitted monthly; and a recommendation to Ofgem to take responsibility for the development and delivery of a performance assurance framework concerning unidentified gas as soon as reasonably practicable.

Remedies to address constraints on competition for prepayment customers

83. In addition, we believe that there are features of the domestic retail energy markets that give rise to two distinct, but related, AECs concerning prepayment meter customers: one on the demand side (the Domestic Weak Customer Response AEC); and one principally concerning the supply side (the Prepayment AEC).

84. In relation to the constraints imposed by the dumb prepayment infrastructure, we are proposing a range of remedies that will make better use of the available tariff slots, so as to reduce the impact of the dumb prepayment meter technical constraints on the ability of suppliers, and in particular new entrants, to innovate by offering tariff structures that meet demand from prepayment meter customers who do not have a smart meter.
85. The proposed remedies include recommendations to Ofgem that it: take responsibility for the efficient allocation of gas tariff pages; and, if necessary, change gas suppliers' standard licence conditions to impose a cap on the number of gas tariff pages that any supplier can hold and to enable Ofgem to mandate the transfer of gas tariff codes to another supplier.
86. To further mitigate the impact of tariff codes on competition for customers on dumb prepayment meters, we recommend that Ofgem change Standard Licence Condition 22B.7(b) to allow suppliers to set prices to prepayment customers on the basis of grouping regional cost variations and deprioritise potential enforcement action against suppliers in relation to this licence condition pending the change. This will allow suppliers to make better use of their limited tariff codes.
87. We are also proposing a remedy to enhance prepayment customers' ability and incentives to engage in the markets and to switch to other suppliers (including by switching to tariffs available on standard meters). This takes the form of a recommendation to Ofgem to take appropriate steps to ensure that changes to the Debt Assignment Protocol (currently being developed by Ofgem and the industry) are implemented by the end of 2016, and in particular in areas relating to objection letters, complex debt and issues relating to multiple registrations.

Helping customers engage to exploit the benefits of competition

88. Engaged customers are an essential component of well-functioning energy markets. If customers are not fully aware of the options available to them, unable to make an informed choice about the relative merits of those options or, having made a choice, are unable to switch, then competitive pressures on suppliers to reduce prices and improve quality of service will be substantially reduced.
89. In our provisional findings report we found that considerable numbers of customers were disengaged, leading to our provisional finding of a Domestic Weak Customer Response AEC. From our customer survey we found that 34% of respondents said they had never considered switching supplier,

while 56% of respondents said they had never switched supplier, did not know if it was possible or did not know if they had done so.

90. We also note that currently around 70% of customers are on the relatively expensive default tariff – the standard variable tariff – and that there are material, persistent gains from switching supplier, tariff and/or payment method that go unexploited by many customers.
91. We have proposed a wide range of remedies that attempt to improve domestic customer engagement by addressing aspects of the features contributing to the Domestic Weak Customer Response AEC. We propose five broad categories of remedy, which focus on the role of different participants in the retail markets – namely, Ofgem, the customer’s own supplier, third party intermediaries (TPIs), and rival suppliers – in strengthening domestic customer engagement. In particular, the proposed remedies provide for:
 - (a) the establishment by Ofgem of a programme to provide customers – directly or through their own suppliers – with information to prompt them to engage;
 - (b) Ofgem making greater use of principles rather than prescriptive rules in addressing potential adverse supplier behaviour concerning the comparability of their tariffs;
 - (c) enhancing the ability and incentives of TPIs to promote customer engagement in the retail energy markets;
 - (d) creating an Ofgem-controlled database of ‘disengaged customers’ on default tariffs, to allow rival suppliers to prompt these customers to engage in the retail energy markets (the Database remedy); and
 - (e) requiring all suppliers to make all their single-rate tariffs available to domestic customers on any type of restricted meter, without making switching conditional on a restricted meter being replaced and to provide additional information to customers on restricted meters.
92. The different market participants identified above differ substantially in terms of the incentives they have to engage customers and their ability to do so and our range of proposed remedies reflects this.

Regulatory interventions to improve engagement/mitigate incentives to keep customers disengaged

93. We consider that customers' current suppliers have the ability to engage their customers – through the regular communications they send to them – but are likely to face limited incentives to do so in a way that encourages customers to engage in the markets. Indeed, since those customers that have not engaged in the markets recently are both less likely to switch and generally on higher tariffs than those who have recently engaged, their suppliers are likely to face a financial incentive to keep them as disengaged as possible.
94. In these circumstances, we recognise that there is an argument for Ofgem to intervene directly to facilitate customer engagement, through influencing the form, content and frequency of communication between suppliers and their existing customers. Ofgem has also recognised the importance of clear information in facilitating customer engagement and introduced the 'clearer information' component of the RMR rules in an attempt to ensure that suppliers' routine communications to customers were clear, easy to understand and personalised to them.
95. However, our concern with these provisions is that they were not subject to adequate testing prior to (or after) their introduction. Without adequate testing it is not possible to know which approach will work best in practice. Further, even if testing is conducted ex ante, changes in technology and cultural practices are likely to mean that what works changes over time.

Ofgem-led programme

96. Our proposed remedies therefore call for a more evidence-based approach to developing such interventions in the future, through the use of rigorous testing and trialling, where appropriate through Randomised Controlled Trials, with a recommendation to focus such trials on a shortlist of measures. If such trials are to provide relevant information that can provide a robust basis for regulatory changes, it is essential that suppliers be required to participate, where the trial design requires it, and our remedies therefore seek to ensure such participation.
97. In particular, the remedies comprise: a recommendation to Ofgem to establish an ongoing programme of identifying, testing and implementing measures to promote engagement in the domestic retail energy markets; and an invitation for all suppliers to offer undertakings to participate in the programme (failing which we would pursue alternative methods of ensuring

compliance such as the use of our order-making powers, changes to licence conditions or legislative change).

Principles rather than rules

98. Our remedies also place a greater emphasis on the use of principles rather than detailed rules in seeking to address potential adverse supplier behaviour, reflecting our concern that prescriptive rules can never be fully exhaustive and risk encouraging gaming behaviour on the part of suppliers. In particular, we recommend that Ofgem introduce an additional ‘standard of conduct’ into Standard Licence Condition 25C that would require suppliers to have regard in the design of tariffs to the ease with which customers can compare ‘value for money’ with other tariffs they offer.

Harnessing the incentives of rival suppliers and third party intermediaries to engage customers

99. Where market participants have an active incentive to engage customers – this category includes rival suppliers and TPIs – the proposed remedies serve to enhance these parties’ ability to engage domestic customers. The proposed remedies seek to achieve this through:

- (a) lifting certain regulatory restrictions that dull PCWs’ incentives to compete to engage customers (amending provisions of the PCW confidence code that undermine incentives for them to be active in the retail energy markets);
- (b) liberalising access to data by:
 - (i) giving PCWs access to the ECOES and SCOGES databases¹⁰ and bolstering the Midata programme to allow TPIs to make more effective use of customer data; and
 - (ii) creating an Ofgem-controlled database of ‘disengaged customers’ who have been on the default tariff for three years or more, to allow rival suppliers to prompt these customers to engage in the retail energy markets.

¹⁰ The Electricity Central Online Enquiry Service (ECOES) database includes certain data to assist electricity suppliers in the transfer of customers, while the Single Centralised On-Line Gas Enquiry Service (SCOGES) database comprises similar data for gas.

Enhancing the ability and incentives of third party intermediaries to promote customer engagement

100. We consider that TPIs such as PCWs are an important means by which customer engagement can improve and effective competition can develop in the domestic retail markets. PCWs have a strong commercial incentive to engage with domestic customers and provide access to their services both online and by telephone. PCWs are also well-placed to: raise awareness among customers of their ability to switch and the potential benefits from doing so; reduce search costs for customers; and exert competitive pressure on energy suppliers by enhancing price transparency and facilitating the purchasing process for customers.
101. Our aim in our proposed remedies relating to TPIs in the domestic retail markets is to help ensure that this potential for PCWs to promote competition to the benefit of customers can be realised by removing regulatory burdens that inhibit this role.
102. To strengthen PCWs' role in facilitating switching our remedies take the form of: orders to Gemserv and Xoserve to give PCWs access upon request to the ECOES and SCOGES databases respectively on reasonable terms and subject to satisfaction of reasonable access conditions.
103. To strengthen PCWs' incentives to engage customers, we are proposing to recommend to Ofgem that it remove the Whole of the Market Requirement in the Confidence Code and introduce a requirement for PCWs accredited under the Confidence Code to be transparent over the market coverage they provide to energy customers. Further, we are proposing to recommend to DECC several changes to the Midata programme that (subject to customer consent) would give PCWs increased access to more customer data and, in so doing, enable PCWs to monitor the market on behalf of their customers and advise them of savings.
104. We are aware of the concerns around trust that led to the Confidence Code requirement that PCWs list all tariffs on the market rather than just those for which they earn a commission. We believe that such concerns around trust can be addressed – without undermining TPIs' incentives to engage customers – in two ways.
105. First, there should be greater clarity around the role of PCWs – effectively acting as brokers offering customers good deals and facilitating switches rather than repositories of all available tariffs. Second, we considered recommending that Ofgem establish a non-transactional PCW listing all tariffs. We note, however, that Citizens Advice is now operating a non-

transactional PCW which lists all tariffs through a web-based service, which we believe will meet the needs of those customers who wish to see the whole of the market (and therefore do not propose to pursue a recommendation that Ofgem provide such a service).

Ofgem-controlled database of 'disengaged customers'

106. Around 70% of the customers of the Six Large Energy Firms are on the standard variable default tariff – ie a tariff that, for many, they did not actively choose. In our provisional findings report, we found that over 30% of the standard variable tariff customers of the Six Large Energy Firms had been on the standard variable tariff with the same supplier for more than five years.
107. In order to enable suppliers to prompt domestic customers of rival suppliers on default tariffs, our proposed remedy would require energy suppliers to disclose certain details of their domestic customers (on any meter type) who have been on their standard variable tariff (or any other default tariff) for three or more years (the 'Disengaged Domestic Customers') to Ofgem, and would recommend that Ofgem retain, use, and disclose this data (via a centrally managed database) to rival suppliers. The Disengaged Domestic Customers would have the option to opt out of the disclosure process at any point in time.¹¹
108. The aim of the proposed remedy would be to enable rival retail energy suppliers to identify the Disengaged Domestic Customers that have not opted out and prompt such customers to engage in the markets. The ultimate aim of this proposed remedy would be to partly address two of the features identified in the provisional findings report giving rise to the Domestic Weak Customer Response AEC (and resulting detriment), ie that domestic customers have limited awareness of, and interest in, their ability to switch energy supplier and that domestic customers face actual and perceived barriers to accessing and assessing information.
109. We recognise that there is a trade-off between the benefits of liberalising channels of engagement and the need to protect customers from excessive and/or misleading marketing. In respect of each of our proposed remedies to liberalise access to customer data, such data will only be available if customers actively choose to make it available (except in relation to communication with customers on the default tariff database, where

¹¹ In the design of this remedy, we have drawn on discussions with the Information Commissioner's Office concerning the implications of the Data Protection Act 1998 and the Privacy and Electronic Communications Regulations 2003.

customers will still have the right to opt out beforehand, and will only be contacted by post unless the customer agrees otherwise).

110. Any communications from suppliers will be subject to standards regarding the form they must take to ensure they are sufficiently clear and informative and a failure to comply with these standards may result in access to the database being withdrawn by Ofgem.

Remedies for customers on restricted meters

111. We believe that the above proposed remedies will help customers on any meter type engage effectively in retail energy markets. Further, to address the specific problems faced by customers on restricted meters in shopping around for better deals and in switching, we propose a set of additional remedies that: require all suppliers to make all their single-rate tariffs available to any domestic customer on any type of restricted meter, without making switching conditional on a restricted meter being replaced; and ensure that domestic customers on restricted meters have access to information on the options available to them.

The impact of smart meters on competition and engagement

112. The roll-out of smart meters to domestic customers is due to be completed by the end of 2020.
113. The introduction of fully-functional (SMETS 2) smart meters will address the technical constraints arising from the dumb prepayment infrastructure. Notably, the problems arising from tariff slots, and their allocation between suppliers, will cease to exist. We also consider that smart meters should address the specific barriers to engagement experienced by customers on restricted meters, although we note that smart meter equivalents are not currently available for all restricted meter types.
114. In relation to customer engagement more generally, we consider it likely that smart meters will help improve customer engagement by making the relationship between prices and consumption more visible and improving the accuracy of bills, although the extent of this effect is uncertain.
115. In view of the benefits of smart meters for competition and engagement, and more specifically for helping to address some of the features we have identified, we believe it is vitally important that the prescribed timetable for their roll-out is adhered to. Ofgem has the power to impose penalties on suppliers in the event that the prescribed timetables are not met and we would expect it to use these tools effectively to ensure that suppliers comply

with their obligation to take all reasonable steps to complete the roll-out by 2020.

Expected costs and benefits from our remedies package

116. We have considered the likely costs and benefits of our proposed remedies package, distinguishing between those measures that will have an effect solely during the transitional period of the smart meter roll-out and those that will have an enduring effect, particularly from around 2019/20 onwards.

Remedies that will have an effect solely during the transitional period

117. Some of our proposed remedies will apply only during the period before the completion of the roll-out of smart meters (end 2020) or earlier. These are: the remedies relating to the allocation of gas tariff pages; the remedies giving TPIs access to the SCOGES and ECOES database; and the remedies designed to improve engagement for customers on restricted meters.
118. We consider that the costs of implementation of the above remedies are very low. In relation to the first two, there would be a minimal administrative cost for Ofgem, Genserv and Xoserve respectively. In relation to the third, there would be a small additional cost for suppliers arising from the need to aggregate consumption volumes in different registers for the purposes of single rate billing.
119. Given the short space of time over which these remedies will be relevant and the inevitable lag between the implementing of the remedy, effectively addressing the feature and reducing detriment, we do not expect that these remedies alone will have very substantial effects in terms of reducing customer detriment. However, given the scale of the total customer detriment that we have identified for prepayment customers almost £500 million in 2015, and customers on restricted meters around £40 million in Q2 2015 even very small reductions in prices during the transitional period would lead to benefits that would far exceed any implementation costs.

Remedies that will have an enduring effect

120. The other remedies that we have proposed – settlement reform, the withdrawal of aspects of the simpler choices component of the RMR rules and the engagement remedies other than the transitional measures discussed above – would work together on an enduring basis as a package. We have accordingly considered their benefits jointly, while noting their

relative contribution to the package and identifying their costs, where material, on an individual basis.

121. We first assess costs and benefits for electricity settlement reform separately, as this reform has benefits in terms of load shifting that are additional to those of the package as whole (although we consider that they would also make a contribution to improving customer engagement).

Electricity settlement reform

122. There are potentially substantial savings from domestic peak load shifting, arising primarily from reductions in the cost of generation and distribution. One recent study estimated savings from the introduction of time-of-use tariffs within the domestic retail markets of between roughly £50 million and £100 million in 2020 and between roughly £100 million and £350 million a year by 2025.¹² Expected savings increase with the roll-out of automated and dynamic time-of-use tariffs (for which settlement reform is necessary) and with increased penetration of low carbon technologies. We note in relation to this latter factor that the demand and supply of heat pumps, smart appliances and electric vehicles will be driven in large part by the availability of opportunities to exploit within-day price differentials. Therefore we would argue that a move to half-hourly settlement will be a necessary step in achieving the higher end of potential benefits from demand-side response.
123. In terms of implementation costs, we consider that these will be very low or nil for distribution network operators and that half-hourly settlement will overall result in a reduction in costs for Elexon. Suppliers indicated to us that the reform would involve substantial upfront and ongoing costs, although we did not receive sufficient information from enough firms to build a consistent, robust picture of the likely costs.
124. Our recommendation is that Ofgem conduct a full cost-benefit analysis of the move to mandatory half-hourly settlement, but overall, and based on the evidence we have seen, there are good reasons to expect the benefits from half-hourly settlement to outweigh the costs of its implementation by a substantial degree.

Effect of the package on engagement

125. In relation to the rest of the package, we consider that the main enduring benefit will accrue from improving customer engagement and therefore

¹² Baringa and Element Energy (August 2012), *Electricity System Analysis – future system benefits from selected DSR scenario*.

overcoming the Domestic Weak Customer Response AEC. We note that, almost 15 years after full price liberalisation, around 70% of the customers of the Six Large Energy firms are on the default tariff, despite very large and growing potential gains from switching. Nevertheless, we believe that our reforms will succeed in improving engagement where other interventions have failed.

126. First, past interventions have been based largely on *a priori* reasoning, with little attempt systematically to test hypotheses through rigorous trials or other forms of testing before the intervention is implemented. *A priori* reasoning can provide useful insights into the sorts of interventions that may help, but rigorous evidence is needed to ensure that those interventions that are most likely to make a difference for given customers at a given point in time are implemented. The Ofgem-led programme that we proposed to recommend is therefore essential to ensure that future interventions are based on what works in practice.
127. Second, our proposed remedies seek to harness the incentives of TPIs and rival suppliers to unlock customer engagement, by giving them greater access to the data they need to perform this role more effectively and at lower cost. TPIs have grown considerably as an acquisition channel over the past few years and we believe that through our remedies they can continue to grow in importance, lowering acquisition costs for suppliers and lowering search costs for customers.
128. In relation to the Database remedy, we recognise that any proposal to free up access to customer data may be controversial, but we believe that such measures are necessary if customers who have not engaged for years are to consider switching in the future. We propose to put in place safeguards to ensure that such data is used appropriately.

Costs and benefits of engagement remedies

129. In relation to the costs of implementing the remedies, these are generally very low compared with the size of the detriment. For example, in relation to the Database remedy, we have estimated that the costs of setting up a secure cloud database in which to store details of the Disengaged Domestic Customers could be in the region of £50,000–100,000.
130. The largest cost would be imposed by the Ofgem-led programme, as it would require an ongoing system of testing and trialling interventions. We note that costs may vary substantially, depending on the size and complexity of the trial. In designing the programme and, in particular, the extent of any supplier participation that might be needed, we note that Ofgem will be

required to assess the proportionality of the various stages involved in the programme.

131. We believe that the benefits of our remedies will be seen in part through a reduction in the average gains from switching that go unexploited by customers. However, crucially, this would not be achieved by a levelling up of prices (a potential risk of regulatory interventions that seek to constrain price differences) but by a gradual reduction in prices towards the competitive benchmark level, as more efficient suppliers gain customers from the less efficient.
132. Given the size of the detriment we have identified (about £1.7 billion a year since 2012, with an upwards trend), it would only take a very small (less than 1%) reduction in this detriment to offset the costs of even a highly comprehensive, onerous set of trials conducted through the Ofgem-led programme. We believe that our package of remedies will be much more effective than this in reducing customer detriment on a sustained basis, and that it therefore represents an effective and proportionate response to the problems we have identified.

Transitional price cap for prepayment customers

133. We believe that competitive retail energy markets, in which energy suppliers operate free of inefficient technical and regulatory restrictions, and customers make informed decisions about the range of choices available to them, represent the best long-term approach to delivering positive outcomes for energy customers.
134. We have identified substantial problems on both the supply- and the demand-side of the retail energy markets, and we believe that our remedies package will provide a long-term solution to them, by putting downwards pressure on prices towards the competitive benchmark level.
135. However, our proposed remedies will take time to implement before they start to address the features that we have identified and, in turn, reduce the detriment to domestic customers arising from them. As a result, we expect that the detriment arising from the Domestic AECs we have provisionally identified will persist in substantial form for the next few years. Given the size of the detriment we have observed, of around £1.7 billion a year over the last three and a half years, with a marked increase in detriment year on year, we have therefore considered the need to intervene to address domestic customer detriment directly in this transitional period, through a price cap.

136. We have provisionally concluded that a price cap should apply to domestic customers on prepayment meters for a transitional period (2017 to the end of 2020). In reaching this provisional decision, we have given consideration to a number of factors, including: the strength of the features contributing to the Prepayment AEC and the Domestic Weak Customer Response AEC as it applies to prepayment customers; and the level of detriment suffered by prepayment customers.
137. The level of detriment suffered by prepayment customers is particularly high. Over the period 2012 to Q2 2015, detriment expressed as a proportion of the bill for prepayment customers was substantially higher than that for direct debit and standard credit customers for both dual fuel customers and single fuel electricity customers, as set out above. Further, we note that, unlike other customers, where prepayment customers pay too high a price, part of the detriment is likely to be felt in abruptly curtailed consumption.
138. We also consider that a cap covering a relatively restricted proportion of customers, such as prepayment customers (about 16% of the total customer base), is likely to be less prone to adverse consequences than a cap covering a broader group and that the use of an easily identifiable criterion for qualification (such as being on a prepayment meter) will help ensure that the remedy is easily implementable within a short period of time.
139. We have provisionally decided to implement a 'reference price and cost index approach' to set the cap for prepayment customers, which would involve setting an initial level of the prepayment cap based on our competitive benchmark analysis (as discussed above) and then allowing the cap to change over time according to movements in exogenous cost indices, including wholesale costs, network costs, policy costs and inflation.
140. In considering the design and stringency of the cap, we have been particularly mindful of the need to avoid distortions to competition, while reducing customer detriment. Notably the design – unlike alternatives we considered – does not lead to a risk of perverse incentives on the part of suppliers. Further, the fact that the cap is strictly time-limited and will be implemented according to an objective formula, will help minimise the risk of regulatory gaming behaviour.
141. In determining the overall level of the cap, we have provisionally decided to include headroom of £25 per fuel per year (ie £50 headroom in a dual fuel cap). This will mitigate the risk that the cap does not allow for the recovery of efficient costs and help ensure that competition in the prepayment segments can coexist with the cap. Indeed, the proposed level of the cap as of Q2 2015 is generally in line with the cheapest prepayment tariff prices in

many regions and we believe that it will be possible for competitive tariffs to undercut the level of the cap.

142. At the current proposed level, we anticipate that the cap will materially reduce detriment for prepayment customers. Had it applied in Q2 2015, it would have reduced prepayment customer detriment – and, equivalently, the revenues of the Six Large Energy Firms – by about £300 million per year, equivalent to a reduction in the average bills paid by prepayment customers of over 8%.
143. We note that the proposed price cap would also apply to Mid-tier Suppliers and smaller suppliers and will therefore result in revenue reductions outside of the Six Large Energy Firms. The extent of revenue reductions for each supplier will be determined by the level of detriment currently experienced (in the form of high prices) by their prepayment customers.
144. We anticipate that, as our remedies to address supply-side constraints and improve customer engagement begin to take hold towards the end of the cap, and as smart meter roll-out increases, competition rather than the cap will be determining the prices paid by most customers. There will therefore be a graduated glide path to the termination of the cap at the end of 2020.
145. While the detriment suffered by prepayment customers is particularly high, we note that other domestic customers will also suffer detriment during the transitional period before full implementation of our remedies, and have therefore given consideration to the application of a price cap to broader categories of customers, notably all customers on the standard variable tariff.
146. Our provisional view is that the costs of attempting to address the detriment of all customers on the standard variable tariff through a price cap would likely be disproportionate. We believe that attempting to control outcomes for the substantial majority of customers would – even during a transitional period – run excessive risks of undermining the competitive process, likely resulting in worse outcomes for customers in the long run. This risk might occur through a combination of reducing the incentives of suppliers to compete, reducing the incentives of customers to engage and an increase in the perception of regulatory risk.
147. Since, as noted above, a large part of the detriment we have observed in the form of high prices is likely due to inefficiency rather than excess profits, we believe the best, most sustainable approach to reducing this detriment in the long term is through fully competitive markets, in which more efficient suppliers gradually replace less efficient suppliers. Having considered very

closely both the short-term benefits to customers and the longer-term risks that a broader cap may create, set against the features of the Domestic Weak Customer Response AEC, we have therefore provisionally decided, on balance, not to propose an intervention to control prices across all customers on standard variable tariffs

Microbusiness retail remedies

148. In the provisional findings report, we found that a combination of features of the markets for the retail supply of gas and electricity to small and medium-sized enterprises (SMEs) in Great Britain gave rise to an AEC through an overarching feature of weak customer response from microbusiness customers. We said that this gave suppliers a position of unilateral market power over their inactive microbusiness customers, which the suppliers were able to exploit through their pricing policies or otherwise (the Microbusiness Weak Customer Response AEC).

Detriment suffered by microbusinesses

149. We have updated our analysis of the detriment arising from the Microbusiness Weak Customer Response AEC. Our revised estimate is that the profits in excess of the cost of capital earned by the Six Large Energy Firms from the supply of gas and electricity to SME customers amounted to approximately £280 million per year from 2007 to 2014,¹³ of which we estimate that approximately £230 million per year related to microbusiness customers.
150. We consider that this is a conservative estimate of detriment, as we have confined our estimate of detriment to a consideration of profits in excess of the cost of capital – that is, we have not included any estimate of inefficiency. We also note that we have not been able to conduct an analysis of supplier bills to produce an alternative, and more direct, estimate of detriment, as we have done for domestic customers.
151. Despite this conservative approach, we believe that the size of the detriment that we have identified is significant. The annual profits in excess of the cost of capital amounted to 6% of average annual microbusiness revenues for the Six Large Energy Firms from FY 2007 to FY 2014. This suggests that prices may have been on average 6% higher between FY 2007 to FY 2014 than would have been the case in a better-functioning market.

¹³ The years referred to are financial years.

Remedies for microbusinesses

152. We have assessed remedies for microbusiness customers considering the same strategic themes as for domestic customers: creating a framework for effective competition; helping customers engage; and protecting customers who are less able to engage to exploit the benefits of competition.

Creating a framework for effective competition

153. Our proposed remedies concerning the electricity and gas settlement systems, as discussed above, would also apply to microbusiness customers. In particular, the plan to move customers in profile classes 1 to 4 to mandatory half-hourly settlement in electricity would affect the majority of microbusiness customers (around 90% of which currently fall into profile classes 3 and 4). Similarly, the proposed remedy to increase the accuracy of the gas settlement system will benefit microbusiness as well as domestic customers.
154. The other remedies that we are proposing with a view to improving the framework for competition for domestic customers either affect very few microbusiness customers or do not apply at all in the microbusiness segments.

Helping microbusiness customers engage to exploit the benefits of competition

155. The main remedies we are proposing regarding microbusiness customers are those designed to help them engage to exploit the benefits of competition. These include remedies to:
- (a) increase price transparency;
 - (b) end auto-rollover contracts¹⁴ with certain restrictions (such as termination fees) that restrict microbusiness customers' ability to switch;
 - (c) establish a programme to provide microbusiness customers with information to prompt them to engage; and
 - (d) provide prompts to microbusiness customers on default contracts by enabling rival suppliers to contact them.

¹⁴ Auto-rollover contracts are fixed-term, fixed-price contracts that microbusiness customers can be moved onto if they fail to negotiate new terms when their existing contract comes to an end.

156. We believe that our engagement remedies will play a key role in addressing the features giving rise to the Microbusiness Weak Customer Response AEC, and the resulting customer detriment.

Price transparency remedy

157. The price transparency remedy would require suppliers to disclose the prices of all their available acquisition and retention contracts to a large proportion of their microbusiness customers. As an additional measure, it would also require suppliers to disclose their out-of-contract (OOC) and deemed contract prices on their websites. The measure in relation to acquisition and retention contracts would significantly increase microbusiness customers' abilities to access and assess price information. It would also facilitate the development of PCWs catering for microbusiness customers, which would further reduce the high search costs faced by microbusiness customers. As a result, the price transparency remedy would address barriers to accessing and assessing information experienced by microbusinesses.

Auto-rollover remedy

158. The auto-rollover remedy would address certain barriers to switching that microbusiness customers on auto-rollover contracts face by: (a) increasing the time window during which microbusiness customers would be able to give their termination notice to suppliers; and (b) prohibiting suppliers from including certain restrictions (prohibiting both termination fees and the use of no-exit clauses).
159. Our proposed remedies will also prohibit termination fees in relation to evergreen and OOC contracts. This measure, together with the measure to prohibit termination fees in relation to auto-rollover contracts, would effectively ensure that suppliers would not be permitted to charge termination fees on default contracts with their microbusiness customers, thereby reducing the barriers to switching for microbusiness customers on evergreen and OOC contracts.

Programme to provide microbusiness customers with information to prompt them to engage/Database remedy

160. The remedies to establish a programme to identify additional (or new) information from suppliers to prompt microbusiness customers to engage, and to disclose the details of their most disengaged microbusiness customers to rival suppliers would increase the engagement of microbusiness customers on default contracts. By incentivising microbusiness customers to

engage, we would expect the competitive constraint on energy suppliers to increase. This would incentivise suppliers to reduce the prices of their available acquisition and retention contracts for microbusiness customers.

Protecting customers who are less able to engage to exploit the benefits of competition

161. We have also considered the case for introducing a price cap for microbusiness customers on prepayment meters. We have provisionally decided not to do so, on the grounds that the costs associated with implementing a price cap for the microbusiness segments would be large relative to the potential benefits, which would accrue to a very small number of microbusiness customers (less than 1% of whom are on prepayment meters).

Costs and benefits of the remedies package

162. In developing our proposed remedies, we have been mindful to ensure that they work together as a coherent package, which, as a whole, provides an effective and proportionate means of addressing the Microbusiness Weak Customer Response AEC, and the resulting customer detriment.
163. We have considered whether the benefits of the remedies package as a whole would be likely to exceed the overall costs of the package.
164. In relation to costs, we estimate that the price transparency remedy would be likely to impose a one-off cost on the Six Large Energy Firms of approximately £750,000; and on all suppliers these costs could amount to approximately £4.5 million if they all adopted the more expensive online quotation tool option. We do not expect the auto-rollover remedy to impose substantial costs on suppliers, and we estimate that the costs of extending the remedy that would enable prompts to microbusiness customers on default contracts to the microbusiness segments would be minimal for suppliers.
165. The costs of the Ofgem-led programme may be more substantial but we note that, in designing the programme and, in particular, the extent of any supplier participation that might be needed, Ofgem will be required to assess the proportionality of the various stages involved in the programme.
166. In relation to benefits, we consider that there is substantial scope for price reductions and that the remedies would still be proportionate if they led to only a small reduction in prices for microbusiness customers. On the basis of our profitability analysis, we consider that prices for the microbusiness

customers of the Six Large Energy Firms could have been on average 6% lower between FY 2007 and FY 2014 in a better-functioning market, equivalent to £230 million a year – and we expect a material reduction in prices from the introduction of our remedies.

167. We have therefore concluded that the benefits of the remedies package for all microbusiness customers are likely to substantially exceed the costs that it would impose on all suppliers in the microbusiness segments.

Remedies relating to the governance of the regulatory framework

168. Efficient and robust rules and regulations are fundamental to well-functioning energy markets. In the provisional findings report, we provisionally identified a number of features of the regulatory framework governing energy markets that led to AECs. We found in particular that these features were likely to increase the risk of policies being developed in the future that are not in customers' interests and inhibit the development of policies that are in their interests.
169. In relation to the governance of the broader regulatory framework, we have provisionally found that:
- (a) Ofgem's statutory objectives and duties may constrain its ability to promote effective competition;
 - (b) there is a lack of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making and implementation can be addressed transparently;
 - (c) the impact of government and regulatory policies over energy prices and bills has not been effectively communicated; and
 - (d) there is a lack of a regulatory requirement for clear and relevant financial reporting concerning generation and retail profitability.
170. As regards the governance of industry codes, where many of the detailed rules underpinning market operation are specified, we have provisionally found that parties have conflicting interests and/or limited incentives to promote and deliver policy changes and that Ofgem has insufficient ability to influence the code modification process.

Detriment arising from problems in the regulatory framework

171. The problems we have identified relate to the processes, structures and institutions involved in regulatory decision-making in the energy sector. They

are systemic in nature, having an impact across all of the energy markets that we have identified. While the detriment arising from these provisional AECs is, by its nature, difficult to quantify, we consider that it is likely to be very substantial.

172. First, the costs of energy policies – the transfers and subsidies put in place to achieve government policy objectives such as reducing greenhouse gas emissions – will comprise an increasing proportion of customers' energy bills. On the basis of current announced plans, DECC estimates that climate and energy policies will add 37% to the retail price of electricity paid by households in 2020.¹⁵ Further, some policies – such as the roll-out of smart meters – are expected to improve energy efficiency and hence reduce energy bills. Given the central role that government policies are expected to play in determining energy bills in the future, we believe it is vital that policy decisions are robust, and informed by a transparent analysis of their impacts on customers.
173. Second, energy markets are highly regulated, and the nature of competition in these markets is shaped by the design of the regulatory regime to a much greater extent than in most other markets. This is particularly the case for wholesale markets, which currently comprise around 50% of the costs faced by electricity and gas customers, and where the nature and size of technological and regulatory changes expected over the next few years are substantial. We also note that many of the competition problems that we have identified in the retail energy markets – the settlement systems for gas and electricity, which fail to give suppliers the right incentives, the introduction of the RMR simpler choices reforms, which have stifled innovation – are regulatory in nature, reflecting specific provisions in legislation, licence conditions and industry codes.

Package of remedies

174. We have developed a package of proposed remedies designed to improve the governance of the regulatory framework. The proposed remedies relate to five specific areas: Ofgem's duties and objectives; the relationship between DECC and Ofgem; the analysis of the impacts of policy and regulation; the regime for financial reporting; and governance of the industry codes.
175. While the proposed package is broad, affecting the full range of regulatory instruments and processes (legislation, licence conditions and industry

¹⁵ 2014 prices. Source: DECC (November 2014), [Estimated impact of energy and climate change policies on energy prices and bills](#).

codes), it is based on a simple set of principles, which recognise the importance of: well-defined powers and objectives aligned with the interests of customers; clear responsibilities and transparent, coordinated implementation; robust analysis underpinning decision-making and improving transparency; and an independent and authoritative regulator.

Ofgem's duties and objectives

176. Our provisional view is that Ofgem's statutory objectives and duties may, in certain circumstances, constrain its ability to promote effective competition. In particular, Ofgem told us that it considered that its duty to pursue its principal objective by 'wherever appropriate promoting effective competition' had been progressively downrated relative to other duties over the last ten years.
177. Our proposed remedy is a recommendation to DECC to amend primary legislation in order to clarify Ofgem's statutory objectives and duties and thereby remove any constraint (actual or perceived) on Ofgem's ability to pursue its principal objective (protecting the interests of existing and future customers) by promoting effective competition where it considers this appropriate.

Relationship between DECC and Ofgem

178. DECC and Ofgem have complementary and, in some cases, overlapping responsibilities in relation to regulatory and policy development in the energy sector. In some cases, the implementation of a particular energy policy requires a combination of measures taken by DECC (mainly through legislation), Ofgem (mainly through licence conditions) and indeed the industry (through the amendment of codes).
179. We have two concerns regarding the relationship between DECC and Ofgem. First, we noted in our provisional findings report that two of Ofgem's most important decisions in recent years (neither of which we consider to have benefited customers)¹⁶ were taken against a backdrop of DECC taking powers – or stating its readiness to take powers – to implement changes in primary legislation in the event that Ofgem did not act, and that the coincidence of DECC's and Ofgem's actions risked creating the perception of a lack of independence on the part of Ofgem. Second, we identified inefficiencies in the implementation of certain policy objectives (for example,

¹⁶ The introduction of the simpler choices component of the RMR reforms in 2013 and of Standard Licence Condition 25A in 2009, prohibiting regional price discrimination.

the introduction of 17-day switching and half-hourly settlement for certain categories of customer) due to a lack of effective coordination.

180. We propose two remedies that are designed to recalibrate the relationship between DECC and Ofgem in a way that recognises Ofgem's independence while allowing for appropriate coordination of activities to deliver overarching policy goals:
- (a) First, we propose to recommend legislation to establish a clear process requiring Ofgem to publish opinions on all draft legislation and policy proposals that are relevant to its statutory objectives and that are likely to have a material impact on the GB energy markets.
 - (b) Second, we propose to recommend to DECC and Ofgem that they publish detailed joint statements setting out action plans for the implementation of proposed DECC policy objectives that are likely to necessitate Ofgem interventions, with clear responsibilities and timetables.

Transparent analysis of the impacts of policy and regulation

181. As noted above, government policies are having an increasing impact of energy bills and yet we have provisionally found that there is a lack of effective communication concerning the forecast and actual impact of government and regulatory policies on energy prices and bills. This has led to a lack of trust between stakeholders and is one of the features contributing to an overarching feature of a lack of robustness and transparency in regulatory decision-making.
182. To help address this, we propose to recommend to Ofgem that it publish annually a state of the market report which would provide analysis regarding issues such as the evolution of energy prices and bills over time; the profitability of key players in the markets; the social costs of policies and distributional impacts arising from them; and the impact of initiatives relating to decarbonisation and security of supply. We also propose to recommend the creation of a team within Ofgem to take this work forward.

Regime for financial reporting

183. We have provisionally found that current regulatory requirements do not provide for clear and relevant financial reporting of generation and retail profitability. Our proposed remedy seeks to address this, and in so doing to help ensure that Ofgem will be better placed in the future to make decisions using relevant financial information and to provide a clear and trusted

assessment of the GB energy markets. This in turn should inform the public debate and support the development of appropriate policies.

184. Our proposed remedy will require the Six Large Energy Firms to:
- (a) report their generation and retail supply activities on market rather than divisional lines;
 - (b) report a balance sheet as well as a profit and loss account separately for their generation and retail supply activities;
 - (c) disaggregate their wholesale energy costs for retail supply between a standardised purchase opportunity cost and a residual element; and
 - (d) report prior year figures prepared on the same basis.
185. We propose to implement this remedy by means of a recommendation to Ofgem to introduce relevant changes in the licence conditions of the Six Large Energy Firms.

Governance of industry codes

186. Industry codes are multilateral agreements that define the terms under which industry participants can access the electricity and gas networks, and the rules for operating in the relevant markets. Industry participants have a key role in the governance of these codes, and, under the current regime, proposed reforms that can have substantial impacts on competition and the delivery of policy objectives are implemented through code changes (the proposals to introduce half-hourly settlement and cash-out reforms are recent examples).
187. In our provisional findings report, we provisionally found that the current system of industry code governance limits innovation and pro-competitive change and causes the energy markets to fail to keep pace with relevant policy objectives. We found that this was due in particular to:
- (a) parties' conflicting interests and/or limited incentives to promote and deliver policy changes; and
 - (b) Ofgem's insufficient ability to influence the development and implementation phases of a code modification process.
188. Current governance structures give industry participants a key role in decision-making even though their incentives are often not aligned with those of customers. Further, we note that incentives often differ between firms, leading to lengthy and costly regulatory processes and delays in

decision-making. Examples of this include the long-running deliberations over whether to introduce locational charges for transmission losses over the past 25 years and discussions regarding gas settlement reform.

189. We are also surprised to note that some decisions that appear to us to be fundamental to ensuring effective competition and meeting the needs of customers appear to be loosely governed under the industry codes, and not to have involved any formal role for Ofgem. For example, in relation to competition for customers on prepayment meters we understand, based on the relevant provisions set out in the Supply Point Administration Agreement, that there are no formal mechanisms in place to monitor the allocation of gas tariff pages and to govern the distribution of tariff pages between suppliers. This is of particular concern since the lack of access to gas tariff pages has been one of the factors inhibiting new entry into the prepayment segments, to the detriment of prepayment customers.
190. Our proposed remedy will see Ofgem taking a more proactive role in code development, by setting a Strategic Direction and engaging actively in the code modification process through its influence over licensed code bodies. Further, we recommend that Ofgem take powers to initiate code modifications where these are necessary to deliver the Strategic Direction and be given powers to take substantive control of any ongoing strategically important modification proposals, as appropriate.
191. We propose to recommend to DECC that it seek to pass legislation: giving Ofgem the ability directly to modify industry codes in certain exceptional circumstances; and making the provision of code administration and delivery services activities that are licensed by Ofgem. This will give Ofgem a means of requiring code bodies to take on an expanded role to deliver code modifications consistent with the Strategic Direction.

Overview of the proposed new regulatory framework

192. Our proposed remedies are individually incremental but in combination represent a substantial reform package. They represent a 'reset' of the regulatory framework governing the energy sector, clarifying and recalibrating the roles and responsibilities of Ofgem, DECC and industry to help ensure that regulatory and policy decisions in the future are robust, efficient and timely, and driven by a concern for the interests of current and future customers.
193. Ofgem will be at the heart of this new regulatory framework, with a simpler and clearer focus on the interests of customers, an additional role to scrutinise and comment on government policies, greater access to relevant

financial information from industry and greater powers to drive through changes to industry codes when these are needed to meet broader policy objectives and are in the interests of customers and competition.

194. We believe that the individual elements of our remedies package are mutually reinforcing. For example, the roles given to Ofgem to comment on and scrutinise the impacts of government policies on the one hand, and undertake greater scrutiny of companies' financial returns on the other, will help both to:
- (a) improve the robustness of the decision-making process, the quality of regulatory decisions and transparency in public debates about energy; and
 - (b) bolster the perception of Ofgem as an authoritative, trusted and independent regulator, consistent with the greater responsibilities it will have in relation to code governance and reform.
195. We consider that our proposed reforms are fully consistent with the government's *Principles for Economic Regulation*¹⁷ and its *Better Regulation Framework Manual*.¹⁸ In particular, our proposed remedies should ensure that new policy proposals and existing policies and regulations are subject to robust scrutiny in terms of their costs and benefits. Further, our proposed remedies relating to the code governance process and mechanisms to improve coordination between DECC and Ofgem should serve to streamline and rationalise the policymaking process, reducing overall regulatory burdens.

Dissenting view

196. One panel member, Martin Cave, felt that the provisional retail remedy package was unlikely to succeed in reducing, in a timely way, the significant level of detriment identified. In his current view, a short-term price cap, covering a substantially larger number of customers, is required to reset the market.

Provisional decision on remedies

197. A comprehensive list of remedies is provided in Section 11 of this report.

¹⁷ BIS (April 2011), [Principles for Economic Regulation](#).

¹⁸ BIS (March 2015), [Better Regulation Framework Manual: Practical Guidance for UK Government Officials](#).

Provisional decision on remedies

1. Introduction

Background on reference and investigation

- 1.1 On 26 June 2014, the Gas and Electricity Markets Authority in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the 2002 Act) (as provided for by section 36A of the Gas Act 1986 (GA86) and section 43 of the Electricity Act 1989 (EA89)), made an ordinary reference to the Chair of the Competition and Markets Authority (CMA) for the constitution of a group under Schedule 4 to the Enterprise and Regulatory Reform Act 2013 for an investigation into the supply and acquisition of energy in Great Britain.
- 1.2 In our provisional findings report, a summary of which was published on 7 July 2015, and in the addendum to provisional findings (the Addendum), published on 16 December 2015, we provisionally found that there are a number of features of the markets for the supply of energy in Great Britain that, on their own or in combination, give rise to adverse effects on competition (AECs) within the meaning of section 134(2) of the 2002 Act.
- 1.3 Where the CMA finds that there is an AEC, it has a duty to decide whether it should take action itself and/or whether it should recommend others to take action to remedy, mitigate or prevent the AEC or any resulting detrimental effects on customers. If the CMA decides that such action is appropriate it must also decide what action should be taken and what is to be remedied, mitigated or prevented. In deciding these questions the CMA has a duty to achieve as comprehensive a solution as is reasonable and practicable to the AEC and any resulting detrimental effects on customers.
- 1.4 We published a notice of possible remedies (Remedies Notice) with the provisional findings report on 7 July 2015, a supplemental notice of possible remedies on 2 October 2015 and a second supplemental notice of possible remedies on 16 December 2015 (together, the Remedies Notices). These set out a number of measures that we considered could address the AECs, and the resulting detrimental effects, and invited comments from all interested parties.
- 1.5 We received a large number of responses to our Remedies Notices and have held response hearings and meetings with relevant parties. Non-confidential versions of such responses and summaries of response hearings held can be found on our [webpages](#). We commissioned further research from NERA Economic Consulting with respect to transmission

losses and Ipsos MORI in relation to any potential barriers faced by tenants to engaging in the retail domestic energy market. These pieces of research are published as Appendix 2.2 and Appendices 6.5 to 6.7 of this document.

- 1.6 This document, together with its supporting appendices, constitutes our provisional decision on remedies required to remedy the AECs and the resulting customer detriment we have provisionally found, and serves as a basis for further consultation with interested parties. Our provisional decision has been reached based on our consideration of all the evidence we have received to date through the course of our inquiry.
- 1.7 We have not, at this stage, made a final decision regarding the existence and form of any AEC and/or resulting customer detriment. Our provisional decision therefore proposes remedies that address the AECs as set out in our provisional findings and as supplemented by the Addendum. In some areas our assessment of the features leading to AECs and the detriment arising from AECs has developed and where this is the case we set out our updated analysis in this document, for the purposes of assessing the proportionality of potential remedies. Our final decision on any AEC, and appropriate remedies, will take into account all evidence received and submissions made including the responses to our provisional findings and provisional decision on remedies.
- 1.8 Interested parties should provide any views on the analysis and proposed remedies in this provisional decision in writing no later than 7 April 2016. We are required to publish our final report by 25 June 2015.

Summary of provisional findings

- 1.9 Our current view, as set out in our provisional findings report and the Addendum, is that a number of features, on their own or in combination, give rise to AECs in the markets for the generation and retail supply of electricity and gas in Great Britain. Where our thinking has developed in light of parties' responses to our provisional findings report and the Addendum, this is set out in Sections 2 to 10.

Framework for the assessment of remedies

- 1.10 Having identified in our provisional findings report and the Addendum a number of features of the markets for energy generation and supply in Great

Britain that give rise to the AECs, we are required to decide the following additional questions:¹⁹

- (a) whether action should be taken by the CMA for the purpose of remedying, mitigating or preventing the AEC concerned or any detrimental effect on customers so far as it has, or may be expected to result from, the AEC;
- (b) whether the CMA should recommend the taking of action by others for the purpose outlined in paragraph 1.12) above; and
- (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.

1.11 A detrimental effect on customers includes such an effect on future customers and is defined as one taking the form of:²⁰

- (a) higher prices, lower quality, or less choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or
- (b) less innovation in relation to such goods and services.

1.12 In choosing appropriate remedial action, we have had regard to our statutory obligation to achieve as comprehensive a solution to the AECs we have provisionally identified and any resulting detrimental effect on customers as is reasonable and practicable.²¹ In light of this requirement, we have considered how comprehensively the proposed remedies (and packages of remedies) set out in this document would address the AECs we have provisionally identified and resulting detrimental effects on customers. Pursuant to our guidelines, we have sought to identify remedies that address the causes of the AEC directly. However, where this is not possible, or as an interim solution, we have proposed to introduce measures to mitigate the harm to customers created by the AEC.

1.13 In deciding what remedies would be appropriate, we have looked for remedies that would be effective and proportionate in achieving their aims. The CMA has made several general observations in its guidance about factors relevant to its consideration of effectiveness and proportionality.²²

¹⁹ Section 134(4) of the 2002 Act.

²⁰ Section 134(5) of the 2002 Act.

²¹ Section 134(6) of the 2002 Act.

²² [Guidelines for market investigations: Their role, procedures, assessment and remedies \(CC3\)](#), paragraphs 334–344.

- 1.14 Some of the proposed remedies set out in this document would require a modification to certain licence conditions. Pursuant to section 168 of the 2002 Act, where relevant in proposing these remedies we have had regard to Ofgem's statutory functions.
- 1.15 In reaching a judgement about whether to propose a particular remedy, we have also considered the potential effects on those persons most likely to be affected by it, generally customers and the businesses subject to the remedies. We have sought to assess the impact of our remedies in accordance with the relevant considerations set out in our guidelines.²³ In particular, we have sought to quantify the costs and benefits associated with a remedy where it is reasonably practical to do so, taking into account any relevant customer benefits arising from the adverse feature or features of the market concerned.²⁴ In practice, our proposed remedies consist in several discrete actions to be taken by the CMA and several discrete recommendations to other public bodies.
- 1.16 Where we propose to make recommendation, we have had regard to the relevant considerations set out in our guidelines.²⁵ We have noted that, while it will be for the person to whom the recommendation is addressed to decide whether to act on the recommendation, the government has made a commitment to give a public response to any recommendation made to it within 90 days of the publication of a CMA report. As per our guidelines, we will consult with the relevant body prior to making the recommendation.²⁶

Excisions and confidentiality

- 1.17 We have excluded from this published version of the provisional decision on remedies certain information submitted to us within the context of this investigation (ie specified information, as defined in Part 9 of the 2002 Act). Within this context, we have considered parties' views on the confidentiality of such specified information; whether disclosing this information would facilitate the CMA's statutory functions; and the duty to have regard to the considerations set out in section 244 of the 2002 Act.²⁷

²³ CC3, paragraphs 348–353.

²⁴ Section 134 (7) and (8) of the 2002 Act.

²⁵ CC3, paragraphs 379, 380, 390 & 391.

²⁶ CC3, paragraph 380.

²⁷ These relevant considerations are:

- The need to exclude from disclosure (so far as practicable) any information whose disclosure we think is contrary to the public interest.
- The need to exclude from disclosure (so far as practicable) commercial information whose disclosure the authority thinks might significantly harm the legitimate business interests of the undertaking to which it relates, or information relating to the private affairs of an individual whose disclosure the authority thinks might significantly harm the individual's interests.
- The extent to which the disclosure of the information mentioned in subsection (3)(a) or (b) above is necessary for the purpose for which the authority is permitted to make the disclosure.

- 1.18 In addition, we have also decided to exclude from the published version of this document the identity of parties with respect to certain results of our analysis of prices and bills, including our analysis of the gains from switching and the detriment suffered by domestic customers. We consider that it is desirable to disclose some of these results (with the identity of the relevant parties), where already publicly available, so that the main issues concerning our investigation are identified. However, we wish to give an opportunity to these parties to comment on the accuracy of our analysis and interpretation prior to any such publication. In reaching this view, we considered the impact that publication of inaccurate or misleading results may have on the parties' business interests.
- 1.19 We currently propose, subject to parties' further submissions, to make the identity of the relevant parties available to the public in our final report.

Dissenting view

- 1.20 One panel member, Martin Cave, felt that the provisional retail remedy package was unlikely to succeed in reducing, in a timely way, the significant level of detriment identified. In his current view, a short-term price cap, covering a substantially larger number of customers, is required to reset the market.

Structure of our provisional decision

- 1.21 As noted above, we have provisionally identified a wide range of features of the energy markets in Great Britain that give rise to AECs. We have organised our discussion of our proposed remedies to these features into the following sections:
- (a) In Section 2, we set out our proposed remedies to address the features identified in the wholesale electricity market.
 - (b) In Section 3, we present an updated analysis of the relative strength of the features contributing to AECs in the retail energy markets and an updated analysis of the detriment suffered by domestic energy customers.
 - (c) In Sections 4 to 8, we set out our remedies to address the features identified in the domestic retail energy markets, and in particular:
 - (i) in Section 4 we provide an overview of our proposed remedies package, highlighting key strategic themes, timescales for implementation and expected costs and benefits;

- (ii) in Section 5, we set out our proposed remedies designed to help create a framework for effective competition in the domestic retail energy markets;
 - (iii) in Section 6, we set out our proposed remedies designed to help domestic consumers engage to exploit the benefits of competition;
 - (iv) in Section 7, we set out our proposed remedy designed to protect domestic customers who are less able to engage to exploit the benefits of competition, through the introduction of a price cap for customers on prepayment meters; and
 - (v) in Section 8, we present our assessment of the effectiveness and proportionality of the package of remedies in the domestic retail energy markets.
- (d) In Section 9, we set out our proposed remedies to address the features identified relating to microbusiness customers.
- (e) In Section 10, we present our proposed remedies relating to the governance of the regulatory framework and industry codes governance.
- (f) In Section 11, we present our provisional decision on remedies, which provides a comprehensive list of all our proposed remedies.

2. Wholesale electricity market rules and regulations

- 2.1 The wholesale price of electricity represents just under half the total cost of supplying electricity to customers, and it is therefore vital, in the interests of ensuring that the overall prices paid by customers are competitive, to ensure that competition operates well in the wholesale market.
- 2.2 In our provisional findings report, we considered a range of aspects of electricity wholesale market design and operation. Generally we found that the wholesale electricity market appears to be working well. In particular:
- (a) generating plant appears to be dispatched in merit order, minimising short-term generating costs; and
 - (b) our provisional view was that our analysis of profitability does not provide evidence that overall, the Six Large Energy Firms earned excessive profits from their generation business over the period or that wholesale market prices were above competitive levels.
- 2.3 However, we provisionally identified two aspects of the regulatory regime governing wholesale market operation that led to AECs:
- (a) the absence of locational charging for transmission losses; and
 - (b) the mechanisms for allocating CfDs.
- 2.4 In this section, we set out our proposed remedies to each of the AECs we have provisionally identified. While the proposed remedies are quite different, they have a similar high-level objective: to help ensure that competitive pressures are brought fully to bear on wholesale cost of electricity, helping to reduce the prices paid by electricity customers.

Locational adjustments for transmission losses

- 2.5 In our provisional findings report, we described the way in which variable transmission losses are priced. We noted that, due to the limits of the transmission network, electricity that is transported from one part of the country to another incurs losses, and the greater the distance travelled, the higher the losses. The costs of losses therefore vary considerably by geographical location – in an area with relatively low levels of demand and high levels of generation, for example, consuming electricity will be associated with low losses and generating electricity will be associated with high losses.

- 2.6 However, despite this locational variation in the costs of losses, under the current regulatory regime, these costs are allocated to generators and customers in a way that takes no account of their geographical location. It follows that there are currently situations in which electricity could be generated at lower avoidable costs (ie incurring lower losses), but that this does not happen because generators do not, under the current market design, bear the incremental avoidable costs of the losses that their production is responsible for.
- 2.7 We have provisionally found that the absence of locational pricing for variable transmission losses is a feature of the wholesale electricity market in Great Britain that gives rise to an AEC, as it is likely to distort competition between generators, raise bills to customers and is likely to have both short- and long-run effects on generation and demand:
- (a) In the short run, costs will be higher than would otherwise be the case, because cross-subsidisation will lead to some plants generating when it would be less costly for them not to generate, and other plants, which it would be more efficient to use, not generating. Similarly, cross-subsidies will result in consumption failing to reflect fully the costs of providing the electricity, although we would expect this effect to be small compared to the supply-side effect.
 - (b) In the long run, the absence of locational pricing may lead to inefficient investment in generation, including inefficient decisions over the extension or closure of plant. There could also be inefficiency in the location of demand, particularly high-consumption industrial demand.
- 2.8 We noted that modelling conducted to inform consideration of a recent proposal to introduce locational charges for losses suggested that the current mechanism of averaging the cost of transmission losses irrespective of location added costs of approximately £160 million to £275 million (on a net present value basis) to the system over a ten-year period.²⁸ In our provisional AEC finding, we also noted that we had seen no evidence to suggest that such a reform might lead to a net loss of efficiency.
- 2.9 We also noted that proposals to modify the relevant industry codes in order to introduce locational charges for transmission losses had been raised in

²⁸ The cost-benefit analyses were undertaken in relation to the P229 modification proposal by LE/Ventyx (for Elexon) and Redpoint (for Ofgem), while a third group of experts, Brattle, reviewed the LE/Ventyx work for Ofgem. The analyses reported a ten-year net present value benefit from the introduction of locational pricing for transmission losses of between £160 million (Redpoint) and £275 million (LE/Ventyx), arising from an average annual reduction in losses of 211 GWh (equivalent to about 5% of losses).

the past. The last time a modification proposal was submitted to Ofgem (Balancing and Settlement Code (BSC) modification proposal P229, September 2011), Ofgem concluded that the proposed modification would not be consistent with its principal objective and statutory duties.²⁹ In its decision, Ofgem recognised however that P229 would have led to more efficient dispatch decisions due to cost signals allowing variable losses to be taken into account. This in turn would have led to production cost savings, reduced losses and reduced emissions. It also stated that, in general, competition was likely to be more effective if the costs which parties impose were reflected in their charges and therefore their decision-making process. Ofgem found that, on balance, the improvements in cost reflectivity in the P229 proposals would help create a better level playing field for generators. It also noted that not all generators needed to be able and willing to respond to achieve the benefits of the proposal.

2.10 However, Ofgem concluded that it could not satisfy itself that the implementation of P229 was in the best interest of existing and future customers. Specifically, Ofgem was concerned by:³⁰

- (a) the large distributional impact both between individual generators and between suppliers/customers, although Ofgem acknowledged that these distributional impacts might be justified by the longer-term benefit from a more efficient, cost-reflective market (we discuss in more detail this point in paragraphs 2.59 to 2.61 below);
- (b) the uncertainty around long-term benefits of this intervention, due to the changing regulatory environment; it noted in particular:
 - (i) a debate at EU level for greater integration of electricity markets focused on market-splitting approaches that create multiple price areas within a national system which could have superseded P229 before the full benefits had been realised, possibly as soon as 2015; and
 - (ii) in the UK, changes to the incentives for the construction of new generating capacity in Great Britain that the government was considering at the time, which may have resulted in some change to the existing GB market arrangements in the medium term that would have undone the benefits of the P229 proposals before any long-term market efficiencies had been realised;

²⁹ Ofgem modification proposal decision (September 2011), [Balancing and Settlement Code \(BSC\) P229: Introduction of a seasonal Zonal Transmission Losses scheme \(P229\)](#).

³⁰ *ibid*, pp6–7.

- (c) the modest benefits arising from P229 in the short term (ie two years from implementation).
- 2.11 As noted in paragraphs 5.62 and 5.63 of our provisional findings report, we have found it difficult to reconcile Ofgem's decision with the evidence and analysis it commissioned and summarised in its impact assessment:
- (a) Specifically on distributional impacts (paragraph 2.10(a)), Ofgem's consultants did not suggest that significant redistribution from customers to generators was likely.
- (b) With respect to the long-term benefits of the proposed policy (paragraph 2.10(a)), we understand that Ofgem's concerns were linked to one of the EU network codes, ie the Capacity Allocation and Congestion Management regulation (which at the time of Ofgem's decision was in an early stage of development) as well as changes to the incentives for the construction of new generating capacity (ie the capacity market). However, this EU network code entered into force in August 2015 and does not contain provisions that in our view would prevent, or undermine, the mechanism set out in our proposed remedy. Further, we have not seen any evidence to suggest that P229 or our remedy would be incompatible with the capacity market currently being implemented by DECC.
- 2.12 Therefore, in view of these recent developments, we believe that longer-term benefits are relevant to assessing the impact of the introduction of transmission charges for losses on existing and future GB customers. For the reasons set out in this section, taking into account both long-term impacts and distributional effects, we believe that the introduction of transmission charges for losses would be in the best interests of existing and future customers.
- 2.13 In our Remedies Notice, we identified a potential proposed remedy, which would involve introducing in relevant standard licence conditions a new condition to require that variable transmission losses are priced on the basis of location in order to achieve technical efficiency.

Aim of the proposed remedy

- 2.14 The aim of this proposed remedy is to improve the accuracy with which the avoidable costs of variable transmission losses are borne by those who cause them, thus reducing waste, reducing the cost of electricity generation, and ultimately reducing total bills to end customers. Ultimately, then, the aim

of this proposed remedy is to address comprehensively the feature set out in paragraph 2.7 above, and the detriment associated with it.

Parties' views on the proposed remedy

- 2.15 We received responses from parties including the Six Large Energy Firms, the Mid-tier Suppliers,³¹ independent power generators,³² National Grid and consumer groups.³³ In particular parties said the following in relation to whether this remedy would be effective and proportional:
- (a) Some of the Six Large Energy Firms,³⁴ some Mid-tier Suppliers,³⁵ Ofgem³⁶ and one independent power generator³⁷ supported the principle of introducing locational pricing for variable transmission losses. E.ON³⁸ and RWE³⁹ considered that the latest code modification proposal, P229, for the introduction of locational pricing for losses provided a solution with a net predicted benefit and that it could be implemented relatively easily, as the parameters needed for its introduction were already contained in the BSC.
 - (b) RWE submitted a new set of simulation scenario results showing that, under certain input and methodological assumptions, charging for losses would yield a net present value of net benefits in the hundreds of millions of pounds.⁴⁰
 - (c) Scottish Power agreed that the introduction of locational pricing for variable transmission losses merited further consideration.⁴¹
 - (d) Ofgem⁴² and some of the Six Large Energy Firms,⁴³ however, considered that the empirical evidence supporting the remedy needed to be updated to reflect changes in market conditions (since P229) before a final conclusion was reached. They considered that a cost-benefit

³¹ In particular First Utility, Ovo Energy, Good Energy, Co-operative Energy and Ecotricity.

³² Eggborough Power and Intergen.

³³ Which? and Citizens Advice.

³⁴ Centrica response to provisional findings and Remedies Notice, p51; E.ON response to provisional findings, p3, paragraph 13; RWE response to provisional findings, p2 paragraphs 50–54;

³⁵ Co-operative Energy response to RN, p1; Ovo Energy response to Remedies Notice, p10; Good Energy response to Remedies Notice, p4.

³⁶ Ofgem response to Remedies Notice, p1.

³⁷ Intergen response to Remedies Notice, p4;

³⁸ E.ON response to Remedies Notice, p10.

³⁹ RWE response to Remedies Notice, p19.

⁴⁰ RWE's submission to the CMA, 3 September 2015.

⁴¹ Scottish Power response to Remedies Notice, p2, paragraph 1.1.

⁴² Ofgem response to Remedies Notice, p1.

⁴³ EDF Energy response to provisional findings, p9; Centrica response to provisional findings and Remedies Notice, p51;

analysis should be conducted and that it should take into account distributional impacts.

- (e) EDF Energy supported the principle of cost-reflectivity, and agreed that locational pricing for losses might theoretically result in lower costs for customers. However, it was not convinced that a locational losses scheme would bring customer benefits in practice, because of uncertainty about the exact method to be adopted; real future market scenarios; and the actual responses of participants to such a scheme. It also questioned the proportionality given the large distributional effects compared with net benefits.⁴⁴
- (f) SSE, instead, said that the CMA had not made the case to support the introduction of locational pricing of transmission losses adequately and considered that the proposed remedy was disproportionate to the potential advantages that had been identified. It considered the analysis and modelling of benefits for locational pricing of transmission losses described in the preliminary findings to be unsound.⁴⁵ Other suppliers (Haven Power,⁴⁶ Ecotricity,⁴⁷ Dong Energy⁴⁸) also did not support the remedy. Haven Power, in particular, said that the remedy was disproportionate and would have few benefits for customers.
- (g) Scottish Power⁴⁹ considered that the problem was not so much one between generators in the UK, but more one of a level playing field between UK generators and imports. It said that the current system created a competitive advantage for importers over UK generators, whereby various charges (including transmission charges, balancing charges and the carbon price support tax) were paid by GB generators but not by overseas generators. SSE also noted this existing distortion and expressed the concern that the introduction of locational pricing could exacerbate the existing market distortion, placing GB generators at a material competitive disadvantage to interconnected continental European generators.⁵⁰

⁴⁴ EDF Energy response to provisional findings (August 2015), p3 and paragraph 4.5, and EDF Energy response to Remedies Notice (August 2015), paragraph 1.6.

⁴⁵ SSE response to Remedies Notice, p16.

⁴⁶ Haven Power response to provisional findings and Remedies Notice, p3.

⁴⁷ Ecotricity response to Remedies Notice, p2.

⁴⁸ Dong Energy response to Remedies Notice, p1.

⁴⁹ Scottish Power response to Remedies Notice, p3, paragraph 1.3.

⁵⁰ SSE response to Remedies Notice, p16.

(h) Which?⁵¹ and Citizens Advice⁵² expressed some concerns about the potential distributional impacts on customers. Specifically, Citizens Advice⁵³ noted potential benefits from the introduction of locational losses, although expressed scepticism that it would be a big enough factor in end user costs to move the location of demand. While it did not think the distributional impact on households would be profound (given that transmission losses only make up a small component of household bills), it suggested that a more detailed assessment of its distributional impacts should be conducted if this remedy were taken forward.

2.16 Some parties considered that the introduction of locational pricing for losses would not have a significant impact on technical efficiency, investment or dispatch decisions while having large distributional impacts. In particular:

- (a) EDF Energy said that a balance needed to be struck between the predictability of loss factors and their cost reflectivity. It considered that averaged loss factors determined in advance based on past circumstances might not be cost-reflective for the present, yet participants might not be able to respond effectively to theoretically more accurate loss factors determined at short notice for the actual circumstances. Overall it considered that technical efficiency expected from locational pricing signals would be suboptimal and that theoretical gains could not readily translate to practical benefits.⁵⁴
- (b) Eggborough Power⁵⁵ considered that while the introduction of locational transmission loss factors would represent a more efficient outcome, the benefits of this change were likely to be limited.
- (c) DONG Energy⁵⁶ submitted that historical modelling performed for P229 and previous modification proposals had repeatedly shown that the distributional impacts were much higher than any calculated benefit or harm.

⁵¹ Which? response to provisional findings and Remedies Notice, p2.

⁵² Citizens Advice response to Remedies Notice, pp1–3.

⁵³ Citizens Advice response to Remedies Notice, pp1–3.

⁵⁴ EDF Energy response to Remedies Notice (August 2015), paragraph 1.2 onwards and EDF Energy response to provisional findings, August 2015, paragraph 4.8.

⁵⁵ Eggborough Power response to Remedies Notice, p1.

⁵⁶ Dong Energy response to Remedies Notice, p1.

- (d) E.ON⁵⁷ and RWE⁵⁸ said that the CMA should not take into account the distributional impacts among generators in coming to a view on the proportionality of this remedy.
- (e) SSE⁵⁹ said that dispatch decisions were driven by a wide range of factors and therefore would be largely unaffected by the introduction of locational pricing. Scottish Power⁶⁰ concurred with this view and said that it was not convinced that locational pricing would have a significant impact on both investment and dispatch decisions. Renewable UK⁶¹ added that it was very doubtful that a system of location charging for losses would have any meaningful impact on siting decisions for renewable generation as TNUoS already contained a substantial locational element. Ecotricity⁶² concurred with these views and believed that a slight increase in transmission charges was highly unlikely to have a substantial impact on whether or not a generation project was built. It said that the location of generating stations was very heavily regulated through governmental and planning policies and that this was especially true for renewable generation, which was also heavily influenced by natural factors such as wind yield.

2.17 SSE⁶³ also submitted that the CMA's analysis had failed to consider a number of other relevant factors. Specifically, it said that the CMA ignored the impact that locational pricing for transmission losses would have on:

- (a) the provision of ancillary services, and the CMA had concluded, without any evidence in support, that even the increased cost of these ancillary services 'would not depart from the economic case for cost-reflective pricing';⁶⁴
- (b) renewable generation, as pricing signals produced by locational pricing for losses would work in the opposite direction to the government's policy on carbon reduction.

⁵⁷ E.ON added that this was in order to be consistent with the approach taken on other similar modifications such as CMP213 (Project Transmit).

⁵⁸ RWE response to Remedies Notice, p23.

⁵⁹ SSE response to Remedies Notice, p16.

⁶⁰ Scottish Power response to Remedies Notice, p2, paragraph 1.1.

⁶¹ Renewable Energy UK response to RN, p2.

⁶² Ecotricity response to Remedies Notice, p2.

⁶³ SSE response to Remedies Notice, p16.

⁶⁴ Provisional findings report, [Appendix 5.2](#), paragraph 44.

Assessment of costs and benefits of the introduction of location charging for losses

2.18 Following the publication of our provisional findings report, we decided to carry out a cost-benefit analysis for the introduction of locational charges for variable transmission losses, as set out in the Remedies Notice. The aim of this simulation modelling was to add to our evidence basis, specifically about the orders of magnitude of the net benefits of the possible proposed remedy and their sensitivity to some input parameters.⁶⁵

2.19 In this section we set out some of the key principles informing our analysis of costs and benefits, describe the approach to modelling and the range of scenarios used, before presenting the results and drawing overall conclusions from our analysis.

Principles

2.20 In order to reach a view on the effectiveness and proportionality of a proposed remedy seeking to introduce locational charges for transmission losses, we need to assess whether it is more likely than not that there will be a net benefit from the proposed remedy to GB customers.

2.21 Before describing the modelling and results, we set out some important concepts and principles that have guided our overall assessment. In particular, we distinguish between, on the one hand, the social costs and benefits that might be expected to arise from the introduction of locational charges from losses and, on the other, the transfers that it might lead to. We also distinguish between effects that we believe *a priori* are likely to hold for all or most plausible scenarios (ie that are systematically related to the proposed remedy) and those that are likely to be more uncertain.

- *Social costs and benefits*

2.22 In terms of social costs and benefits (ie efficiency savings or costs that accrue to society as a whole), we would expect these to comprise:

(a) short-run efficiency gains from the reduction in losses and hence reduction in generation costs (these are systematically associated with the proposed remedy);⁶⁶

⁶⁵ CMA (8 December 2015), [Notice regarding assessment methodology for losses proposed remedy – consultation on methodology and scenarios](#).

⁶⁶ By ‘systematically’ we mean that we would expect to see these in all cases in which the remedy is implemented.

- (b) short-run costs from implementing the proposed remedy (these are systematically associated with the proposed remedy);
 - (c) short-run costs or benefits from impacts on air quality (these are uncertain and not systematically associated with the proposed remedy);⁶⁷ and
 - (d) dynamic benefits arising from more efficient investment in generation and energy-intensive demand (these are systematically associated with the proposed remedy).
- 2.23 We have attempted to quantify the first three elements in our cost-benefit assessment, but not the fourth. More efficient prices are likely to bring dynamic as well as static effects, but we considered that attempting to incorporate such investment benefits within the model would overcomplicate the modelling with insufficient benefit in terms of model realism.
- 2.24 Therefore our principal interest in modelling social costs and benefits was to establish whether the short-run efficiency gains from reduced losses are likely to exceed the costs of implementation under a range of scenarios. We also wished to establish whether air quality effects were generally positive or negative and whether their inclusion might affect the overall cost-benefit analysis.
- *Transfers*
- 2.25 The introduction of the proposed remedy may also be expected to lead to three distinct types of transfers:⁶⁸
- (a) Regional transfers within Great Britain: the proposed remedy will be expected to lead to transfers from customers in areas of low generation relative to demand to customers in areas of high generation relative to demand, with transfers between generators flowing in the opposite direction (these effects are systematically associated with the proposed remedy).
 - (b) Transfers between generators and customers, as a result of the change in the wholesale price of electricity, with the direction of transfer

⁶⁷ If plants with relatively high emissions tend to have their generation reduced by the policy, the policy will have a net benefit in terms of air quality effects. If the opposite is true, the policy will entail a net cost.

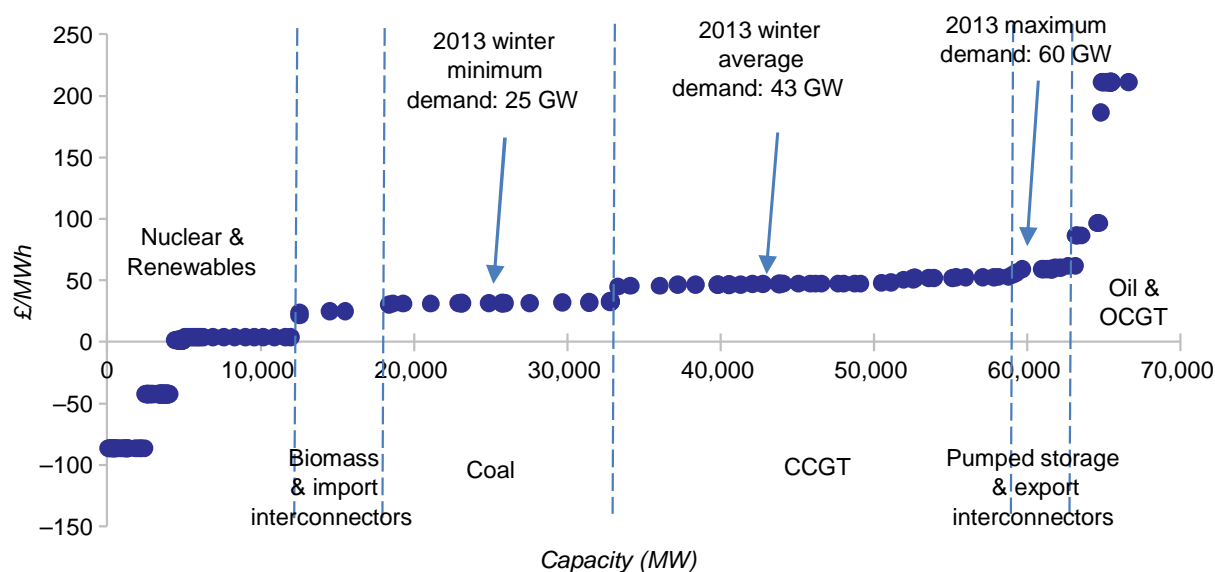
⁶⁸ A transfer is simply a redistribution of money from one party to another, without entailing any social cost or benefit.

dependent on whether the price increases or falls (these transfers are not systematic *a priori* and highly uncertain).

- (c) Transfers between Great Britain and the rest of the EU through the effect on import prices (these transfers are again not systematic).
- 2.26 Of these transfers, only the first is systematically associated with the introduction of locational pricing for transmission losses. The other two types of transfer are uncertain *a priori* – both in terms of direction and magnitude. Considering in particular transfers between generators and customers, these depend on whether the wholesale price increases or falls as a result of the change, which itself depends on whether marginal generators pay for a greater share of losses under the locational charging regime (in which case the price increases) or a lower share of losses under the locational regime (in which case the price falls).
- 2.27 The short-run effect on the wholesale price depends therefore on the location of the marginal plant. As shown in the diagram below, the GB merit order has been such in recent years that the marginal plant can change due to small changes in relative fuel costs or other factors. Therefore, the overall short-run impact of the proposed remedy on wholesale price is likely to be uncertain (and indeed may vary from half hour to half hour, reducing the price in certain periods and increasing it in others).⁶⁹ The total effect on the cost – and in a well-functioning market, the price – of meeting energy service demand is unambiguously to reduce it, but the short-run effect on the wholesale price component may be ambiguous.

⁶⁹ It should be noted that the remedy will affect consumer bills through other avenues than the wholesale price effect. We expect that bids and payments in the capacity market will be affected, and that the quantity of energy billed to suppliers will fall because of reduced total losses. Therefore, the short-run effect on the wholesale price is not equivalent to the impact of the remedy on customers.

Figure 2.1: Representation of GB merit order, winter 2013



Source: CMA analysis.

2.28 Our modelling has attempted to estimate the short-run impacts of the proposed remedy on customer bills and generator margins and hence has simulated both short-run wholesale price effects and transfers between Great Britain and the rest of the EU. For the reasons discussed above, however, we note that the results are likely to be highly uncertain.

- *Conclusion on modelling and uncertainty*

2.29 When considering the results of our simulation modelling, we have been mindful of the limitations of such exercises and the evidential weight that can be attached to them. Simulation models of energy systems are relatively sophisticated but their results are uncertain and can be hard to interpret, particularly far into the future. It is not usually possible to ascribe exact probabilities to complex input scenarios, and therefore results should be taken as being indicative only. Sensitivity analysis is helpful in this context, but we note that even the most sophisticated simulation models of this sort are necessarily partial, so judgement has to be brought to an overall assessment of results.

2.30 We also note, as discussed above, that some elements of the modelling are likely to be more uncertain than others. In particular, while it should be possible to produce reasonable estimates of the social costs and benefits of the proposed remedy, the short-run transfers arising from wholesale price effects are likely to be uncertain in direction and magnitude, contingent on a number of factors and difficult to model precisely within a medium- to long-term modelling exercise.

- 2.31 Finally, while dynamic benefits have been excluded from the modelling for reasons of complexity,⁷⁰ the existence of such benefits (more efficient location of generation investment) should, in a competitive market, result in lower long-run costs for customers, regardless of whether there is a short-term increase in the price.

Modelling methodology

- 2.32 The modelling methodology adopted by our consultants (NERA) was shaped, reviewed and approved by us. It is described in detail in Appendix 2.2. Parties also had the opportunity to comment on it, as described in paragraph 2.40.
- 2.33 At a high level, the method adopted can be described as involving the following steps:
- (a) Construct plausible sets of input assumptions (that is, scenarios) covering the major variables that will affect the electricity system over the next 20 years, including:
 - (i) environmental policy;
 - (ii) technological developments and their costs (including costs of sites, for example for new nuclear build);
 - (iii) fuel prices and renewable resource endowments (eg wind levels and profiles);
 - (iv) the level and location of customer demand; and
 - (v) regulatory behaviour with respect to transmission network charging.
 - (b) For each scenario, determine what capital equipment will produce the electricity needed to meet demand and where plausibly it will be located (based, for example, on the existence of sites that have previously been used for generation), producing a view of the generation and demand aspects of the system.
 - (c) For each such system, simulate the building of a consistent transmission grid.

⁷⁰ Modelling the dynamic benefits would have added another layer of complexity to the modelling and required another iteration. Further, it would have also required the treatment of Transmission Network use of the system charges as an endogenous variable.

- (d) Simulate generation to determine loss factors on that grid.
- (e) Examine the pattern of generation with and without losses to determine a consistent picture of the impact of the introduction of locational pricing for transmission losses.
- 2.34 There are many approximations and judgements involved in a modelling exercise of this sort. We met with parties in order to expose the methodology and allow others to propose alternative approaches and results. There was a technical discussion about the likely impact of some of the approximations made. Some of this is reflected in the scenarios we have developed, as explained in Appendix 2.2. However, given the purpose of the modelling – as described above – we did not conclude from this discussion that the methodology itself required changes.

Scenarios

- 2.35 The input assumptions that we have collected into scenarios are described in detail in Appendix 2.2. Table 2.1 below provides a high-level description of two key inputs, fuel and carbon prices, under the three scenarios considered in the modelling exercise.

Table 2.1: Fuel and carbon prices under the scenario modelled

Reference case	Low case	High case
UK Carbon Price Support rate remains frozen at its current level of £18/tCO ₂ indefinitely.	Carbon Price Support is scrapped entirely from 2016/17 onwards, with the Carbon Price Support at zero £/tCO ₂ .	Carbon Price Support is £18/tCO ₂ until 2019/20 and then £30/tCO ₂ in 2020, rising to £70/tCO ₂ in 2030.
Merit order of coal and gas based on the International Energy Agency New Policies commodity prices scenario and assumptions on coal and CCGT plants' efficiencies.	Merit order is most advantageous to coal relative to gas; based on DECC Low case commodity prices scenario and assumptions on coal and CCGT plants' efficiencies.	Merit order is least advantageous to coal relative to gas; based on the International Energy Agency 450 scenario commodity prices scenario and assumptions on coal and CCGT plants' efficiencies.

Source: NERA (2015). Modelling the Impact of Zonal Transmission Loss Multipliers.
CCGT = combined cycle gas turbine.

- 2.36 The most direct mechanism through which charging for losses has an impact on generation costs arises when it is possible to substitute between different generating plant in different locations.

- 2.37 For each input scenario, we consider two options for introducing locational pricing for transmission losses: one in which the costs of losses are split 55/45% (option A) between generators and customers, as in the current arrangements; and another in which losses are borne entirely by generators (option B).
- 2.38 We met parties to present and discuss these scenarios. Many suggestions were made of other scenarios to consider. These included scenarios with more rapid penetration of renewable technologies. We did not make major changes to our existing scenarios but encouraged parties to present their own analysis of charging for losses based on those scenarios. A summary of parties' views on the methodology employed and scenarios used is presented below.

Parties' views on methodology and scenarios

- 2.39 In our consultation on the assessment of the losses proposed remedy,⁷¹ we encouraged parties to submit comments on both the methodology and scenarios proposed by our consultants, NERA, to assist the inquiry group in deciding how much evidential weight to put on this work. We also invited parties wishing to conduct their own analyses to submit their results to the CMA.
- 2.40 We received responses from the Six Large Energy Firms (except for E.ON and Scottish Power), National Grid, Dong Energy and Ofgem. We summarise their views below.
- 2.41 Most parties provided responses on the methodology, scenario and assumptions proposed by NERA. SSE and Dong Energy also provided more general comments.
- 2.42 In particular, SSE noted that economic modelling of the type proposed in the Notice could not be relied upon to simply provide the 'right answer'; instead, it should only be considered as one part of the evidence towards better understanding of the question of zonal losses. It said that as a relevant comparison, Ofgem's decision regarding MP213 was based on a broad spectrum of economic modelling, peer review and detailed economic analysis and that Ofgem did not rely on any single modelling result.
- 2.43 Dong Energy expressed concerns over whether the benefits of locational pricing could justify the added transaction costs and complexity. It added

⁷¹ CMA (8 December 2015), [Notice regarding assessment methodology for losses proposed remedy – consultation on methodology and scenarios](#).

that the introduction of locational pricing for transmission losses would have a disproportionate impact on smaller suppliers who might find it more difficult to precisely factor in the additional costs. It considered that this could result in additional risk premiums that would drive additional costs for customers.⁷²

- 2.44 The majority of parties commented on the overall approach adopted by NERA.
- (a) Dong Energy considered that the modelling approach seemed appropriate for an initial evaluation of the effects of more accurately reflecting transmission losses in the costs to generators and customers.
 - (b) RWE said that the approach adopted by NERA and Imperial College provided a comprehensive basis for the assessment of a zonal transmission losses scheme.
 - (c) Ofgem noted the complexity and interactions between assumptions in modelling of this type and considered that small changes in assumptions could significantly change results. It encouraged the CMA to carefully consider all the assumptions made by NERA in its model.
 - (d) SSE expressed a number of 'significant' concerns with the modelling methodology and assumptions proposed by NERA. It said that critical assumptions (eg simplified treatment of continental European interconnectors, Aurora's model to optimise the generation mix) affecting the modelling results were not clearly explained in the notice and that a thorough peer review of the modelling results was necessary in order to draw robust conclusions from the NERA/Imperial College models.⁷³
 - (e) National Grid said that adopting an ex ante approach to the derivation of transmission losses (such as P229 and the one proposed by the CMA), while having the benefit of being predictable, was likely to constrain the accuracy that could be achieved in capturing a given party's real-time impact on losses. It considered that losses would be sensitive to actual system conditions, which would be subject to short-term variability due to wind production and power demand. Further it noted that inconsistencies between locational pricing for losses such as envisaged

⁷² As discussed in paragraph 2.86(d) and 2.104(b), our proposed remedy would involve the calculation of annual transmission loss factors, which would be made available to parties at least three months before being used. We therefore consider that all parties, including smaller suppliers, would have sufficient time to factor in the additional costs.

⁷³ We address this comment in paragraph 2.122. We also note that parties have had several opportunities to comment on our methodology and were invited to submit the results of their own analysis to the CMA. As discussed in paragraph 2.122, we do not believe that further analysis, including a peer review, would alter our view on the merits of the proposed remedy given the substantial body of evidence on the merits, including technical benefits, of the remedy.

under P229 and new pricing zones might emerge as a result of the implementation of the EU's Capacity Allocation and Congestion Management regulation.

(f) EDF Energy said that the exact form of the zonal transmission losses scheme proposed by the CMA was not clear, nor were the potential options being considered, for instance a seasonal or hourly approach. It added that as part of this new analysis it was important that sufficient information was provided to identify the estimated economic benefits for GB customers, GB producers, the national economic benefit and impacts on the economic benefit for producers and customers in the EU as a whole.

(g) Additionally, EDF Energy considered a comprehensive cost-benefit analysis of the introduction of locational pricing required estimation of the implementation costs of locational pricing for losses and that costs would differ depending on the approach being implemented (eg costs would be lower for a seasonal zonal implementation approach).

2.45 We also received a number of detailed comments on the assumptions and scenarios proposed by NERA, which we report in Appendix 2.1.

Results

2.46 In this section we discuss the modelling results. First we consider the time frame of the analysis, before presenting the results according to the categorisation presented above, considering first the social benefits from the proposed remedy and then the transfers that it might lead to.

- *Time frame of the analysis*

2.47 In reviewing the results, we have focused on those relating to the next ten years (2017 to 2026). We note that the model simulated the system to 2035, but we have put no evidential weight on the results from these later years because we cannot be confident that the results beyond 2026 are meaningful. Indeed, we believe these are largely the results of a modelling artefact. In particular, beyond 2026 in the simulations, the geographic structure of the GB energy system inverts, with the North on average becoming an importing region and the South an exporting region. Therefore from 2026 the results essentially model a system which is the inverse of the system we see today.

2.48 This switch in the model is driven not by the losses charging regime itself, but by assumptions about the evolution in Transmission Network Use of

System (TNUoS) charges, which are the main determinant of plant location decisions in the model. The assumed TNUoS charges are taken from NERA's and Imperial College's work during Project TransmiT⁷⁴. However, the TNUoS charges are not recomputed for each investment scenario. Thus, the incentive to locate plant in the South does not abate as the amount of plant in the South increases in our scenarios. We consider that it is in large part the fact that we did not model this feedback which has led to the switch in energy flows and losses.

- 2.49 For these reasons, we do not consider the results based from the later years of the model to provide useful information about the impact of the proposed remedy. In the next ten years, we would expect the non-modelled dynamic benefits to have only a modest impact, since there is less locationally incentivised investment on the system.

- *Technical efficiency benefits*

- 2.50 Table 2.2 summarises the total efficiency benefits over the medium term (ie next ten years) of the proposed remedy under our three sets of input assumptions and two scenarios. The measure shown is the reduction in the cost of meeting the electricity demand of GB customers due to the proposed remedy. Total technical benefits vary between £144 million and £159 million for option A and £158 million and £190 million for option B. Option B (in which 100% of losses are assigned to generators) always yields greater benefits than option A.⁷⁵
- 2.51 The order of magnitude of the results appear stable and robust, in that the estimated benefits are not very sensitive to our scenario input assumptions. This result of our modelling exercise should be interpreted as showing that, as modelled, the cost of meeting GB electricity demand would fall by this order of magnitude under our proposed remedy.
- 2.52 The additional efficiency gain of moving to a 100/0% split from the current 45/55% split (moving from option A to option B) is simulated to be worth between £14 million and £31 million. This effect is as expected, since the supply side of the market is the one that is most able to respond to short-term locational signals by changing the geographic pattern of generation.

⁷⁴ [Project TransmiT](#) is Ofgem's review of electricity transmission charging and associated connection arrangements.

⁷⁵ This approach to estimating cost savings values changes in net imports based on the change in generation costs in neighbouring jurisdictions. We believe that this is a more reliable estimate of the social benefits of the policy than the alternative approach, which values changes in net imports and prevailing market prices, and which produces a range of benefits of between £97 million and £205 million for option A and £122 million and £246 million for option B.

Table 2.2: Total efficiency gain from introduction of locational pricing for losses, 2017 to 2026

2015, £ million						
	Reference case		High case		Low case	
	A	B	A	B	A	B
Total efficiency gain	144	158	134	151	159	190
Change in generator fuel, CO2 and operating and maintenance costs	-7	-20	-8	-24	-4	-26
Change in cost of transmission losses	27	49	42	71	43	91
Change in cost of constraint management	124	128	101	103	120	126

Source: CMA scenarios with Imperial College and NERA calculations.

Notes:

1. All values are £ million net present value from 2017 to 2026 at a discount rate of 3.5%. Positive numbers are benefits from the introduction of locational pricing for losses (no intervention minus costs of the proposed remedy shown). Case A refers to the 55/45% split and Case B to the 100/0% split.

2. Change in cost of constraint management refers to the cost of managing situations when power cannot be transmitted to where it is needed, due to congestion at one or more points on the electricity transmission network.

2.53 The model also estimates that there will be a moderate additional environmental benefit from the reduction in SO₂ and NO_x emissions from the proposed remedy, valued at between £0.4 million and £14.4 million over the period.

2.54 As noted, we have not attempted to model the dynamic benefits from the proposed remedy, in terms of more efficient investment, due to the complications and uncertainties of such modelling.

- *Changes in customer bills and generator margins*

2.55 The tables below show the modelled impact of the proposed remedy on customer bills and generator margins.

Table 2.3: Impact of introduction of locational pricing for losses on customer bills and generator margins, 2017 to 2026

2015, £ million						
	Reference case		High		Low case	
	A	B	A	B	A	B
Total aggregate change in customer bills	1,560.63	1,637.78	-200.81	-214.53	38.26	278.80
Change in generator margin	-897.87	-705.89	312.55	660.80	337.57	719.50

Source: CMA scenarios with Imperial College and NERA calculations.

All values are £ million net present value from 2017 to 2026 at a discount rate of 3.5%. Positive numbers are benefits from the introduction of locational pricing for losses (no intervention minus costs of the proposed remedy shown). Case A refers to the 55/45% split and Case B to the 100/0% split.

2.56 In relation to customer bills, the modelling results generate a reduction in bills in the reference and low fossil fuel scenarios and an increase in the high fossil fuel scenario. Generator margins fall in the reference scenario and rise in the high and low scenarios. These results arise largely out of the impact of the introduction of locational pricing for losses on the wholesale price which,

for the reasons discussed above, is highly uncertain. The magnitude of the effect on wholesale prices is also relatively small. The largest impact in any scenario in any year is £0.4/MWh, compared with a projected wholesale energy price of between £70/MWh and £90/MWh.⁷⁶

2.57 Overall, we do not believe that the short-run effect of the proposed remedy on wholesale prices is systematic or stable, or likely to be very large.⁷⁷ In this sense, our view is similar to that expressed in Ofgem's impact assessment for the P229 code modification, which concluded that 'it is reasonable to conclude that the impact on wholesale prices is likely to be minimal'.⁷⁸

2.58 Further, as argued below in paragraph 2.76, we have good reason to believe that benefits in sufficiently competitive GB electricity markets will, whichever the mechanism that allows this transfer, lead to lower bills for customers. We therefore do not consider that the risk of generators capturing the efficiency gain through a transfer from customers as a result of the proposed remedy is a significant one.

- *Regional transfers*

2.59 Table 2.4 shows the simulated change in annual bills within different regions as a result of the proposed remedy. In our reference case, average bills fall in all regions. In the other cases, the picture is more varied. The North of Scotland shows falling bills in all scenarios. We note that the absolute magnitude of the effects are again small – of the order of 0.1% of annual bills.

Table 2.4: Changes in customer bills in different regions as a result of the introduction of locational pricing for losses (positive number shows reduction in bills), net present value average of £ per customer per year, 2017 to 2026

Change in annual customer bill	£					
	Reference case		High case		Low case	
	A	B	A	B	A	B
National average	1.69	1.77	-0.22	-0.23	0.04	0.30
North Scotland	2.57	2.66	0.77	0.75	1.08	1.34
South Scotland	1.69	1.77	-0.22	-0.23	0.04	0.30
North England/Wales	0.43	0.51	-1.27	-1.29	-1.12	-0.86
Midlands of England/Wales	1.02	1.10	-0.51	-0.53	-0.39	-0.13
South England/Wales	0.70	0.79	-0.94	-0.96	-0.80	-0.54

Source: CMA, with Imperial College and NERA calculations.

Note: Positive numbers are GB benefit from the introduction of locational pricing for losses (no intervention minus costs of the proposed remedy shown). Case A refers to the 55/45% split and Case B to the 100/0% split.

⁷⁶ NERA report, section 4.4.2.

⁷⁷ Although the effect is not large relative to the price of electricity, the modelled effect is large because it multiplies a small price effect by a large quantity.

⁷⁸ Ofgem (2011), [Impact Assessment on RWE proposal P229 - seasonal zonal transmission losses scheme](#), paragraph 4.28.

- 2.60 We note that these results are the combination of a systematic effect and an uncertain effect. The systematic effect, as discussed above, is that the introduction of locational pricing for losses will result in a transfer from customers in areas where consumption is high relative to generation to areas where consumption is low relative to generation. This pattern is borne out in the pattern of relative beneficiaries in the table above: customers in the North of Scotland tend to benefit to a greater extent than customers in the South of England, for example. However, the impact on customers in each region is also driven by wholesale price effects (for example, in the reference case all customers benefit in each region of Great Britain) which, as discussed above, is highly uncertain.
- 2.61 We note that distributional effects were one of the grounds for Ofgem's rejection of P229 (see above paragraph 2.10). The main distributional impacts examined by Ofgem were from generators in the North to customers in the North and generators in the South. However, the main conclusion that we draw from an examination of regional transfers is that we do not believe that these are such as would undermine the effectiveness of the remedy (as described above in paragraph 2.9).
- *Impact on GB/EU transfers*
- 2.62 Table 2.5 shows the details of modelled financial flows to and from continental Europe. Details of the calculations are contained in the NERA report.
- 2.63 The second line in the table below shows the change in the total cost of imports due to the introduction of locational pricing for transmission losses. This is composed of two effects: the increase in volumes of non-GB generation and the average price at which they are imported. In the reference case, GB average import prices fall and counteract the increase in generation costs, and in the other cases they rise. We do not believe that average price changes at times of import are linked to the proposed remedy in any systematic direction.
- 2.64 The first line shows the change in the cost of generation outside GB due to the proposed remedy. In all cases, the costs of generation outside GB increase. This is entirely due in the model to an increase in generation outside GB. Although we have not modelled the non-GB European market in great detail, we believe this is a plausible impact of the proposed remedy, since it will tend to reduce generation in distant locations and increase imports which are, under the current implementation of EU regulations, subject to a different mechanism for losses charging. In this context, we would welcome any move by Ofgem and the Agency for the Cooperation of

Energy Regulators (ACER) to implement a more cost-reflective mechanism for the pricing of intra-EU losses, but we do not consider that the absence of such an improved regime is a reason to delay improvement to the system of charging for losses in the GB wholesale electricity market.

Table 2.5: Proposed remedy impact on GB import costs

<i>£ million, net present value</i>						
	<i>Reference case</i>		<i>High case</i>		<i>Low case</i>	
	<i>A</i>	<i>B</i>	<i>A</i>	<i>B</i>	<i>A</i>	<i>B</i>
Total change in generation costs outside GB	–23	–32	–19	–17	–127	–224
Total change in net import cost valued at GB market prices	37	56	–56	–46	–138	–209

Source: CMA with Imperial College and NERA calculations.

Note: All values are £ million net present value from 2017 to 2026 at a discount rate of 3.5%. Positive numbers are GB benefit from the introduction of locational pricing for transmission losses (no intervention minus costs of the proposed remedy shown). Case A refers to the 55/45% split and Case B to the 100/0% split.

2.65 The modelling of import prices and EU production changes provides us with indications that benefits of the proposed remedy to the GB economy do not flow primarily from reducing overall efficiency within connected electricity markets. If in some scenarios payments to EU generators increase, this is because supplying the GB market from imports is sometimes a cheaper solution. In such cases, the net benefit to GB customers is positive.

- *Summary of modelling results*

2.66 The simulation modelling was primarily intended to answer a question about the order of magnitude of the technical efficiencies that could be expected from the introduction of locational pricing for transmission losses. In view of the results of our modelling for the period 2017 to 2026, we believe that these technical efficiencies arising from short-term effects are likely to be between £130 million and £190 million, with a slight increase in expected benefits under option B, where losses are fully assigned to generators⁷⁹.

2.67 We believe that the transfers arising from the introduction of locational pricing for transmission losses – particularly insofar as effects on the wholesale price and import price effects are concerned – are highly uncertain and not systematically correlated with the introduction of locational pricing for losses.

2.68 The simulation modelling results have therefore been useful in confirming the broad order of magnitude of quantitative results that were referred to in our provisional finding of an AEC. They have also been useful in providing

⁷⁹ See paragraph 2.50 for a definition of option B.

some evidence that, unlike in the modelling exercise submitted to us by RWE, the benefit is not driven to any large extent by reductions in transfers to continental Europe. Similarly, any increase in payments to continental Europe that we see are the result of minimising the costs of meeting GB customer demand.

Our updated assessment

- 2.69 Based on the modelling work we have conducted and other analysis, our provisional conclusion is that introducing locational charging for transmission losses will reduce costs and be in the long-term interests of customers.
- 2.70 The aim of the proposed remedy is to improve the accuracy with which avoidable costs of losses are borne by those who cause them, thus reducing waste and reducing the overall cost of electricity production. In a well-functioning market, we would expect unnecessary technical costs to be stripped out of production processes and those cost savings to be passed on to customers. In the energy markets, competition ought to put pressure on firms to reduce avoidable production costs to pass on technical efficiencies ultimately to customers.
- 2.71 As a result of the proposed remedy , we would expect:
- (a) Efficiency gains arising from short-run effects: costs will be higher for less efficient generation plants (ie subject to a higher level of losses) and lower for more efficient plants, leading to a more efficient use of the overall generation capacity.
 - (b) Efficiency gains arising from long-run effects: investment decisions relating to generation plants (ie extension, closure or new plants) would take into consideration the costs of transmission losses and there could also be increased efficiency in the location of demand, particularly in investment decisions relating to the location of high-consumption industrial demand.
 - (c) Efficiency gains to be passed through to GB customers: in a well-functioning market, the reduction of production costs would eventually be passed through to customers through their bills.
- 2.72 Our simulation modelling confirms the efficiency gains arising from the short-run effects outlined above. Over the next ten years, the model provides an estimate of total efficiency benefits of between £134 million and £159 million for option A and £158 million and £190 million for option B. Option B (in which 100% of losses are assigned to generators) always yields greater benefits than option A. While our model also provides an estimate for the

period until 2035, for the reasons set out in paragraph 2.47 above we do not believe the results for this later period are reliable. We note, however, that under all scenarios, benefits remain positive over this period.

- 2.73 In our simulation modelling we have not tried to model the efficiency gains arising from long-run effects. However, we believe that in the long run, these efficiencies will eventually lead to lower prices for customers through the process of competition as a result of lower production costs in GB and/or lower GB wholesale prices.
- 2.74 We note that our arguments relating to the transfer of benefits to customers rely on GB wholesale electricity markets being broadly competitive. We have seen no evidence that these transfers would systematically disadvantage customers. We would therefore expect that, as a matter of principle, by virtue of competition in the wholesale and supply markets, increased technical efficiency will benefit GB customers. In the next section we consider two arguments that have been put to us suggesting that the existence of imperfections elsewhere in wholesale electricity markets might undermine this principle, and therefore the case for a move to locational pricing of transmission losses.

- *Potential imperfections in wholesale market operation*

- 2.75 In order to be confident that it is more likely than not that the technical efficiency gain we expect in light of the above will benefit GB customers rather than generators, we need to be confident that competition will work effectively in the wholesale electricity market as well as in all of the design mechanisms that have been put in place within this market (for example, the capacity market, the balancing mechanism, the CfD auctions etc).
- 2.76 Our assessment of the wholesale market and associated mechanisms as presented in our working papers and provisional findings report ⁸⁰ is that these function competitively. Where we have concerns over the proper functioning of competition, we are addressing these elsewhere in this report. We therefore consider it right to assume that the wholesale electricity market and associated mechanisms work competitively for the purpose of assessing this proposed remedy.

⁸⁰ See [Gas wholesale market working paper](#).

- 2.77 The first argument concerns the market for ancillary services.⁸¹ SSE has submitted (see paragraph 2.17(a) that the cost of providing voltage support (a location-specific ancillary service) to maintain system stability could increase as a direct consequence of the proposed remedy, resulting in excessive costs for disproportionately low returns.⁸²
- 2.78 We consider that SSE's argument would count against locational pricing of transmission losses if there was a good reason for ancillary services not to be priced in a cost-reflective way. However, in such a case we do not consider that locational pricing for transmission losses ought to be used to correct in a contingent, non-systematic way another pricing mechanism that may not be cost-reflective. We, in any case, do not believe that the market in ancillary services has any reason not to be cost-reflective. We also consider that locational pricing should make it easier for the system operator (ie National Grid) to efficiently and competitively procure ancillary services by making trade-offs explicit and transparent.
- 2.79 A second argument relates to interconnectors. SSE and Scottish Power put to us that (see above parties' views, paragraph 3(d)) that the proposed remedy would create market distortions as interconnected continental European generators are not liable for transmission losses. We understand that transmission system operators (eg National Grid Transmission) receive compensation for transmission losses for hosting cross-border electricity flows on their network under the inter-transmission system operator compensation mechanism.⁸³ However, we note that this mechanism presents pricing imperfections as it operates ex post (annually) and as such it does not provide signals allowing variable losses to be taken into account in generators' dispatch decisions across interconnectors.
- 2.80 We believe that Ofgem, ACER and other European regulators should consider whether the system should be reformed to address the views put to us by SSE and Scottish Power. However, we consider that the inefficiencies in the inter-transmission system operator compensation mechanism do not invalidate our case for having a more efficient allocation of transmission losses within Great Britain. As discussed above, our analysis shows that, despite pricing inefficiencies the inter-transmission system operator compensation mechanism, the remedy results in the net benefits of the order of over a hundred million pounds in Great Britain.

⁸¹ Ancillary services can be defined as specialty services and functions provided by the system operator that facilitate and support the continuous flow of electricity so that supply will continually meet demand.

⁸² SSE response to Remedies Notice, paragraphs 3.2.5 & 3.2.6; SSE's response to provisional findings, paragraphs 9.6.2–9.6.4.

⁸³ [ITC Transit Losses Data Report](#).

- 2.81 Overall, given a reduction in the cost to meet electricity demand in GB of over a hundred million pounds, we believe that it is more likely than not that, given our assessment of competition in the wholesale electricity market set out in our provisional findings report, a substantial portion of that cost reduction will benefit GB customers over the next ten years.

Design considerations

Scope of the proposed remedy

- 2.82 As contemplated in previous modification proposals seeking to introduce locational pricing for losses (eg code modification P229⁸⁴), the proposed remedy would apply to generators and suppliers located within Great Britain. Interconnectors are exempt from variable transmission losses in Great Britain⁸⁵ (see paragraphs 2.79 and 2.80).

Proposed implementation for the proposed remedy

- 2.83 We have taken as a starting point the design that was chosen for P229 because it has the virtue of having already been thoroughly described and assessed. In the next section we discuss alternative possible remedies and why we do not believe these to be capable of effective and timely implementation.
- 2.84 We are proposing to implement this remedy by way of an order rather than recommending that Ofgem (or the industry) raise a code modification proposal. Experience to date shows that it has been extremely difficult to introduce locational charging of transmission losses through code modification processes. We believe that much of that is due to the possible differential impact of the introduction of locational pricing for losses on some producers who have found it to be in their commercial interest to slow down the pace of change, often to such an extent as to preclude it altogether.⁸⁶
- 2.85 We are therefore proposing to implement this proposed remedy as set out below.
- 2.86 First, an order would be imposed on National Grid, as system operator, to calculate imbalance charges taking into account transmission losses

⁸⁴ See Elexon, [Final Modification Report P229: Introduction of a seasonal Zonal Transmission Losses scheme](#), p6.

⁸⁵ They are considered as 'a transmission line which crosses or spans a border between Member states and which connects the national transmission systems of Member States' Third Energy package. Electricity Regulation 714/2009, Article 2(1).

⁸⁶ See [provisional findings report](#), paragraphs 5.42–5.43 and 5.48–5.50.

calculated as per the principles that would be set out in the order. Specifically, the order (largely inspired by P229) would set out, among other things:

- (a) the formula to calculate the transmission loss factors (which ultimately feeds into the imbalance charges) for this purpose;
- (b) an obligation on National Grid to create a Load Flow Model;
- (c) an obligation on National Grid to create a networking mapping statement and collect annually relevant network data;
- (d) an obligation on National Grid to appoint third party agents to collect metered volumes data and to calculate annually the transmission loss factors pursuant to the principles set out in the order and using the models created, and information collected, pursuant to the order;
- (e) an obligation on National Grid to direct Elexon, as appropriate, to update the networking mapping statement and carry out other administrative tasks that are necessary to the calculation by the third party agents; and
- (f) an obligation on National Grid to raise any consequential code modification. Further, we have also provisionally decided to make a recommendation to Ofgem to support National Grid by taking necessary steps that might facilitate the implementation of the order above.

2.87 This order would include a provision modifying National Grid's licence conditions to reflect the above. This would allow Ofgem to monitor compliance with the principles of this order (as reflected in National Grid licence conditions).

2.88 We propose that this order would modify the formula contained in the BSC that allocated 45% of losses to generators with a formula that has 100% of losses borne by generators. The reason for this, as confirmed by the modelling (see paragraph 2.52), is that it is the supply side of the market that can respond more efficiently to locational signals, and that in the light of our modelling exercise, the benefits of the proposed remedy should be materially higher for the 100/0% case than for the 45/55% case.⁸⁷

⁸⁷ Note that the benefits are to the consumer, but the mechanism through which the consumer benefits is through adjustments of the supply side of the market.

- 2.89 Second, we would recommend that Ofgem support National Grid by taking necessary steps which might facilitate the effective and timely implementation of the proposed remedy.

Possible alternative design mechanisms

- 2.90 We have also considered whether other possible designs would be effective in achieving the aim of this proposed remedy.
- 2.91 National Grid⁸⁸ has provided a submission to the inquiry that sets out its early thinking on a possible direction of the GB mechanisms for locational pricing. Under the EU's Capacity Allocation and Congestion Management framework, each EU system operator (National Grid in the case of the GB market) must submit, at least every three years, its thinking on whether or not to 'split' previously integrated markets to account for both losses and transmission constraints.⁸⁹ National Grid's submission describes the way in which the GB balancing market mechanism could be used to accommodate market splitting compatible with the EU's preferred 'Target' model.
- 2.92 The Target Model envisages that where constraints and/or losses are large enough, it makes sense to have separate price-setting mechanisms. Trade between zones is facilitated by the creation of tradable transmission capacity permits and the simultaneous clearing of spot market auctions ('market coupling'). If all of the European markets were operated in this way and were competitive, an outcome close to technically efficient dispatch would be achieved, and the relevant 'borders' in the system would not be national but zonal.
- 2.93 The design relies on the idea of splitting the GB market into a number of zones – perhaps 4 – and having the system operator run a balancing mechanism in each of these zones. In the absence of contracts, a generator in one zone would have a positive imbalance in that zone, while a source of demand in another zone would have a negative imbalance there. The two parties could trade those exposures just as they do today in a single zone. Losses and constraints could be accommodated in various ways in such a mechanism: for example, if imbalance is defined at the level of the zone, a generator wanting to contract to satisfy the demand of a supplier in another zone will have to produce enough to cover the supplier's metered quantity in that zone and will receive a payment from balancing based on their supply to

⁸⁸ National Grid response to Notice regarding assessment methodology for losses proposed remedy – consultation on methodology and scenarios.

⁸⁹ Article 34 actually requires an evaluation of bidding zone configuration on market efficiency, with specific reference to congestion. National Grid suggested that losses could be addressed through this.

another zone. The price differences between zones can therefore reflect loss factors.

- 2.94 There are several potentially attractive features of this sort of design:
- (a) It can use measured quantities, property rights and trading to determine the level of pricing for losses and constraints simultaneously.
 - (b) In the absence of market power, this should lead to close to the marginal cost of losses and constraints.
 - (c) It is consistent with the market design that over time should apply in the rest of the EU, reducing the distortions that apply today to the treatment of losses across EU borders.
 - (d) It is an evolution of the balancing-market-based mechanism that British Electricity Trading and Transmission Arrangements (BETTA) operates today and change should therefore be less costly and more incremental than other potential solutions to the locational pricing problem.
- 2.95 In principle, there are therefore some reasons to believe that a mechanism such as the one described by National Grid might in theory be more efficient than the P229 mechanism. However, as noted in paragraphs 5.73 to 5.80 of our provisional findings report, the impact on competition of locational pricing for congestion is much less clear-cut than it is for transmission losses. Although there are arguments in principle for locational pricing of congestion – through the creation of split markets – no comprehensive cost-benefit analysis has been conducted into even the short-run benefits of such a move. Further, there are complexities of implementation and the potential for unintended consequences (such as a possible reduction in liquidity), neither of which apply to locational charging for transmission losses.
- 2.96 We do not therefore intend to propose this alternative remedy. National Grid's model is at a very early stage of development and might take several years to be implemented or not be implemented at all. Further, even if we did wish to implement such an approach, we would not be confident that an order or a recommendation to Ofgem could be sufficiently precise so as to ensure implementation of a remedy based on National Grid's design in a timely and effective manner. In contrast, we believe, for the reasons set out below, that our proposed remedy is capable of timely and effective implementation by 1 October 2017.
- 2.97 For these reasons, we consider that our proposed remedy would be more effective in the short and medium term. We also note that our proposed

remedy does not rule out a later move towards National Grid's proposed design, if this is considered appropriate.

Costs of implementing the proposed remedy

- 2.98 The costs of implementing the P229 proposal were estimated by LE/Ventrix as part of the modelling commissioned by Elexon. LE/Ventrix identified two categories of upfront (one-off) implementation costs: costs to BSC parties and central systems costs.⁹⁰
- 2.99 It estimated that the costs to BSC parties, which mostly relate to IT systems (billing and metered volumes), would range between £2.8 million and £4.1 million, with a midpoint estimate of £3.4 million. Central system costs consisting of changes to central BSC IT systems were estimate to be £0.4 million. Total upfront costs would therefore be £3.8 million when the midpoint estimate is considered.
- 2.100 In addition to these upfront costs, LE/Ventrix also estimated that there would be some ongoing costs for systems maintenance. These were estimated at approximately £0.2 million per year.
- 2.101 The costs estimated by LE/Ventrix were later reviewed by the Brattle Group, which considered them prudent when compared with implementation cost estimates from previous similar proposals.⁹¹
- 2.102 We consider that parties would incur similar costs for implementing the proposed remedy proposed here. Taking a net present value of these costs at 3.5% yields a present cost of well under £10 million for the proposed remedy.

Time frame for implementation

- 2.103 The P229 Assessment Report prepared by the BSC code panel indicated that most parties required six to nine months to implement P229 and that the relevant transmission loss factors needed to be made available to relevant parties at least three months before being used in calculating imbalance charges for the purpose of the settlement process. This would allow parties to take into account the effects of the proposed remedy in their contracts.⁹²

⁹⁰ Ofgem (2011), [Impact assessment on RWE proposal P229 – seasonal zonal transmission losses scheme](#), pp37 & 38.

⁹¹ Ofgem (2011), [Impact assessment on RWE proposal P229 – seasonal zonal transmission losses scheme](#), p38.

⁹² See P229: [Introduction of a seasonal Zonal Transmission Losses scheme](#), Assessment report, p19.

- 2.104 Specifically, the following activities/steps will need to be undertaken before the remedy can become effective:
- (a) National Grid to carry out the steps set out in paragraphs 2.86 and 2.86 (eg appoint third party agents, establish a load flow model, and calculate the relevant transmission loss factors).
 - (b) Relevant transmission loss factors to be published at least three months before being used in settlement.
- 2.105 Parties to amend their own systems, processes and documentation before the transmission losses factors are first published. We note that industry, throughout the BSC Panel, proposed an implementation date for P229 of either 1 April or 1 October due to existing contractual arrangements. We propose to follow this recommendation in designing our remedy.
- 2.106 Further, we consider that the implementation of the proposed remedy shall not be phased in and that there should be no gradual introduction of non-zero transmission loss factors.⁹³
- 2.107 In view of the above, and taking into consideration the time necessary for the CMA to make an order, we consider that the proposed remedy could be implemented by 1 October 2017.

Assessment of effectiveness

- 2.108 For the reasons set out above we believe that the implementation of the proposed remedy would bring a net benefit over (at least) the next ten years due to an enhancement in technical efficiency. The evidence from our simulation model provides a robust indication of the magnitude of the overall efficiency benefits that will arise from short-run effects of this proposed remedy. These will be (on a net present value basis) of the order of £130–£190 million over the next ten years for option A, and of £160–£190 million for our preferred option B, substantially in excess of the costs of implementing the proposed remedy. Positive benefits of a similar magnitude were estimated by previous models, as set out in our provisional findings report. In addition, we have identified efficiency benefits arising from long-term effects that we have not sought to quantify (although we consider these unlikely to be material).
- 2.109 While it is not possible to give a precise quantification of the distribution of the overall efficiency benefits, we believe that it is more likely than not that,

⁹³ *ibid*, p19.

through the process of competition, these benefits will be passed through to GB customers, at least in the medium term.

- 2.110 Additionally, we note that our proposed remedy might have an impact on the costs of ancillary services provided by National Grid and the future development and location of renewable generation within Great Britain (see parties' views, paragraphs 2.16(e), 2.17(a) and 2.17(b)). However, we have not seen evidence that any such effects would systematically add to total system costs. Any such impacts can be mitigated through other existing market mechanisms or appropriate changes to policy. For instance, the auction price of CfDs can take into account pricing for variable transmission losses.
- 2.111 As noted above, the experience of the industry to date has been that it has been extremely difficult to move from a position of not charging for losses to one of imposing some charges. We believe, however, that our proposed remedy, which sets out the key principles to calculate locational charges, and which clearly allocates responsibility for implementation, is capable of effective implementation and monitoring. This is because:
- (a) National Grid has the expertise and ability to obtain the necessary information to implement this proposed remedy and calculate locational charges;
 - (b) any incentives that National Grid and the industry participants have to alter, undermine or delay implementation of our proposed remedy will be constrained by our order and Ofgem's supervision; and
 - (c) Ofgem has the duty to monitor compliance with the licence condition and the ability to further support timely implementation.
- 2.112 Implementation of our remedies will require National Grid to take a number of steps (see paragraphs 2.86 and 2.86). Based on our review of the P229 Assessment report, we believe that National Grid would be in a position to calculate the relevant transmission loss factors and reflect them in its calculation of the imbalance charges for the purpose of the settlement process by 1 October 2017. In view of the potential impacts to GB generators and customers arising from the proposed remedy, the inherent complexity of the transmission network and proposed remedy, and the need to ensure that the transmission losses factor are calculated in a robust manner, we believe that this time frame is appropriate and timely.
- 2.113 For these reasons, we believe that the proposed remedy is effective in addressing the feature that gives rise to the AEC we have provisionally

identified, as well as remedying the associated detriment, and that it is capable of effective and timely implementation.

Assessment of proportionality

- 2.114 For the reasons set out above, we consider that the proposed remedy is effective in achieving its aim by addressing the feature giving rise to the AEC we have provisionally identified, and associated detriment. We have then considered whether our proposed remedy, implemented by way of an order, was no more onerous than necessary and the least onerous proposed remedy of the options available.
- 2.115 As noted above, implementation of our proposed remedy will require National Grid to take a number of steps. The proposed remedy will also have implementation costs for parties. As noted in paragraphs 2.98 to 2.102, estimated implementation costs are a small fraction (a net present value of under £10 million) of the overall likely net benefits arising from the proposed remedy.
- 2.116 In our view, each of the implementation steps set out in our proposed remedy is necessary to ensure that transmission losses factors are calculated in a robust manner. This in turn should increase the effectiveness of the proposed remedy and avoid unintended consequences.
- 2.117 We have also considered alternative designs for implementing locational pricing for transmission losses.
- 2.118 We considered an alternative proposal raised by National Grid. However, for the reasons set out above in paragraphs 2.90 to 2.96, we do not believe that these alternative proposals are capable of effective and timely implementation.
- 2.119 We have also considered whether a different allocation of variable transmission losses between generators and demand would be more efficient or less onerous. For the reasons set out above, we believe that allocating these losses entirely to generators will achieve higher efficiency, and will not be more onerous in its implementation costs than a different generation/demand split.
- 2.120 We have also considered whether it would be more appropriate to take action by way of an order (as set out above in paragraphs 2.83 to 2.96) or a recommendation.
- 2.121 The latter could lead either to Ofgem modifying licence conditions, or to a modification proposal being raised for the industry to develop a modification

proposal (similar to the process followed in the past, eg P229). In principle, this approach would give an additional opportunity to Ofgem and/or the industry to carry out further analysis and consult upon it (eg a more detailed simulation model).

- 2.122 Having compared the analysis performed by the CMA with the analysis carried out in the context of previous modification proposals, we do not see merit in recommending that Ofgem carry out further analysis concerning the merits of this proposed remedy. The central purpose of modelling is to provide for an order of magnitude of technical benefits. Having consulted with third parties regarding NERA analysis, we do not believe that other credible sets of input parameters or different types of model will alter the type or magnitude of effect that we have identified to a substantial extent.
- 2.123 In addition, we are concerned that a recommendation to Ofgem or the industry would lead to unnecessary delays. As noted above, previous experience shows the difficulty in implementing this proposed remedy. Ofgem's process to modify licence conditions would likely, within the context of a historically controversial measure such as this one, be longer than the CMA's process to impose an order (which is constrained by a statutory time frame). As noted in our provisional findings report, the code modification process, in particular when incentives are misaligned (as it is the case within this context), may lead to long delays. Moreover, a recommendation by the CMA, compared with an order, would increase the risk of the proposed remedy not being implemented at all. We consider that an order by the CMA would lead to a simpler, less costly, implementation process.
- 2.124 For these reasons, we believe that our proposed remedy is no more onerous than necessary to achieve its aim and the least onerous of the alternative proposals that we have considered.
- 2.125 We have also considered whether this proposed remedy may have disadvantages that are disproportionate to its aim. We noted that the proposed remedy will have distributional effects, including transfers between generators in different regions, customers in different regions and between the GB market and generators (and possibly customers) in the rest of Europe. While we have not tried to assess the magnitude of these transfers with precision, we believe for the reasons set out above that it is more likely than not that the proposed remedy will have a positive impact on GB customers' bills overall. Even if customers in certain regions of GB were to see their bills increase as a result of the proposed remedy (to the benefit of other GB customers) we would expect this effect to be small (for individual domestic customers, under a few pounds per year).

- 2.126 We have also sought to examine whether the proposed remedy may have unintended consequences on the environment, as a result of a shift of production from cleaner to more polluting plants (ie overall increase in CO₂), or a shift from generation in areas with low density population to high density population (ie SO₂ and NO_x emissions affecting a larger population). However, based on our modelling exercise (albeit acknowledging its limitations), and the absence of evidence pointing in the opposite direction, the reduction in overall generation of electricity to satisfy demand should overall have a beneficial environmental impact.
- 2.127 Further, we have discussed above (see paragraphs 2.79 to 2.81) the inefficiencies of the losses charging mechanism for interconnectors and noted that it does not provide signals allowing variable transmission losses to be taken into account in generation dispatch decisions. While we believe that Ofgem, ACER and other European regulators should consider how the charging mechanism should be reformed, we consider that this does not invalidate our case for having a more efficient allocation of transmission losses within Great Britain given that net benefits arise from it. It is possible that a reformed charging mechanism for interconnectors, which includes locational signals would bring even higher net technical efficiency benefits.

Assessment of the proposed remedy against the relevant statutory functions of Ofgem

- 2.128 Where the CMA is considering whether to modify the licence conditions of entities involved in the transmission of electricity, it must 'have regard' to the relevant statutory functions of Ofgem in deciding whether such action would be reasonable and practicable⁹⁴
- 2.129 Ofgem's statutory functions concerning the transmission of electricity are set out in Part 1 of the EA89, as amended by the Energy Act 2010 (EA10), and include (among other things) granting transmission licenses, promoting efficiency and economy on the part of persons authorised by licences or exemptions to transmit, distribute or supply electricity, and to secure a diverse and viable long-term energy supply. Ofgem, as the regulator, sets price controls for the companies that operate GB gas and electricity networks.⁹⁵

⁹⁴ Section 168 of the 2002 Act and [CC3](#), paragraph 347.

⁹⁵ [Ofgem factsheet: Price Controls Explained](#).

- 2.130 Ofgem’s principal objective in carrying out such functions is to protect the interests of existing and future customers of gas and electricity supply.⁹⁶ The interests of such customers are taken as a whole, including their interests in (a) the reduction of greenhouse gases; (b) the security of supply; and (c) the fulfilment by Ofgem of the objectives set out in Article 36(a) to (h) of the Electricity Directive.⁹⁷
- 2.131 In reaching a decision to modify a licence condition, we must therefore assess the proposed remedy against Ofgem’s principal objective, as set out above. As part of our own application of the legal framework requiring us to decide upon proposed remedies that are effective and proportionate,⁹⁸ we have explicitly taken into account many of the above factors to which Ofgem must have regard when doing carrying out its functions. In particular, we have noted the expected net benefits of our proposed remedy for GB electricity customers. We have therefore concentrated below on those considerations not explicitly taken into account elsewhere in this section.
- 2.132 We believe that the proposed remedy is consistent with Ofgem’s environmental objective of reducing greenhouses gases. As noted above, our modelling exercise estimates that there will be a moderate additional environmental benefit from the reduction in SO₂ and NO_x emissions from the proposed remedy.
- 2.133 While the proposed remedy would have an impact on decisions relating to investment in, and dispatch of, capacity, we have seen no evidence that this would have any negative impact on the overall level of generation capacity in GB. On the contrary, increased efficiency in system performance is in our view consistent with the aim of achieving security of supply.
- 2.134 Our proposed remedy will directly promote some of the objectives set out in the Electricity Directive, namely it will provide system operators and system users with the appropriate incentives, in both the short and the long term, to increase efficiencies in system performance. With locational pricing for

⁹⁶ See, among others, section 3A and section 6B of the EA89.

⁹⁷ Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC, OJ L211/55 (the Electricity Directive).

⁹⁸ CC3, paragraph 327. These objectives include, among other things, a requirement on the national regulator to take all reasonable measures for a competitive, secure and environmentally sustainable internal market in electricity within the European Union, and ensuring appropriate conditions for (i) the effective and reliable operation of electricity networks, taking into account long-term objectives; (ii) developing competitive and properly functioning regional markets within the European Union; (iii) eliminating restrictions on trade in electricity between member states; (iv) eliminating restrictions on trade in electricity between member states; (v) facilitating access to the network for new generation capacity; (vi) ensuring that system operators and system users are granted appropriate incentives, in both the short and the long term, to increase efficiencies in system performance and foster market integration; (iv) ensuring that customers benefit through the efficient functioning of their national market; and (viii) helping to achieve high standards of universal and public service in electricity supply, contributing to the protection of vulnerable customers.

losses, generators will have incentives to dispatch electricity more efficiently thus reducing the total amount of losses generated to meet demand. A more efficient pricing mechanism for losses will therefore promote the development of a competitive and properly functioning market in Great Britain and in turn may foster market integration with other regional markets. In this respect, we noted above that it is more likely that the GB system will evolve to an even better mechanism for locational pricing if it starts from a position of some locational pricing rather than none.

- 2.135 As discussed in paragraphs 2.9 and 2.10 above, Ofgem concluded in September 2011, with respect to P229, that the proposed modification would not be consistent with its principal objective and statutory duties.⁹⁹ In its decision, Ofgem noted however that increased cost reflectivity as per P229 (as per our proposed remedy) should result in more efficient dispatch due to cost signals allowing variable losses to be taken into account leading to production cost savings, reduced losses and reduced emissions. It also stated that, in general, competition is likely to be more effective if the costs which parties impose are reflected in their charges and therefore their decision-making process. For the reasons set out in paragraphs 2.11 and 2.11(b) above, and in paragraphs 5.62 and 5.63 of our provisional findings report, we have found it difficult to reconcile Ofgem's decision on P229 with the evidence and analysis Ofgem commissioned and summarised in its impact assessment. We also noted in paragraph 2.11(b) above that some of the concerns relating to the long-term benefits of the introduction of locational pricing for transmission losses were in our view unlikely to materialise in the light of recent development at EU level.
- 2.136 Therefore, while we note the decision taken by Ofgem in 2011, for the reasons set out in this section, and in particular the expected net benefits for GB customers in the next ten years, we consider that the proposed remedy is consistent with Ofgem's principal objective of promoting the best interests of existing and future customers.

Allocation of Contracts for Difference

Introduction

- 2.137 As set out in our provisional findings report, we consider that one of the key benefits of moving from the system of Renewables Obligation Certificates (ROCs) to CfDs is the ability to allocate CfDs using a competitive auction

⁹⁹ Ofgem modification proposal decision (September 2011), [Balancing and Settlement Code \(BSC\) P229: Introduction of a seasonal Zonal Transmission Losses scheme \(P229\)](#).

process. Allocating CfDs via an auction ensures that CfDs are awarded to those projects that require the lowest level of support, and therefore that they are allocated in an efficient manner. Since customers will pay for this support through increased bills, ensuring an efficient allocation of CfDs is likely to minimise the costs they face in meeting GB decarbonisation targets.

- 2.138 Given DECC's estimate that CfD support payments will increase steadily, reaching an estimated £2.5 billion per year by 2020/21,¹⁰⁰ it is essential that future CfD auctions are designed in such a way that future costs to customers are minimised.
- 2.139 We noted that DECC has retained its ability, in exceptional circumstances, to allocate CfDs outside an auction. We also identified concerns relating to the insufficient disclosure of analysis around the division of technologies and budgets into pots. Given the significant amounts of support being allocated to renewable generators, it is important that DECC bases its decisions on robust analysis, demonstrating clearly why it considers that its preferred course of action can be expected to benefit customers, and communicates its findings to stakeholders in a transparent manner.
- 2.140 Accordingly, we provisionally found that the mechanisms for allocating CfDs are a feature of the GB wholesale electricity market giving rise to an AEC due to the absence of an obligation for DECC to:
- (a) carry out, and disclose the outcome of, a clear and thorough impact assessment supporting a proposal to use its powers to allocate CfDs outside a competitive process; and
 - (b) regularly monitor the division of technologies between different pots, which form the basis of CfD auctions, and provide a clear justification when deciding on the allocation of budgets between the pots for each auction.
- 2.141 The Remedies Notice proposed two possible remedies that we have considered in more detail below:
- (a) DECC to undertake and consult on a clear and thorough impact assessment before awarding any CfD outside the CfD auction mechanism ('non-competitive allocation proposed remedy').

¹⁰⁰ In 2011/12 prices. The remaining budget to 2020/21 under the Levy Control Framework is set out in DECC (October 2014), [Annual energy statement](#) 2014, p75.

(b) DECC to undertake and consult on a clear and thorough assessment before allocating technologies between pots and the CfD budget to the different pots ('pot design proposed remedy').

2.142 This section considers these two remedies in turn. It sets out the aim of each proposed remedy, and parties' views on each proposed remedy in response to the Remedies Notice, before setting out the main design considerations. The section then concludes by setting out (for both remedies together) why we consider these remedies to be effective and proportionate and our provisional decision.

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

2.143 In our provisional findings report, we set out our provisional finding that the mechanisms for allocating CfDs are a feature of the GB wholesale electricity market giving rise to an AEC due to the absence of an obligation for DECC to carry out, and disclose the outcome of, a clear and thorough impact assessment supporting a proposal to use its powers to allocate CfDs outside a competitive process.

2.144 As set out in our provisional findings report, we estimate that DECC's decision to award CfDs outside the competitive auction process through Final Investment Decision enabling for Renewables (FIDeR) was likely to have resulted in considerable overcompensation of the generators securing these contracts. Had the strike prices for the offshore wind projects awarded under FIDeR in 2014 been in line with the strike prices for offshore wind projects under the first CfD competitive auction concluded in February 2015, the level of support to those projects would have been approximately £250–£310 million per year lower.

2.145 We note that any decision to allocate CfDs outside a competitive process must be notified to the European Commission under state aid rules. Also, parties could challenge such a decision by judicial review. However, we are concerned that the absence of requirements on DECC to carry out and disclose a clear and thorough explanation of the basis of any decision to use its powers to allocate CfDs in a non-competitive way might make such challenges more difficult.

2.146 We set out in the Remedies Notice our view that without some further constraints on DECC's ability to award contracts outside the competitive process, further contracts may be awarded that result in excessive costs to energy customers.

Aim of the proposed remedy

- 2.147 The aim of this proposed remedy is to increase the likelihood that, in future, if DECC is considering allocating one or more CfDs outside the competitive auction process, it undertakes and consults on a clear and rigorous analysis of the impact of doing so.
- 2.148 We consider that there are the following likely benefits of DECC undertaking and consulting on impact assessments before allocating CfDs outside the competitive auction process:
- (a) **Improved decision-making:** The proposed remedy aims to improve DECC's decision-making process by encouraging it to undertake a rigorous analysis before making decisions with potentially costly outcomes. By consulting on such analysis, this will further ensure that DECC has undertaken a rigorous analysis. In doing so, this will increase the likelihood of DECC following the lowest cost path to achieving decarbonisation targets and minimising costs for energy customers.
 - (b) **Increased transparency:** In addition to enabling stakeholders to provide feedback and challenge to DECC's proposals (which as noted above will reinforce the robustness of DECC's decision-making), increased transparency may increase stakeholders' trust in the energy markets. To the extent that this proposed remedy gives stakeholders greater clarity around the budget available for future CfD auctions, it may also enable developers to make better-informed decisions regarding whether to develop future projects to the stage where they can bid in CfD auctions.

Parties' views

- 2.149 Below is a summary of parties' responses to our provisional findings.¹⁰¹ A large number of parties set out that they broadly supported our proposal for DECC to undertake and consult on a clear and thorough impact assessment before awarding any CfDs outside the CfD auction mechanism.¹⁰² However, two parties (Citizens Advice and Ecotricity) set out their concerns that the proposed remedy might fail to change DECC's approach to awarding CfDs in practice.
- 2.150 A number of parties set out their view that there might be circumstances under which it might be appropriate for DECC to award CfDs outside the

¹⁰¹ See [Responses to provisional findings and notice of possible remedies](#).

¹⁰² This included Citizens Advice, Co-operative Energy, Drax, Ecotricity, EDF Energy, ENGIE, EON, Good Energy, Opus, RWE, Scottish Power, SSE and Which?

competitive auction.¹⁰³ However, a number of these parties set out their view that this should be only in limited circumstances, with parties expressing a range of views around the specific circumstances under which this might be appropriate.

- 2.151 Regarding the degree of flexibility DECC should have in determining the types of project to which it may award a CfD outside the auction, Carbon Capture & Storage Association, EDF Energy, Scottish Power and Shell set out their views that DECC should retain a degree of flexibility.¹⁰⁴ In contrast, Energy Action Scotland set out its concerns with DECC maintaining a high level of discretion in this area.
- 2.152 A number of parties set out their concerns that previous non-competitive allocation of CfDs might not have been in customers' best interests.¹⁰⁵
- 2.153 A large number of parties had comments relating to the transparency of DECC's decision-making in this area. Co-operative Energy, E3G, the Highlands and Islands Housing Associations Affordable Warmth Group, [X], RWE and Scottish Power set out their views around the need for greater transparency. National Grid recognised the value of a transparent process for allocating CfDs. In addition, CCSA, Centrica, Citizens Advice, EDF Energy, ESB and RWE all set out their views that our proposed remedy should result in increased transparency in this area.

Design considerations

- 2.154 In this section we set out our provisional views on the circumstances under which it may be appropriate for DECC to award CfDs outside the competitive auction process. We then consider when DECC should undertake and consult on impact assessments on its decision to award CfDs outside the competitive process, and set out our thoughts on the sorts of analysis that should form part of these assessments.
- *DECC to set out why the project should not compete in the competitive auction process*
- 2.155 As noted in our provisional findings report, awarding CfDs through a competitive auction process is likely to drive costs down, relative to awarding CfDs in a non-competitive (eg bilaterally negotiated) manner. As a result, we

¹⁰³ This included CCSA, Centrica, EDF Energy, [X], ENGIE, EON, Good Energy, Renewable UK, [X], RWE, Scottish Power, Shell.

¹⁰⁴ Shell considered that this should be for a transitory period of time.

¹⁰⁵ See for example Energy Policy Group (Exeter University), EON, Ovo Energy, REG Group and Which?

believe that DECC should allocate support to low carbon generators through the competitive auction process, unless there is objective and compelling justification for departing from this approach. If DECC considers it appropriate to award a CfD directly, it should set out in its impact assessment clearly why it considers a direct award to be preferable to making the project compete in the competitive auction process. However, the default should be to award CfDs through a competitive process.

2.156 As part of this proposed remedy, we do not propose to recommend absolute restrictions on the types of project to which DECC should award CfDs outside the competitive process, or the specific situations in which it should do so. As a general principle, we consider that DECC should allocate a CfD outside the competitive auction process only where it can demonstrate that the benefits to customers of doing so can be expected to exceed the costs.¹⁰⁶ We note that there may be particular circumstances under which allocating CfDs directly (outside the competitive auction process) could potentially result in an efficient mix of generating technologies in the long run and/or minimise costs to customers:

- (a) Firstly, there may be technologies and projects to which it would be efficient to allocate CfDs, but that might not be able to compete in the competitive auction process. For example, there may be potential projects with a lifespan and other operating characteristics that are so different to the characteristics of potentially competing projects that it is difficult to compare them on a like-for-like basis. If it would be efficient to award CfDs to such projects (ie they face lower costs than other low carbon technologies that would otherwise receive support), it may be in customers' interests to award CfDs directly to these projects outside the competitive auction process.
- (b) Secondly, there may be positive externalities associated with supporting particular types of technology now. For example, some currently less developed (and higher cost) technologies may require support now in order to reduce the costs of similar projects in the future. If this is the case, even though these technologies may be part of the efficient energy mix over the long run, a technology neutral competitive auction (or one of similar levels of neutrality to the competitive auction process) may fail to award them CfDs. This may prevent them from successfully reducing

¹⁰⁶ While we consider it highly unlikely that it would be in consumers' best interests to award further CfDs outside the competitive auction process to technologies of the kind that were allocated CfDs under FIDeR (since they are allocated to auction pots and should therefore be able to compete in the competitive auction process), we are not minded to make a recommendation that DECC's powers to do so should be limited.

their costs over time, and eventually becoming part of an efficient energy system. In such cases, there may be an argument for DECC to award CfDs directly to these projects outside the competitive auction process.¹⁰⁷

2.157 An element of judgement will be required in making these assessments in any individual case (albeit based on a more rigorous analysis of costs and benefits) and we have therefore not considered it appropriate to recommend imposing absolute rules determining the situations in which non-competitive allocation would be allowed. We do consider, however, that before deciding to allocate support on a non-competitive basis, DECC should set out clearly in its impact assessment why it considers that it is not feasible (or appropriate) for the project to compete in the competitive auction process and why the benefits of non-competitive allocation are likely to exceed the costs.

- *When should DECC undertake (and consult on) impact assessments?*

2.158 In order to achieve the aim of this proposed remedy, we believe that DECC should undertake impact assessments seeking to establish whether it is appropriate for the government, in the light of the UK's long-term objectives of decarbonisation and security of supply, to support a type of project that, due to its particular characteristics, could not be allocated (or would not be appropriate to allocate) through the competitive auction process.

2.159 In our view, DECC should seek to address this question in two phases. DECC should first undertake and consult on a high-level impact assessment at an early stage (ie before entering into negotiations with prospective generators), in order to identify the possible costs and the benefits that may arise from supporting a given technology. Within that context, it should explain why CfDs could not be allocated to that type of project through the competitive auction process (eg due to its size/and or technology). In the second phase, after the negotiations with the prospective generators and the provisional agreement of a strike price, DECC should present a detailed assessment of whether supporting the project in question is in customers' best interests.

2.160 At both phases, the expected costs and benefits of the proposal should be exposed transparently for public consultation, and DECC should set out both the social costs and benefits of the proposal and expected distributional

¹⁰⁷ We note that DECC has designed the CfD auction process in such a way that it sets aside some of the available budget to support less developed technologies. We discuss this in more detail in paragraphs 2.184–2.215 below.

impacts with respect to both firms and customers (notably, the forecast impact on customers' bills).

- 2.161 In a hearing with the CMA, DECC raised concerns that the timing of the publication of an impact assessment could jeopardise its ongoing negotiations. We have reflected on these concerns and consider that under the present formulation of this proposed remedy, there is minimal risk of this taking place. We consider that the initial impact assessment would be relatively high level, and may rely largely on already publicly available information (such as DECC's published estimates of the cost of the relevant technology, and potentially information provided by the developer),¹⁰⁸ and that as a result it should not unduly affect DECC's negotiating position.
- 2.162 Likewise, undertaking an impact assessment following the conclusion of negotiations would not jeopardise DECC's negotiation position (although we accept that certain details of the terms of the agreement might need to be kept confidential) and need not delay the overall decision-making process. Any CfD agreed outside the competitive process mechanism would need to be cleared by the European Commission under state aid rules. Within the context of this process, DECC could publish its impact assessment after reaching the initial agreement with the counterparty, consulting on it in parallel to the formal state aid notification of this agreement.¹⁰⁹
- *Assessing the impacts of allocating CfDs outside the competitive auction process*
- 2.163 In this section, we give a brief overview of the various impacts that might result from allocating CfDs outside the competitive auction process, and how we believe DECC should assess them. Broadly, we consider that DECC should assess the impact on costs, the externalities that may result, and any other impacts that may be expected. To the extent possible, these impacts should be quantified.

¹⁰⁸ For example, DECC sets out its estimates of the costs of different generating technologies in DECC (2013), [Electricity Generation Costs](#). In the case of Swansea Bay Tidal Lagoon, the developer has set out that it would require a strike price of £168/MWh. See Pöyry (March 2014), [Levelised costs of power from tidal lagoons – A report to Tidal Lagoon Power plc](#).

¹⁰⁹ We note that, in the case of Hinkley Point C, the initial agreement – including strike price – was publicly announced on 21 October 2013, the formal notification to the European Commission was filed on 22 October 2013, the decision to open an in-depth investigation was taken on 18 December 2013 and the positive decision was taken on 8 October 2014. See press release (21 October 2013), [Initial agreement reached on new nuclear power station at Hinkley](#) and the [case page](#) on the European Commission website.

- *Costs*

- 2.164 When setting out its estimates of costs, as well as presenting the overall cost of supporting a given project, DECC should present the costs of a given CfD compared with those that would have arisen under the counterfactual scenario under which it does not allocate a CfD outside the competitive auction process. That is, DECC should set out its estimate of the incremental cost of awarding the CfD in question outside the competitive auction process. By doing so, it would provide transparency to stakeholders around the additional cost (if any) of DECC's proposed policy.
- 2.165 By awarding a CfD outside the competitive auction process, the amount of low carbon generation required to meet decarbonisation targets will be reduced (along with the overall CfD budget available for other projects). As a result, another low carbon project (or projects) that would have been built had this particular CfD not been awarded outside the competitive auction process may be displaced. The incremental cost to customers of awarding a CfD outside the competitive auction process would be the cost of supporting the project under consideration relative to the cost of supporting any projects displaced. As part of the impact assessment, DECC should consider the suitable counterfactual in undertaking its assessment of costs.¹¹⁰
- 2.166 These incremental costs could be either positive or negative. If awarding a CfD outside the competitive auction process increases the costs relative to the counterfactual (eg if a tidal lagoon project displaces lower cost offshore wind projects), doing so will result in a positive incremental cost. However, if awarding a CfD outside the competitive auction process results in lower costs than would have resulted under the counterfactual (eg if a nuclear power station displaces higher cost offshore wind projects), the incremental costs would be negative.
- 2.167 In order to ensure maximum transparency, we consider that DECC should set out the incremental costs in terms of total costs (net present value), total annual costs, and average impact on customer bills.

- *Externalities*

- 2.168 Where the case for supporting a high cost project is based on it resulting in lower costs for similar projects in future – ie it results in long-run externalities

¹¹⁰ For example, if DECC opts to award a CfD to a tidal lagoon generator, the incremental cost would be the cost of supporting that project minus the cost of providing that volume of generation from the projects that are displaced as a result (eg offshore wind).

– DECC should set out the evidence informing its view that supporting the project will result in lower total costs to customers over the long run. In doing so, DECC should demonstrate that supporting a given technology will result in cost reductions that would not materialise absent support.¹¹¹ Any impact of these externalities should be weighed against any incremental costs identified above.

- 2.169 Supporting a given technology could result in either positive or negative externalities. If awarding a CfD outside the competitive auction process decreases the costs of future projects of the same technology, this may reduce long-run costs (ie a positive externality). However, if the project displaces other projects, it is possible that this could increase the costs of projects involving that technology in the long run (ie a negative externality). DECC should take both these impacts into account.
- 2.170 It is important to note that demonstrating cost reductions alone does not necessarily indicate that there is a case for supporting a given technology. In order for there to be benefits to customers, the future costs would need to be low enough that this technology would form part of the future energy system (ie it would actually need to be deployed at this lower cost). If this were not the case, any future cost reductions would not deliver a lower cost energy system in future.¹¹²
- 2.171 Where it is not possible to quantify these impacts, DECC should nevertheless be transparent about the trade-offs it is making in reaching its decisions. For example, if it has quantified the incremental cost of allocating a CfD outside the competitive auction process, but is unable to quantify the benefits (positive externalities), it should be able to articulate clearly why it considers that the benefits can be expected to exceed the costs.

¹¹¹ As noted above, there may also be projects where DECC is considering allocating a CfD outside the competitive auction process, without the expectation of significant future cost reductions. For example, DECC's main rationale for allocating a CfD to Hinkley Point C was not to reduce the cost of future nuclear plants. Rather it considered that securing reliable, long-term, low carbon baseload generation at the agreed strike price represented good value for consumers (without relying on future cost reductions). While its case for awarding a CfD outside the competitive auction process in such cases does not rely on future cost reductions for nuclear power stations, DECC should nevertheless consider the impact on the future costs of any technologies displaced by its decision to award a CfD directly (ie whether there are any negative externalities from supporting the project in question).

¹¹² Take the example of a project that requires support of £200/MWh now, in order to reduce the required support of future projects to £150/MWh in the 2020s (instead of remaining at £200/MWh without support). While supporting this technology would clearly reduce the costs of future projects involving that technology, even following this reduction the cost may be prohibitively high. As a result, such a technology may be unlikely to form part of an efficient future energy system, despite reducing its cost. As a result, despite support leading to a reduction in cost of the technology in the long run, it is unlikely to deliver benefits to consumers.

- *Other impacts*

- 2.172 In addition to considering the impacts outlined above, DECC should also consider a range of broader impacts. As with the direct impact on costs and externalities set out above, these impacts should be considered relative to the counterfactual of not awarding a CfD outside the competitive auction process.
- 2.173 These broader benefits could be either positive or negative. For example, where a particular technology results in lower 'system-wide costs',¹¹³ or where supporting a given technology would result in a more diverse energy system,¹¹⁴ these may result in positive impacts that DECC may want to take into account. Conversely, where DECC is considering awarding a CfD to a project that has certain, less desirable characteristics (eg risks around waste disposal for nuclear, or impacts on air quality for other types of plant), DECC should factor this into its assessment of the costs and benefits of awarding a CfD outside the competitive auction process.
- 2.174 This does not provide an exhaustive list of the other factors DECC may wish to consider in its impact assessment. As with the other impacts, it should aim to quantify these where possible. Where it is unable to do so, it should articulate clearly why it places value on them, the trade-offs it is making, and why it considers these to be in the best interests of customers.¹¹⁵
- 2.175 As set out above, we are proposing to recommend that DECC undertakes and consults on impact assessments at two stages when it is considering allocating CfDs outside the competitive auction process. We set out below the types of analysis we would expect DECC to undertake for each of these assessments.

¹¹³ For example, if DECC is considering supporting a given low carbon technology that is readily dispatchable or has a more predictable output than the technology that is displaced (i.e. the technology that would be deployed under the counterfactual), there may be benefits of supporting this technology that cannot be measured by comparing only the required levels of support (strike price).

¹¹⁴ It is impossible to predict the precise characteristics of a future efficient energy system. As a result, there is likely to be some value in ensuring that GB low carbon generation consists of a diverse range of technologies. Ensuring this diverse mix may come at a cost (as it may require not always deploying the lowest cost technologies), but may deliver benefits through added resilience.

¹¹⁵ For example, it should set out the incremental costs of its proposed course of action (as set out above), and why it considers that the benefits of securing a source of dispatchable low carbon generation can be expected to outweigh these costs (even if it is unable to quantify the benefits).

- *Assessments before and after negotiations*

- *Before entering into negotiations with a party*

- 2.176 An impact assessment at this early stage would be strategic in nature, as it would not, for example, be able to reflect detailed contractual provisions that would be negotiated at a later date.¹¹⁶ However, we consider that there is value in DECC setting out at a 'high level' why it considers that awarding a CfD directly may be in customers' best interests at this stage, and why it considers that the project in question should not have to compete for a CfD in the competitive auction process (as discussed above). While DECC's understanding of the underlying costs and benefits of awarding a CfD is likely to be limited at this stage, it should be in a position to articulate why it is planning to do so, and the range of potential impacts.¹¹⁷
- 2.177 On assessing the incremental costs, DECC should undertake assessments of the underlying costs of different generating technologies on a regular basis.¹¹⁸ While it should undertake considerably more detailed assessments of costs before reaching a decision to award a CfD outside the competitive auction process (including an in-depth assessment of the specific project's claimed costs), these broad estimates should enable DECC to set out the approximate costs of entering into a CfD with a given project. By making reasonable assumptions about the deployment of technologies under the counterfactual, DECC should be able to undertake an analysis of the incremental cost of awarding a CfD outside the competitive auction process.¹¹⁹
- 2.178 As with assessing the direct impact on costs, DECC may be unable to undertake a full assessment of the externalities at this early stage. However, we consider that DECC should have developed a good understanding of the nature of the technology ahead of entering into negotiations, and as a result should be able to set out at a high level its assessment of the potential for supporting a project to enable future cost reductions. As a result, where DECC's case for allocating a CfD outside the competitive auction process

¹¹⁶ The level of detail with which DECC could set out the costs and benefits at this early stage is likely to vary with different types of project, based on its knowledge of different technology types.

¹¹⁷ DECC did consult on its decision to enter into negotiations with Swansea Bay Tidal Lagoon, but did not publish an assessment of the likely costs and benefits of doing so.

¹¹⁸ We understand that DECC currently does this. See for example DECC (2013), [Electricity Generation Costs](#).

¹¹⁹ In addition to DECC's own estimates of cost, potential developers may already set out the strike price they would require to invest (for example, in the case of Swansea Bay Tidal Lagoon, the developer has set out that it would require a strike price of £168/MWh – see Pöry (March 2014), [Levelised costs of power from tidal lagoons – A report to Tidal Lagoon Power plc](#)). While DECC should not put too much weight on this figure, given the potential incentives for the developer to behave strategically in stating the level of subsidy it requires, it does provide a starting point (potentially an upper bound) for assessing the potential costs of supporting a project. Indeed, if developers thought that overstating these costs at an early stage could result in failing to get beyond this initial stage, they may face greater incentives to report their required level of support truthfully.

relies on these types of positive externality, it should be able to articulate at a high level why it considers that these benefits are likely to outweigh any costs identified.

2.179 Regarding its assessment of other impacts, DECC should be able to set out at this early stage its understanding of the characteristics (both positive and negative) of the generating technology it is considering supporting (eg predictability of output).

2.180 Overall, we consider that DECC should have sufficient information at this stage to set out its broad assessment of the likely costs and benefits of awarding a CfD outside the competitive auction process.

- *Following negotiations with a party*

2.181 After concluding negotiations with a party, DECC should have a detailed understanding of the project's costs and the strike price it would require.¹²⁰ In addition, we would expect that by this point, DECC would have firmed up its view of the likely counterfactual (or set out a range of possible scenarios, if necessary). This should enable it to assess the likely incremental costs of supporting a given project in a considerably more detailed and robust manner than it would have been able to do under the initial high-level impact assessment.¹²¹

2.182 By this late stage of the process, DECC should have developed a good understanding of the extent to which there is scope for cost reductions in future (where applicable), and the extent to which these are dependent on supporting the technology now. As DECC's understanding of the project's costs would have improved over the course of the negotiations (through rigorous and independent assessment of its reported costs), so should DECC's understanding of the technology's cost structure more generally, and therefore the potential for cost savings in the future, and the extent to which any future cost savings are dependent on supporting the project in question.¹²²

¹²⁰ We would expect DECC to undertake independent verification of the project's reported costs as part of its assessment.

¹²¹ As noted above, we consider that DECC should set out its estimates of the incremental cost in terms of total amount (net present value) for the project, total annual costs, and average impact on consumer bills.

¹²² Where DECC is unable to quantify the impact of these externalities, having identified its estimate of the costs of supporting a project, it should be able to set out the thresholds for future cost savings and levels of deployment beyond which it would expect the benefits of the externalities to outweigh any incremental costs identified. For example, DECC may conclude that given the costs of supporting a project, it would have to reduce the strike price required for future projects by £50/MWh and achieve deployment of 2 GW in order for the benefits of these externalities to outweigh the costs. DECC should be sufficiently well-informed by this point to be able to explain

- 2.183 By this late stage, DECC should have a more refined view of the value it places on any of the other impacts identified, and should therefore have more advanced thinking around the value of trading off the level of support (cost) for these other characteristics.¹²³

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

- 2.184 In our provisional findings report, we set out our provisional finding that the mechanisms for allocating CfDs are a feature of the GB wholesale electricity market giving rise to an AEC due to the absence of an obligation for DECC to (among other things) regularly monitor the division of technologies between different pots, which form the basis of CfD auctions, and provide a clear justification when deciding on the allocation of budgets between the pots for each CfD auction.
- 2.185 As set out in the introduction to this section, we consider that a technology neutral competitive auction should be DECC's starting point when considering how to allocate CfDs, as it ensures that CfDs are allocated to the projects with the lowest costs from the entire pool of potential bidders.
- 2.186 DECC's decision to separate technologies and budgets into different pots risks allocating CfDs to currently more costly (less efficient) projects, while excluding less costly (more efficient) ones. Given the large amounts of support being allocated to renewable generators, decisions in this area have the potential to have considerable impacts on customers' bills.
- 2.187 We recognise that there may be cases where a technology neutral competitive auction could not be expected to result in an efficient outcome over the long term, for example if supporting less developed technologies enables them to lower their costs in future (ie positive externalities). Indeed, even where a technology neutral competitive auction may result in an efficient outcome, it may nevertheless not result in an outcome that minimises costs to customers now or in the longer run (eg if it results in successful projects receiving considerably more support than they require).

whether it considers this to be a likely scenario, and therefore whether the benefits of supporting a project are likely to outweigh the costs.

¹²³ We note that no such assessment was carried out in relation to the FIDeR projects. If any such assessment had been carried out, we do not believe that it would have led to the conclusion that it was in customers' interests to allocate the FIDeR projects outside of the competitive auction process. As noted in our provisional findings report, we consider that the CfDs awarded to offshore wind projects under FIDeR resulted in consumers paying approximately £250–£310 million per year more than had these CfDs been awarded at the strike price received by the two offshore wind projects that were successful in the first competitive CfD auction. We noted that the cost characteristics of the FIDeR projects were very similar to the projects awarded CfDs through the competition auction process less than a year later.

- 2.188 However, as set out in our provisional findings report, we have not been made aware of any significant analysis undertaken by DECC on the rationale for its decision on how to allocate the technologies and budget between the pots for the first CfD auction in the manner it chose to do so.
- 2.189 In our provisional findings report, we did not quantify customer detriment arising from DECC's initial decision to allocate budgets to pots for the first CfD auction, but we noted that the absence of robust analysis increases the risk of customer detriment in the future. Recent modelling work undertaken by NERA¹²⁴ (discussed in more detail below) estimates that for a potential CfD auction in 2017, holding a technology neutral competitive auction would result in a cost reduction of £50 million per year compared with keeping the same allocation of technologies and budgets to pots as in the 2015 CfD auction. This illustrates the significant impacts that DECC's decisions in this area can have on the costs faced by customers (who ultimately pay for the support to low carbon generators). It is essential, therefore, that DECC makes such decisions based on rigorous analysis, and communicates this in a clear and transparent manner.

Aim of the proposed remedy

- 2.190 The aim of the proposed remedy is to ensure that, in future, when making decisions about the technologies and budgets to allocate to different auction pots, DECC undertakes a rigorous and transparent analysis of the impacts of its decisions. As with the proposed remedy discussed above concerning undertaking and consulting on impact assessments before allocating CfDs outside the competitive auction process, we consider that there are the following likely benefits of DECC undertaking and consulting on such an assessment:
- (a) Improved decision-making: The proposed remedy aims to improve DECC's decision-making process by encouraging it to undertake a rigorous analysis before making decisions with potentially costly outcomes. By consulting on such analysis, this will further ensure that DECC has undertaken a rigorous analysis. In doing so, this will increase the likelihood of DECC following the lowest cost path to achieving decarbonisation targets and minimising costs for energy customers.
 - (b) Increased transparency: In addition to enabling stakeholders to provide feedback and challenge to DECC's proposals (which as noted above will reinforce the robustness of DECC's decision-making), increased

¹²⁴ NERA (October 2015), [Modelling the GB Renewable Electricity CfD Auctions – the cost of excluding onshore wind and maintaining separate pots – A project for Citizens Advice – Final Report](#).

transparency may increase stakeholders' trust in the energy markets. To the extent that this proposed remedy gives stakeholders greater clarity around the budget available for future CfD auctions, it may also enable developers to make better-informed decisions regarding whether to develop future projects to the stage where they can bid in CfD auctions.

- 2.191 We note that the European Commission cleared the CfD regime under state aid rules.¹²⁵ It may, however, under Article 108 of the Treaty on the Functioning of the European Union (TFEU), review this regime. If the European Commission finds that the CfD regime is no longer compatible or is being misused, it may decide to require the UK government to abolish or alter such regime. In addition, parties are able to challenge decisions to allocate CfDs by judicial review.
- 2.192 In addition, we consider it unlikely that the European Commission will revisit the allocation of technologies and budgets on a regular basis. It is therefore important that DECC undertakes regular reviews in order to ensure that the allocation of technologies and budgets to pots remains in the interests of customers.

Parties' views

- 2.193 Below is a summary of parties' responses to our provisional findings.¹²⁶ A number of parties set out their support for our proposed remedy.¹²⁷ In addition, a number of parties (Drax, EDF Energy, Renewable UK, [X] and Scottish Power) all set out more general views around the need to move towards technology neutral competitive auctions. Citizens Advice and E.ON also set out that the process of reviewing the allocation of technologies to pots should enable DECC to establish which technologies had developed sufficiently to move into the 'more established' technologies pot (Pot 1). EDF Energy noted that less established technologies that failed to reduce costs should not be supported indefinitely and that those that did reduce costs should be moved into Pot 1 at the appropriate time.
- 2.194 A large number of parties agreed that the proposed remedy would increase transparency around DECC's decision-making.¹²⁸ However, Ecotricity set out its view that despite increasing transparency, our proposed remedy would not ensure that DECC was obliged to act on the findings of its

¹²⁵ The CfD scheme was approved by the European Commission under state aid rules (European Commission (July 2014), [Letter to the United Kingdom, State aid SA.36196 \(2014/N\) – electricity market reform – contract for difference for renewables](#)).

¹²⁶ See [responses to provisional findings and notice of possible remedies](#).

¹²⁷ These included Co-operative Energy, Drax, E.ON, Good Energy, RWE, SSE, Which?

¹²⁸ These included Carbon Capture & Storage Association, Centrica, Ecotricity, EDF Energy, ENGIE, E.ON, SSE.

analysis. National Grid recognised the value of a transparent process for allocating CfDs.

2.195 We received a range of responses regarding the regularity with which DECC should undertake analysis of the appropriate allocation of technologies to pots:

- (a) Citizens Advice, EDF Energy and E.ON set out that DECC should undertake this analysis ahead of each auction;
- (b) Ecotricity and ENGIE set out that this should be done annually;
- (c) Centrica set out that this should take place every two years as a default, if an earlier consultation had not been triggered by proposed changes in approach;
- (d) Co-operative Energy set out that this should take place at a minimum of every two years; and
- (e) Scottish Power considered that this should take place 'once every few years'.

2.196 Two parties (Renewable UK and Good Energy) also set out that it was important for DECC to make any announcement around the allocation of technologies to pots considerably ahead of the auction in order to ensure predictability for investors. Renewable UK suggested that there should be clarity around the allocation of technologies two auctions ahead, while Good Energy considered that changes should be signalled several auctions ahead of time. On a similar note, Citizens Advice and [§] both set out that it was hard to predict the amount of levy control framework budget remaining, and that it was important to have clarity on this to reduce risks to investors.

2.197 All parties offering an opinion (Centrica, EDF Energy, E.ON and ENGIE) set out that they did not consider that DECC should face absolute limits on the proportion of budget it was able to allocate to each of the pots.

Design considerations

2.198 In this section we set out our provisional views on the sort of analysis DECC should undertake when deciding whether and how to allocate different technologies to different pots in the CfD auctions, and how to allocate the budget between the CfD pots.

2.199 As set out in paragraph 2.156 above, there may be objective and compelling justification for DECC to depart from allocating CfDs under a single,

technology neutral competitive auction. As part of our proposed remedy, we do not propose to recommend absolute restrictions on the circumstances in which DECC can depart from allocating CfDs under a single, technology neutral competitive auction. However, we set out below two possible justifications for separating technologies and budgets into pots in the CfD auctions:

- (a) As noted above in the context of awarding CfDs outside the competitive auction process, there may be positive externalities associated with supporting particular types of currently less developed technology. In such cases, there may be an argument for DECC to support these technologies now, in order to reduce the costs of future projects of the same technology.
 - (b) In addition, it is possible that customers may be better off if DECC allocates ‘high cost’ and ‘low cost’ technologies to separate pots, with separate auctions held for each, despite the risk of inefficient allocation. Under a single, technology neutral competitive auction, low cost bidders could be expected to receive a level of support considerably above the amount they require.¹²⁹ By separating the auction into different pots, DECC may be able to price discriminate, to ensure that lower cost technologies receive only the low clearing price of the ‘low cost’ auction rather than receiving the higher clearing price of a single auction. We note, however, that this approach places a strong onus on DECC’s ability accurately to estimate the different costs of different projects; if it is wrong in its estimations it may well increase the cost to customers. As a result, DECC should seek compelling evidence of the benefits to customers in order to justify departing from a technology neutral competitive allocation for this reason.
- *DECC to estimate increased costs of auction relative to technology neutral competitive auction*

2.200 We consider that a technology neutral competitive auction should be DECC’s default approach to allocating CfDs, absent any objective and compelling reason for departing from this. As set out above, departing from this approach (by separating technologies and budget into pots) risks an

¹²⁹ Under a single ‘pay as clear’ auction, all successful bidders would receive the clearing price set by the highest successful bid; under a ‘pay as bid’ auction, bidders would likely face incentives to bid close to the amount they expect the highest successful bidder to bid. That is, under either design, in a single auction we would expect low cost projects to secure strike prices above the level they require.

inefficient allocation of CfDs, and potentially increases the costs of supporting low carbon generation.

- 2.201 In the first CfD auction, DECC opted to divide the technologies and budget into three separate pots, in order to support less developed technologies, in the belief that it would decrease the costs of these technologies in the future – to the long-run benefit of customers.
- 2.202 We consider that, in order to demonstrate that separating technologies and budget into separate pots can be expected to be beneficial to customers, DECC should estimate the extent to which the short-run costs of supporting low carbon generation are affected by its decision. This can then be weighed against any long-run benefits (eg cost reductions of future projects), to arrive at the outcome that is best for customers.
- 2.203 We also propose to recommend that as part of its analysis DECC undertakes a modelling exercise to understand the likely impact of its decisions concerning the allocation of technologies and budgets to pots in the CfD auctions. We are aware that NERA has undertaken a similar exercise,¹³⁰ which provides a useful example of the sort of work that can be done to estimate the additional short-run costs of supporting less developed technologies in the CfD auctions.
- 2.204 In its model, NERA constructed a supply curve of potential bidders based on information about the pipeline of potential renewable generation projects and assumptions around the strike prices that each project would require (and therefore the level at which each project could be expected to bid). Using this supply curve, it was able to compare the auction outcomes under a range of different scenarios, including a technology neutral competitive auction, and an auction that takes the same form as the completed 2015 auction (ie the same allocation of technologies and budgets to pots). As noted above, NERA's analysis suggests that the cost of support could be reduced by £50 million per year¹³¹ by adopting a technology neutral competitive auction.¹³²
- 2.205 By undertaking (and consulting on) its own analysis of the likely auction outcomes under different design parameters, DECC would be able to estimate the impact on short-run costs of its decision to depart from a technology neutral competitive auction. We would expect that with its

¹³⁰ NERA (October 2015), [Modelling the GB Renewable Electricity CfD Auctions – the cost of excluding onshore wind and maintaining separate pots – A project for Citizens Advice – Final Report](#).

¹³¹ For each of the 15 years of the CfD.

¹³² Compared to adopting the same split of technologies and allocation of budgets to pots as DECC did in the first CfD auction.

understanding of the sector, DECC should be in a good position to make sound assumptions about the pipeline of projects and their underlying costs with which to populate such a model.

2.206 As set out above, it is possible that separating the CfD auction into different pots could reduce the total costs to customers, if it reduces the extent to which projects are able to secure a level of support above that which they require. Undertaking a modelling exercise as outlined above should enable DECC to assess whether separating the auction into pots would be justified on these grounds.

2.207 It is worth noting that we consider it important to consider (a) the impact of the decision to allocate technologies into different pots, and (b) the decision concerning the allocation of budget to pots, together. In our view, it is not possible to assess the impact of allocating different technologies to different pots without reference to the level of budget that will be made available and how it is to be split between the different pots.

- *DECC to assess long-run benefits of supporting less developed technologies*

2.208 Where possible, DECC should aim to quantify the extent to which the future levels of cost for a given technology are likely to depend on the level of support the technology receives in GB. This will enable it to weigh the benefits of any long-run cost reductions against any increase in short-run costs identified. While we do not expect that DECC will be able to predict with certainty the precise impact of supporting a given technology on its future costs, we consider that DECC should be able to gain a sufficient understanding to make a well-reasoned argument for whether supporting a given technology is likely to result in cost savings that would not otherwise materialise.

2.209 We noted in our provisional findings report that The Crown Estate's Offshore Wind Cost Reduction Pathways report set out the potential for a 39% decrease in the levelised cost of energy for offshore wind for projects reaching final investment decision in 2020 compared with those that reached final investment decision in 2011. Some of the possible future cost reductions highlighted in the study, such as deploying larger wind turbines as they are developed, may materialise without needing to support their deployment in GB. Conversely, some other potential cost reductions – such

as those that result from developing the GB supply chain for offshore wind components – may be dependent on levels of GB deployment.¹³³

- 2.210 We consider that DECC should, for instance, be able to make reasonable estimates of the extent to which these different categories of potential cost reduction may materialise both with and without GB support for offshore wind. In addition, we would encourage DECC to undertake similar analysis for other technologies it is considering supporting in this manner.
- 2.211 As noted in the previous section, cost reductions will benefit customers only where the technology in question can be expected to be deployed in a future efficient energy system. As a result, DECC should take this into account when considering whether supporting a given technology is likely to result in the long-run lowest cost path to meeting GB decarbonisation targets. In addition, where supporting a given technology results in other projects being displaced (not receiving CfDs when they would have under a technology neutral competitive auction), DECC should consider the extent to which its decision affects the future cost of the displaced technologies.
- *When should DECC undertake (and consult on) impact assessments?*
- 2.212 In considering when, and how frequently, DECC should undertake and consult on the analysis outlined above, there are two main factors to consider. Firstly, it is important that the allocation of technologies and budgets to pots takes place frequently enough that the CfD auctions result in an efficient outcome (and therefore minimise costs to customers).
- 2.213 Secondly, it is important that potential bidders have sufficient foresight of the auction parameters that they are able to make well-informed decisions about whether to bid. Progressing a project to the point where it can bid in a CfD auction can be costly, so ensuring that bidders are able to respond to changes that may affect their likelihood of securing a CfD may minimise the risks they face in developing projects. A number of respondents to our provisional findings noted that the uncertainty around the future budgets available to each technology may undermine the case for developing projects to the point where they can compete in auctions (given the high costs).
- 2.214 On balance, we consider that DECC should undertake and consult on an assessment of the appropriate allocation of technologies and budgets to pots prior to each CfD auction. In order to ensure that bidders have sufficient

¹³³ Provisional findings, [Appendix 5.3](#).

understanding of the budget available in order to make well-informed decisions around whether to progress a project, DECC should finalise its proposals for the allocation of technologies and budgets at least one year ahead of each CfD auction.

- 2.215 We recognise that setting out these parameters a long time ahead of each CfD auction will remove DECC's flexibility to adjust the budget closer to the date of the auction. However, we consider it important that potential bidders are able to make well-informed decisions around whether to participate in each auction. If they are unable to do so, it could reduce the pool of willing bidders, potentially resulting in a less competitive auction and potentially higher costs to customers.

Assessment of effectiveness and proportionality of remedies package

- 2.216 For the reasons set out above, we are proposing the following remedies package to address the CfDs AEC and/or associated detriment:
- (a) A recommendation to DECC to undertake and consult on a clear and thorough impact assessment before awarding any CfD outside the CfD auction mechanism.
 - (b) A recommendation to DECC to undertake and consult on a clear and thorough assessment of the appropriate allocation of technologies and CfD budgets between pots.

Assessment of effectiveness

- 2.217 In assessing the effectiveness of this proposed remedy, we believe this proposed remedy package would be effective because it:
- (a) meets its aim;
 - (b) is capable of effective implementation; and
 - (c) will be implemented in a timely manner.
- 2.218 The proposed remedies set out above seek to improve certain aspects of the process for the allocation of CfDs, with a view to bolstering DECC's ability to achieve its decarbonisation objectives efficiently, improve the robustness of DECC's decision-making, increases stakeholders' understanding of DECC's decisions (and therefore increase trust in the energy markets), and thereby to reduce the risk of detriment identified in the AEC we have provisionally found.

- 2.219 Our proposed remedy relating to the non-competitive allocation of CfDs will encourage DECC to carry out a rigorous and clear analysis required to reach a decision that is cost-effective for customers, which will in our view reduce the risk of CfDs being allocated to projects outside a competitive auction process which may result in customer detriment.
- 2.220 Our proposed remedy regarding the allocation of technologies between different pots will encourage DECC to monitor on an ongoing basis the evolution of low carbon technologies, and their relative costs and benefits. This will allow DECC to maintain a good understanding of the evolving costs and externalities associated with each low carbon technology, again minimising the risk of outcomes that are not in customers' interests.
- 2.221 As a result of the implementation of these two remedies, we believe that the CfD regime as a whole will be a more cost-effective mechanism for achieving the UK decarbonisation objectives.
- 2.222 We note that the responsibility of any future decision concerning the award of CfDs outside the competitive auction process, and the quality of such decisions, rests with DECC. While more robust processes as per our proposed remedy package will reduce the risk of suboptimal interventions, it is in our view essential that DECC complies with the broader spirit of our remedial action (see, for example, our proposed remedy package noted in Section 10 below).
- 2.223 As noted in our guidelines, before deciding to implement a proposed remedy by way of a recommendation to another public body, the CMA will form a view as to the likelihood that the recommendation will be acted upon. In reaching this view, the CMA must have regard to the stated policy of the body to which the recommendation is to be directed. In this regard, we note the government's commitment to respond in writing to CMA recommendations within 90 days.¹³⁴ Further, we believe that our recommendations are consistent with the government's stated policy, as set out in the its Green Book on policy appraisal,¹³⁵ which emphasises among other things the importance of robust cost-benefit analysis prior to decisions being made, and of reviewing policies to assess whether existing measures can be improved.
- 2.224 In the light of the above, we believe that DECC will be well placed to implement our recommendations, and that DECC can implement the recommendations promptly after our final report (ie as regards any subsequent CfD

¹³⁴ CC3, paragraph 327.

¹³⁵ HM Treasury, *The Green Book – Appraisal and Evaluation in Central Government*.

awards or auction processes). This is particularly the case given that the remedies do not require any legislative changes. As noted above, these recommendations are also consistent with the other aspects of our overall proposed remedy package, including the remedies we have provisionally decided upon concerning the governance AEC as set out in Section 10.

Assessment of proportionality

2.225 Based on the design features above, we believe this proposed remedy package would be proportionate because it:

- (a) is effective in achieving its legitimate aim;
- (b) is no more onerous than needed to achieve its aim;
- (c) is the least onerous if there is a choice between several effective measures; and
- (d) does not produce disadvantages which are disproportionate to the aim.¹³⁶

2.226 For the reasons noted in paragraphs 2.217 to 2.224 above, we believe the proposed remedy package would be effective in achieving its legitimate aim.

2.227 As regards not producing disadvantages that are disproportionate to its aim, we set out above the scale of the potential cost to customers from departing from a technology neutral competitive auction. The scale of the support available to renewable generation projects is considerable, meaning that decisions around how to allocate CfDs can have enormous impacts on the costs faced by customers.

2.228 In the case of the ‘non-competitive allocation proposed remedy’, we set out that in awarding CfDs outside the competitive process under FIDeR, customers are likely to face costs of approximately £250–£310 million higher than may have been the case had these CfDs been awarded at the strike price at which the first CfD auction cleared.

2.229 In the case of the ‘pot design proposed remedy’, while we did not quantify the impact of DECC’s decision to allocate the majority of the CfD auction budget to less developed technologies, more detailed modelling from NERA suggests that the level of support to successful bidders was considerably

¹³⁶ CC3, paragraph 344, citing the principles established in the *Fedesa* case, Case C-331/88, *the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others*, (1990) ECR I-4023, paragraph 13.

higher than it would have been under a technology neutral competitive auction. NERA estimates that for a potential CfD auction in 2017, holding a technology neutral competitive auction would result in a cost reduction of £50 million per year compared with keeping the same allocation of technologies and budgets to pots as in the 2015 auction.

- 2.230 We expect that the cost to DECC from implementing recommendations would be low, both in terms of the additional resource needed to produce and publish robust and clear impact assessments (as it already has substantial expertise in undertaking this sort of analysis) and in terms of the additional time it will take to hold the relevant consultations and consider stakeholders' responses (where such consultations are held at the points in DECC's timetable as noted above, we would expect DECC to factor this into its project plans).
- 2.231 Given the scale of the costs identified and therefore the scope for over-payment if these decisions are not efficient, we believe that the costs and timing implications of undertaking and consulting on the analysis outlined above would be more than offset and, therefore, both would be proportionate remedies. Even if undertaking this analysis improves the allocation of CfDs only fractionally, it could have a significant impact on the costs to customers; likely considerably in excess of the costs of undertaking such an analysis. As a result, we consider that these remedies are no more onerous than is needed to achieve their aims.
- 2.232 As set out above, we considered versions of these remedies that would have been more onerous. Regarding DECC's ability to allocate CfDs outside the competitive auction process, we considered whether it would be appropriate to recommend certain circumstances or types of project where DECC should not allocate CfDs outside the CfD auction. However, we considered that the version of the proposed remedy set out above (without such restrictions) would be effective and less onerous. In addition, we considered whether it would be appropriate to recommend limits on how DECC should allocate budgets to pots in the CfD auction. However, we considered that the proposed remedy would be effective and less onerous.

3. Retail supply to domestic customers: provisional AECs and associated detriment

Introduction

- 3.1 In our provisional findings report and addendum we provisionally identified a number of AECs affecting domestic retail energy markets, leading to substantial levels of detriment for domestic customers (that is, outcomes that were substantially worse than we would expect to see in a well-functioning market).
- 3.2 In this section we have summarised our updated thinking and analysis concerning the features contributing to these provisional AECs and the detriment arising from them, distinguishing in both cases between domestic customers according to a variety of dimensions, including tariff type, meter type and payment method.

Summary of provisional AECs and updated analysis of features

- 3.3 In our provisional findings report published in July 2015, we provisionally found four AECs concerning domestic retail energy markets. We provisionally found: one AEC relating to weak customer response (the Domestic Weak Customer Response AEC); and three AECs relating to aspects of the regulatory framework (the Regulatory AECs). These relate to: the 'simpler choices' component of the RMR rules (the RMR AEC); the gas settlement system; and the absence of a firm plan for moving to half-hourly settlement for domestic electricity customers (the Settlement AECs).¹³⁷
- 3.4 In relation to the Domestic Weak Customer Response AEC, we provisionally found that:
- (a) a combination of features of the markets for domestic retail supply of gas and electricity in GB give rise to an AEC through an overarching feature of weak customer response, which, in turn, gives suppliers a position of unilateral market power concerning their inactive customer base which they are able to exploit through their pricing policies or otherwise. More particularly, these features are as follows:
 - (i) Customers' limited awareness of and interest in their ability to switch energy supplier.

¹³⁷ The Settlement AECs also concern the SME retail energy markets.

- (ii) For certain customers, actual and perceived barriers to accessing and assessing information relating to domestic retail gas and electricity supply.
- (iii) Actual and/or perceived barriers to switching.
- (iv) Prepayment meters place technical constraints on customers on such meters from engaging fully with the markets.

3.5 In relation to the Regulatory AECs, we provisionally found that:

- (a) the 'simpler choices' component of the RMR rules gives rise to an AEC through reducing retail suppliers' ability to innovate in designing tariff structures to meet customer demand, in particular, over the long term, and by softening competition between PCWs;
- (b) the current system of gas settlement gives rise to an AEC through the inefficient allocation of costs to parties and the scope it creates for gaming, which reduces the efficiency and, therefore, the competitiveness of domestic and microbusiness retail gas supply; and
- (c) the absence of a firm plan for moving to half-hourly settlement for domestic electricity customers gives rise to an AEC through the distortion of suppliers' incentives to encourage their customers to change their consumption profile, which overall reduces the efficiency and, therefore, the competitiveness of domestic and microbusiness retail electricity supply.

3.6 In addition, on 16 December 2015, we published an addendum setting out features that in our view give rise to a fifth AEC in the domestic retail markets, separate from and additional to the Domestic Weak Customer Response AEC and the Regulatory AECs that we had previously identified, relating specifically to prepayment customers (the Prepayment AEC). We have provisionally found that these features, in combination, reduce retail suppliers' incentives (and, for some, their ability) to compete to acquire prepayment customers (in particular, customers with an outstanding debt or a poor credit history) and to innovate by offering tariff structures that meet customers' demand. As a result, the tariffs available in the prepayment meter segments are not competitively priced compared with the direct debit segments.

3.7 These features are as follows:

- (a) Technical constraints that limit the ability of all suppliers, and in particular new entrants, to innovate by offering tariff structures that meet demand from prepayment customers who do not have a smart meter.
 - (b) Softened incentives for all suppliers, and in particular new entrants, to compete to acquire prepayment customers due to:
 - (i) actual and perceived higher costs to engage with, and acquire, prepayment customers compared with other customers; and
 - (ii) a low prospect of successfully completing the switch of indebted customers, who represent about 15% of prepayment customers.
- 3.8 We received many responses from parties to our provisional findings report and the addendum, and have conducted further analysis. As a result, our understanding of two of the provisional AECs – the Domestic Weak Customer Response AEC and the Prepayment AEC – has developed. In the rest of this section, we set out our updated thinking on the relative strength of these provisional AECs and the features contributing to them for three different categories of customer, defined according to the meter they use:
- (a) Customers on single-rate credit meters and Economy 7 credit meters: we have updated our gains from switching analysis to assess the most recent evidence on the Domestic Weak Customer Response AEC for these customers.
 - (b) Customers on prepayment meters: we have considered parties' responses and reviewed recent evidence in relation to both the Prepayment AEC and the Domestic Weak Customer Response AEC for these customers.
 - (c) Customers on restricted meters: we have considered parties' responses and conducted new analysis to assess the extent to which the Domestic Weak Customer Response AEC applies to these customers.

Customers on standard and Economy 7 meters

- 3.9 Domestic customers on single-rate credit meters (henceforth referred to as 'standard meters') and Economy 7 credit meters comprise the substantial majority of all domestic customers. Most of our analysis in the provisional findings report concerned these categories of customer.
- 3.10 In the provisional findings report, we noted a number of pieces of evidence that were consistent with these customers exhibiting weak customer response, including our customer survey, evidence on the numbers of

customers on default tariffs and the existence of material, persistent gains from switching supplier, tariff and/or payment method that go unexploited by such customers. We do not summarise this evidence here, but present the results of updated analysis of gains from switching.

Updated analysis of gains from switching

3.11 Since the publication of our provisional findings report, we have updated the gains from switching analysis, as follows:

- (a) We have extended the Relevant Period of the analysis from Q1 2012 to Q2 2015.¹³⁸
- (b) We have extended the calculations of annual potential savings to customers of the four Mid-tier Suppliers (ie Co-operative Energy, First Utility, Ovo Energy, Utility Warehouse).
- (c) We have improved the quality of all existing data, such as missing observations and erroneous entries.
- (d) We have defined new switching scenarios to shed light on the potential range of customer choices.¹³⁹

Summary of results

3.12 The revised results are set out in full in Appendix 3.2. As expected, and consistent with previous results, the gains available to customers differ quite substantially according to the scenario chosen and category of customer concerned (and in particular, the supplier they are with, the type of tariff they are on and the payment method they employ). The table below shows average period results for the domestic customers of the Six Large Energy Firms under the most liberal scenario for customer choice taking into account exit fees (scenario 5x).¹⁴⁰

¹³⁸ The analysis presented in the provisional findings report covered the period Q1 2012 to Q2 2014.

¹³⁹ Appendix 3.2 provides a full description of the new data, the updated methodology we have employed and the new scenarios we have defined.

¹⁴⁰ In this scenario, customers are able to switch supplier, tariff, payment method (except for prepayment customers, reflecting the greater barriers they face in using other payment methods), and gains are reduced to reflect the exit fees a customer may incur in moving from a non-standard tariff. Appendix 3.2 presents the results of a broad range of scenarios, which differ according to the parameters of choice available to the customer.

Table 3.1: Weighted average savings under scenario 5x for domestic customers of the Six Large Energy Firms on different tariffs and payment methods Q1 2012 to Q2 2015

<i>Dual or single fuel</i>	<i>Tariff type</i>	<i>Payment type</i>	<i>Average savings under scenario 5x, £</i>	<i>Average savings under scenario 5x, %</i>
Dual	Non-standard	All	109	9
Dual	SVT	Direct debit	205	16
Dual	SVT	Standard credit	245	23
Dual	SVT	Prepayment	70	8
Single gas	Non-standard	All	96	14
Single gas	SVT	Direct debit	132	19
Single gas	SVT	Standard credit	142	24
Single gas	SVT	Prepayment	48	13
Single electricity	Non-standard	All	55	9
Single electricity	SVT	Direct debit	95	15
Single electricity	SVT	Standard credit	118	23
Single electricity	SVT	Prepayment	45	8

Source: CMA analysis.

Note: SVT = standard variable tariff.

3.13 In summary, the results are broadly consistent with those we found at provisional findings:

- (a) there were material, persistent savings available to customers of the Six Large Energy Firms over the period;
- (b) the savings available to SVT customers were, on average, larger than savings available to non-standard tariff customers; and
- (c) the savings available to standard credit customers were, on average, higher than those available to customers on other payment methods.

3.14 We also note that the savings available to customers on prepayment meters were, on average, substantially lower than those available to other customers, reflecting the more restricted range of tariffs available to them. This is discussed in more detail in the section on prepayment customers below.

3.15 We note that the overall gains available to customers of the Six Large Energy Firms are somewhat higher than previously calculated. For example, we previously calculated that the weighted average gains to all the dual fuel customers of the Six Large Energy Firms was £159,¹⁴¹ and this has now risen to £164 per dual fuel customer, as a result of improvements to data quality, methodology and the extended period of analysis.

¹⁴¹ Note that this £159 figure is based on the most flexible scenario without taking into account exit fees (scenario 5) and this is therefore not a like for like comparison. For scenario 5 the weighted average gains to all the dual fuel customers of the Six Large Energy Firms has now risen to £172. In scenario 5, customers are able to switch supplier, tariff and payment method (except for prepayment customers, reflecting the greater barriers they face in using other payment methods). Appendix 3.2 presents the results of a broad range of scenarios, which differ according to the parameters of choice available to the customer.

Differences in savings by supplier

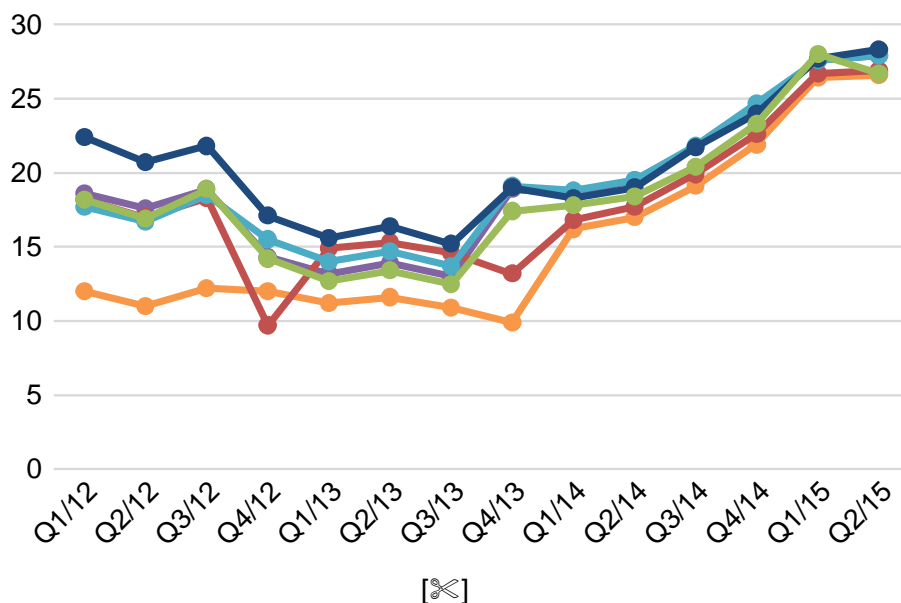
- 3.16 We also found that the savings available to customers of the Six Large Energy Firms were on average higher than those for the customers of the Mid-tier Suppliers. However, there were large differences between firms within each category:
- (a) the savings available to dual fuel customers of the Six Large Energy Firms, with period savings under scenario 5x highest for the customers of [X] and lowest for the customers of [X]; and
 - (b) the savings available to dual fuel customers of the Mid-tier Suppliers, with period savings highest for the customers of [X] and lowest for the customers of [X].
- 3.17 We draw on the data and other analysis in making our assessment of the competitive benchmark price as set out in the section on the analysis of detriment below.

Comparison of savings by supplier over time

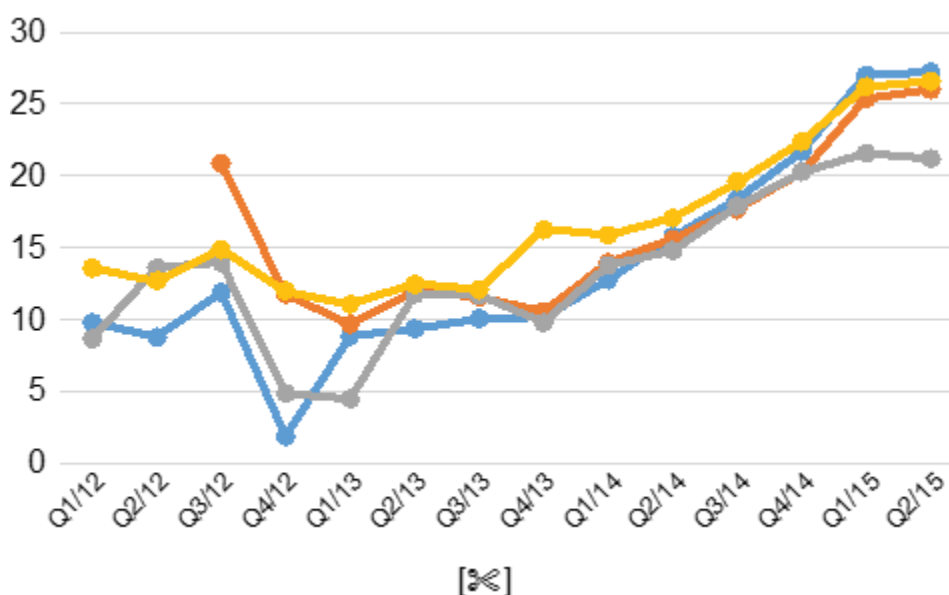
- 3.18 We have also assessed how the potential savings to customers have evolved over time. Figure 3.1 below shows the annual potential savings from switching (% of the bill) available to dual fuel SVT customers (excluding those on prepayment meters) of each of the Six Large Energy Firms over time under scenario 5x.

Figure 3.1: Weighted average potential savings (% of the bill) available to the dual fuel SVT standard meter customers (excluding prepayment) of the Six Large Energy Firms and of the Mid-tier Suppliers under scenario 5x

Six Large Energy Firms



Mid-tier Suppliers



Source: CMA analysis.

Notes:

1. Within each quarter the weighted average is calculated using data on the distribution of consumption and the weights reflect the number of accounts that belong to each tariff.
2. In Q1 2012, Q2 2012 and Q3 2013, First Utility did not have a standard evergreen product.
3. Base: all dual fuel SVT customers (excluding prepayment).

3.19 Figure 3.1 shows that, for the SVT customers (excluding those on prepayment) of the Six Large Energy Firms, annual potential savings fell somewhat between Q1 2012 and Q3 2013 but have risen substantially over the past two years, and have reached their highest level in the most recent

period of the analysis, Q2 2015, reaching an equivalent of between £310 and £360.¹⁴² There is a similar pattern for the SVT customers of the Mid-tier Suppliers, although there is a bigger disparity in the positions of individual suppliers. We also note that the Mid-tier Suppliers have far fewer customers on the SVT than the Six Large Energy Firms: 26% of their gas customers and 28% of their electricity customers are subscribed to SVT¹⁴³ compared to around 70% of the customers of the Six Large Energy Firms for gas and electricity separately.¹⁴⁴

- 3.20 We note that in February 2016, the Six Large Energy Firms announced a reduction in price of their gas tariffs, ranging from 5 to 5.4%.¹⁴⁵ These announcements relate mainly to their SVTs (see Appendix 8.5 of our provisional findings report). The cuts are expected to come into effect from February to March 2016.
- 3.21 However, we do not believe this will materially change the pattern of results seen in the chart above. Indeed, gains may even have increased further, since we would expect the acquisition tariffs to follow more closely the reduction in wholesale gas and electricity prices, which comprise roughly 50% of the total costs incurred in supplying gas and electricity and have fallen around 33% and 20% since Q2 2015, respectively.
- 3.22 Figure 3.2 and Figure 3.3 show the day-ahead¹⁴⁶ baseload¹⁴⁷ price as monthly average for the period January 2012 to February 2016 separately for gas and electricity. We note that wholesale gas prices have been on a broadly downward trend since their highs in 2013. Particularly, we note that prices in February 2016 were on average 42% down compared to the same period the previous year. Electricity wholesale prices reflect changes to the price of gas as a key fuel source used to generate electricity in Great Britain.

¹⁴² See Appendix 3.2.

¹⁴³ CMA analysis of Mid-tier Suppliers' tariff data used in the analysis of the potential gains from switching, see Appendix 3.2, Table 83 and Table 84.

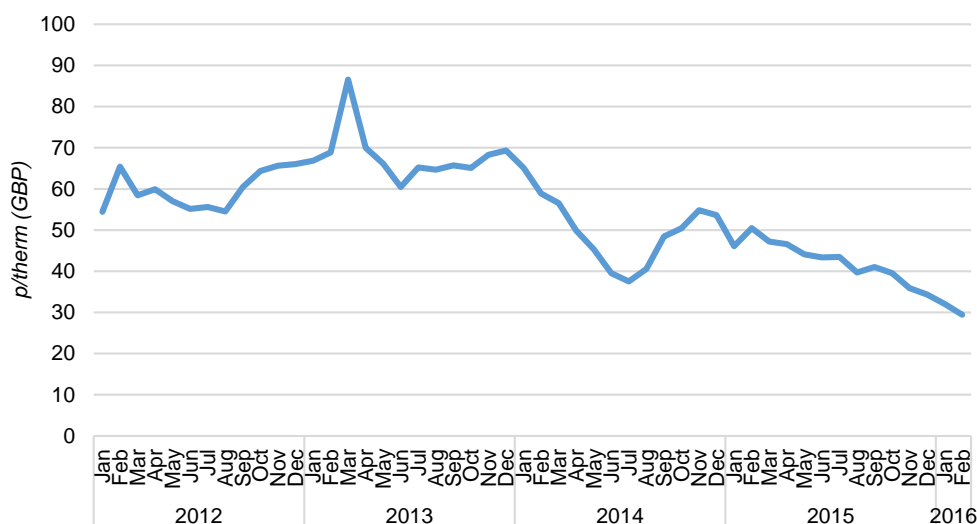
¹⁴⁴ CMA analysis of customer accounts data for the Six Large Energy Firms.

¹⁴⁵ EDF Energy announced a price cut of 5%; British Gas announced a price cut of 5.1% (British Gas also cut its gas prices by 5% in August 2015); E.ON announced a price cut of 5.1%; RWE npower announced a price cut of 5.2%; SSE announced a price cut of 5.3%; and Scottish Power announced a price cut of 5.4%.

¹⁴⁶ We note that day-ahead prices are just one measure of the price of gas and they do not reflect the price that suppliers will have paid for their gas.

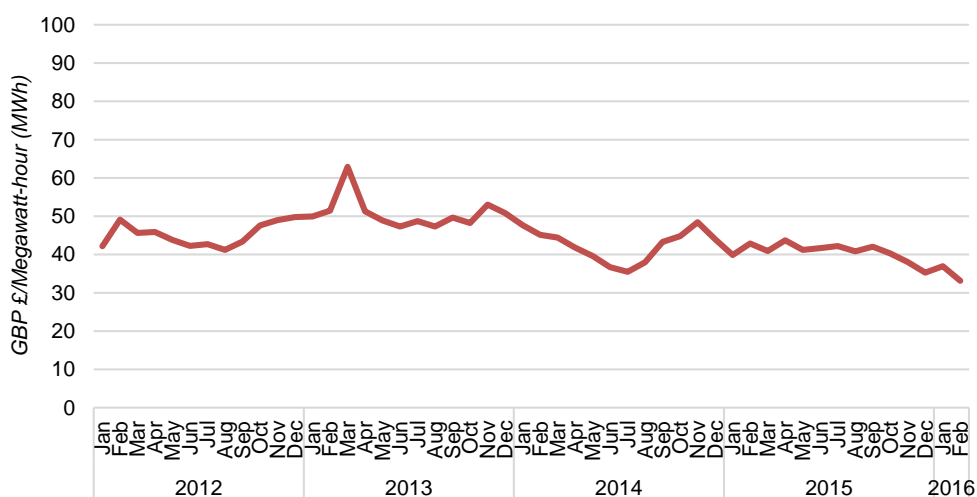
¹⁴⁷ The baseload rate refers to a contract for electricity that is produced continually throughout the day and is distinct from 'peak rates' when electricity is bought/sold for consumption at peak times (7am to 7pm).

Figure 3.2: Wholesale gas day-ahead price – monthly average (GB)



Source: CMA analysis of data provided by ICIS Heren.

Figure 3.3: Wholesale electricity day-ahead price – monthly average (GB)



Source: CMA analysis of data provided by ICIS Heren.

Provisional conclusion

- 3.23 Our most recent analysis of the gains from switching available to customers has strengthened our view that substantial numbers of domestic customers on standard meters and Economy 7 meters exhibit weak customer response. Indeed the most recent evidence demonstrates that the gains available to – but not exploited by – SVT customers (who still make up the substantial majority of the customers of the Six Large Energy Firms) have increased considerably over the last two years.

Customers on prepayment meters

3.24 This section sets out our updated views on the nature and importance of the constraints facing prepayment customers, considering both:

- (a) the Prepayment AEC; and
- (b) the Domestic Weak Customer Response AEC.

Prepayment AEC

3.25 The proportion of customers on prepayment meters has increased steadily over the last 20 years, from 7% in 1996 to 16% currently.¹⁴⁸ Unlike the choice of whether to pay by direct debit or standard credit, prepayment is not generally a choice on the part of the customer. Prepayment meters are generally installed where a customer has had a poor payment history or in certain types of accommodation such as student accommodation. Nearly all prepayment customers are on SVTs, reflecting the limited choice of non-standard tariffs they face.

3.26 In our addendum to provisional findings, we identified particular supply-side constraints affecting customers on ‘dumb’ (ie non-smart) prepayment meters and which limit the extent of competition in the segments. These constraints, arising from the dumb prepayment infrastructure, take the form of limitations on the numbers of tariffs that suppliers can offer due to the limited number of gas and electricity tariff ‘slots’. We found these constraints to be particularly binding for new entrants in gas on account of the low availability of gas tariff slots – over 85% of which were held by the Six Large Energy Firms, including a large proportion that they were not using.¹⁴⁹

3.27 We also provisionally found softened incentives for all suppliers, and in particular new entrants, to compete to acquire all prepayment customers, whether on smart or dumb prepayment meters. This was due to actual and perceived higher costs to engage with, and acquire, these customers compared with other customers, and the low prospect of successfully completing the switch of indebted customers (who represent about 15% of prepayment customers).¹⁵⁰

¹⁴⁸ We note that as at Q2 2015 for electricity roughly 16% of customers were on prepayment meters, roughly 24% of customers paid by standard credit and 60% paid by direct debit. For gas roughly 15% of customers were on prepayment meters, roughly 23% of customers paid by standard credit and 62% paid by direct debit. CMA analysis of data provided by the Six Large Energy Firms, Mid-tier Suppliers, Utilita and Economy Energy.

¹⁴⁹ See the [addendum](#).

¹⁵⁰ See the [addendum](#).

3.28 Our provisional analysis of the prepayment segments suggested that competition is significantly weaker than in the wider GB domestic retail energy markets. We found that entry and expansion by suppliers other than the Six Large Energy Firms in the prepayment segments is slower, and that entry is limited to fewer suppliers, than we have observed in the broader domestic markets. We also found that the range of tariffs available to prepayment customers is significantly more limited than those available in the credit meter segments, and that the cheapest tariffs that are offered by suppliers to prepayment customers are significantly higher (even accounting for differentials in the costs to serve) than the cheapest tariffs in the direct debit segments.

3.29 As part of our provisional analysis, we also considered in detail a number of characteristics of the prepayment meter segments that may account for the outcomes we found, including:

- (a) technical constraints in the prepayment meter segments;
- (b) higher costs of acquiring customers in the prepayment meter segments, and especially so for new entrants;
- (c) the complexities involved in the assignment of customer debt in some prepayment meter switches; and
- (d) the opportunity costs that the four-tariff rule imposes on suppliers seeking to target particular segments of the market with competitive offerings.

- *Responses to the addendum*

3.30 We received a large number of responses to the addendum. The majority of respondents, including some of the Six Large Energy Firms, agreed that some of the constraints that we identified in the addendum have contributed to the poor outcomes in these market segments.

3.31 Several independent suppliers gave us examples of the difficulties that they encountered when they tried to secure a gas tariff page in order to enter or expand their offering in the prepayment meter segments. Robin Hood Energy told us that it signed a contract with Siemens in May 2015 but this contract could not be fulfilled due to a lack of slot availability. Robin Hood Energy contacted Ofgem in September of the same year, complaining that this was a barrier to entry, and a few weeks later it eventually received a slot from Siemens which had been returned by a party that was not using it.

- 3.32 Ovo Energy explained that it had not had difficulty in acquiring one gas tariff page from Siemens in May 2013. However, Ovo Energy explained that in order to offer fixed-rate tariffs, as well as an SVT, one gas tariff page was not enough and therefore it had requested an additional tariff page from the Supply Point Administration Agreement forum.¹⁵¹ Ovo Energy told us that although it had received a gas tariff page in September 2015 it had experienced difficulty in doing so. In particular, it had tried to engage with the Supply Point Administration Agreement forum first through Siemens in July 2015 and subsequently directly at the Supply Point Administration Agreement's September 2015 meeting. Ovo Energy told us that after its experience at the September 2015 meeting it had not expected to find a resolution to its problem at the Supply Point Administration Agreement forum and had raised the issue with Ofgem. Ovo Energy explained that [REDACTED].
- 3.33 First Utility has [REDACTED] gas tariff [REDACTED], which [REDACTED] assigned to it in April 2015. It has asked Siemens [REDACTED]. Siemens has told [REDACTED]. First Utility also noted that the prepayment meter segments are not considered to be [REDACTED]
- 3.34 Economy Energy told us that it had started selling in the prepayment meter segments in Q3 2012 and had no problems procuring the required electricity or gas tariff pages necessary to enter. It currently offered a one-year fixed tariff and an SVT to prepayment customers.
- 3.35 Some of the respondents suggested that within the four broad categories of the constraints, there are other issues which we have not identified, and which impact adversely on the ability and/or incentives of suppliers, particularly the independent suppliers, to compete for customers in the prepayment meter segments.
- 3.36 Those other issues are:
- (a) Entrants wanting to compete to supply customers with 'dumb' prepayment meters may incur higher metering costs than the incumbent suppliers, see paragraphs 3.37 to 3.39.
 - (b) The current Debt Assignment Protocol is not only a barrier to switching, which reduces the likelihood of successfully acquiring customers (as suggested in the addendum), but it also adds to suppliers' costs, see paragraphs 3.43 and 3.44. Some independent suppliers' also suggested that their growth rate in the prepayment meter segments may be

¹⁵¹ Supply Point Administration Agreement forum is the industry forum in which suppliers discuss a range of issues relating to gas.

constrained by capex (and its impact on cost of capital) required to take on customers with debt, see paragraphs 3.41 and 3.42.

- (c) Certain RMR rules may adversely affect suppliers' strategy in the prepayment meter segments, see paragraphs 3.45 to 3.49.
 - (d) Marketing channels for prepayment customers may be more expensive compared to other customers, see paragraphs 3.50 and 3.51.
- 3.37 We understand that there are two options for a new entrant when supplying customers with a dumb prepayment meter:
- (a) allow the customer to continue to use their previous supplier's prepayment card and collect the payments from the previous supplier; or
 - (b) issue a new prepayment card to the customer so that the customer can be directly billed by the new entrant.
- 3.38 Good Energy told us that it used both options. First, prepayment customers that switched to Good Energy continued to use their previous supplier's prepayment card and Good Energy had to collect the payments from the previous supplier. Good Energy told us that it was not always possible to recoup all payments made by the customer and that there could be difficulties in changing tariff rates. Second, for Good Energy's existing customers who fell into debt it had agreements with prepayment infrastructure providers to install prepayment meters and issue prepayment cards for these customers. Good Energy also told us that the prepayment meter segments were not a priority for it and it was obliged to serve it as it recently passed the 50,000 customer threshold (see similar points made by another independent supplier, paragraph 3.77 below).¹⁵² Therefore Good Energy told us that it had not devoted a great deal of corporate effort into optimising its processes or offering in the prepayment meter segments.
- 3.39 Ovo Energy entered the prepayment meter segments with a smart solution in May 2014 where a customer's dumb prepayment meter was changed to a smart meter on switching to Ovo Energy. Ovo Energy found that due to the difficulty in scheduling the change in supplier and meter for the same point in time there was an interim period where a customer would be supplied by Ovo Energy and still have a dumb meter. For this interim period Ovo Energy

¹⁵² SLC 27.2.

had [redacted] prepayment infrastructure [redacted]¹⁵³ for what was a short interim period before a smart prepayment meter was installed.¹⁵⁴

- 3.40 In addition, we understand that the interim period during which new Ovo Energy customers are on a dumb prepayment meter constrains the number of tariffs Ovo Energy can offer on its smart solution. This is because Ovo Energy is constrained to offer the same tariffs for the interim period and when the new smart meter has been installed. This means that Ovo Energy's smart offering is constrained by the technical constraints related to dumb prepayment meters. First Utility also told us that its offering on smart prepayment meters, which it installed for its existing customers who were in debt, was constrained by its offering to customers who switched to First Utility on dumb prepayment meters. We note however that another (smaller) supplier with a smart offering told us that this was not a material issue.
- 3.41 Robin Hood Energy told us that it was concerned about the cost of capital associated with taking a large number of customers under the Debt Assignment Protocol. It suggested that this might be a constraint on the rate of growth that could be achieved in the prepayment meter segments. Specifically, the transfer of debt via the Debt Assignment Protocol required the payment of 90% of the debt with 28 days whereas it took a lot longer for a supplier to recover that debt (approximately two years).¹⁵⁵ However, Robin Hood Energy had not found this to be a problem so far.¹⁵⁶
- 3.42 Our Power Energy Supply also told us that the Debt Assignment Protocol had had a negative impact on new entrants due to the cost of capital it entailed. In particular, the transfer of debt required scarce working capital, involved a significant 'buy-out' rate (90%), made it more difficult for new entrants to raise further working capital and took a long time to recover.¹⁵⁷
- 3.43 In relation to the Debt Assignment Protocol, Centrica told us that there were a number of process and procedural issues which made it difficult and costly to administer, including that the Debt Assignment Protocol remained very manual, time consuming, and costly to operate.

¹⁵³ Ovo Energy told us that the [redacted].

¹⁵⁴ As noted by Centrica, new entrants in relation to dumb prepayment meters have to invest upfront in the prepayment infrastructure which will soon be redundant with the introduction of smart prepayment meters such that the payback period for that investment is short.

¹⁵⁵ According to Robin Hood Energy, Ofgem's Social Obligation Report 2014 shows that on average it takes 112 weeks to recover debt from a prepayment customer.

¹⁵⁶ In relation to this we note that as of 28 February 2015 Robin Hood Energy had [redacted] prepayment customers.

¹⁵⁷ The set maximum recovery rate for debt of £5 per week means that a customer with £500 debt would take a minimum of two years to repay that debt.

- 3.44 Utilita told us that the Debt Assignment Protocol was currently manually intensive and onerous for suppliers. In addition, Utilita told us that it had filtering mechanisms in accordance with the supply licence in its sales process aimed at minimising the time spent by face to face agents on prospects with low-probability success because of debt issues. Utilita explained that face to face agents might not sign up customers with debt above £500, as these customers had to be managed through a different process, including its credit control team.
- 3.45 In relation to the current RMR rules, [REDACTED].
- 3.46 Similarly Centrica and RWE npower told us that the four-tariff rule acted as a constraint in relation to the prepayment meter segments. In particular, they told us that a prepayment meter specific tariff would take up a slot under the four-tariff rule that could otherwise be used for a tariff targeted at a larger customer base.
- 3.47 Scottish Power told us that the removal of the ‘simpler choices’ component of the RMR rules would relax the technical constraints arising from tariff codes. In particular, Scottish Power told us that if a supplier had an SVT for credit meters that varied by PES region then the ‘simpler choices’ component of the RMR rules required the same regional variation for the prepayment SVT and this took up 14 prepayment tariff codes. Given the existence of the four-tariff rule, suppliers that wanted to offer a prepayment meter fixed-term tariff had to offer a prepayment meter version of a credit meter fixed-term tariff, which, if there was regional variation, would require another 14 prepayment meter tariff codes, or use one of the scarce four-tariff slots. Absent these two rules suppliers could offer prepayment meter tariffs with more limited regional variation and therefore reduce the number of prepayment meter tariff codes needed for each separate tariff. This would increase the number of prepayment meter tariffs that could be offered within the current system.¹⁵⁸
- 3.48 Each gas tariff page contains 11 codes such that based on Scottish Power’s suggestion of removing the four-tariff rule and grouping the 14 regions into three separate regional groups a supplier could offer three tariffs (eg one variable and two 12-month fixed tariffs), each varying by the three regional groups, with one gas tariff page and seven tariffs (eg one variable and six 12-month fixed) with two gas tariff pages. However, we note that because costs vary by region and over time, a supplier constrained to offer reduced

¹⁵⁸ Scottish Power’s response to the second supplemental remedies notice, p21, paragraphs 23.4 & 23.5.

variation either over time and/or by region due to a shortage of tariff codes would be disadvantaged relative to an unconstrained supplier that would be able to adjust prices by region and introduce fixed tariffs more frequently in line with changes in costs.¹⁵⁹

- 3.49 Although, we note that First Utility told us that the four-tariff rule did not adversely impact the prepayment meter segments as the rule was on a per meter type basis.
- 3.50 We have also received some evidence on the extent to which prepayment customers are acquired through more expensive marketing channels relative to direct debit customers, and therefore on the extent to which this reduces suppliers' current incentives to compete to acquire prepayment customers.
- 3.51 In particular, Scottish Power told us that as few as [X]% of its prepayment customers had been acquired through PCWs. The rest were acquired through more expensive channels, including external sales ([X]%) and face to face ([X]%). For Scottish Power's direct debit customers, in contrast, just under half were acquired through PCWs, with the rest being accounted for by a mixture of internal and external telesales. Only [X]% were recruited face to face.¹⁶⁰
- 3.52 In relation to smart meters, EDF Energy told us that although technical constraints were likely to be addressed by the roll-out of the second generation of smart meters (SMETS 2) this was not the case in relation to the first generation of smart meters (SMETS 1). In particular, EDF Energy told us that SMETS 1, unless and until adopted by the Data Communications Company,¹⁶¹ would not be fully interoperable between suppliers such that a customer with a SMETS 1 meter who switched supplier was likely to lose the smart functionality. Therefore customers with SMETS 1 prepayment meters would face higher costs to switch.¹⁶²
- 3.53 We understand that SMETS 2 meters will operate by sending or receiving information through the Data Communications Company to/from customers' current suppliers (and/or network operators or authorised third parties). While currently SMETS 1 meters are not able to function via the Data Communications Company in this way we understand that although the

¹⁵⁹ For a further discussion of the gas tariff codes and fixed-term tariffs see the [addendum](#), Appendix 1.

¹⁶⁰ EDF Energy also noted that 'PPM customers are generally harder to access and less responsive to approaches by suppliers and so cost more to acquire per account'. See EDF Energy response to addendum 26 January 2016.

¹⁶¹ First Utility also told us that currently there was uncertainty around the adoption of SMETS 1 meters by the Data Communications Company.

¹⁶² EDF Energy response to addendum to provisional findings (13 January 2016), paragraph 1.6. Centrica also noted that not all smart meters installed by Utilita were SMETS compatible.

timing is uncertain a project is currently underway to assess how SMETS 1 meters could be 'enrolled' into the Data Communications Company.

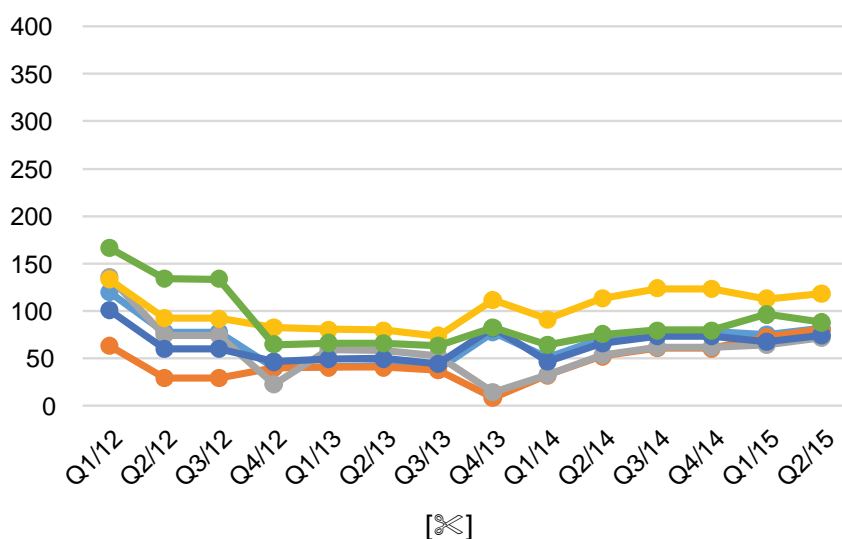
- *Additional analysis*

- 3.54 Some of the respondents, the Six Large Energy Firms in particular, submitted that the addendum may have been more pessimistic about prospects for competition in the prepayment meter segments than the most recent evidence suggested. In particular, we were told that:
- (a) the participation of firms other than the Six Large Energy Firms was growing much more quickly than the addendum suggested;
 - (b) more recent data showed keener pricing in the prepayment meter segments than suggested by the addendum; and
 - (c) E.ON's rolling out of SMART PAYG would change the nature of competition in the prepayment meter segments.¹⁶³
- 3.55 We have considered each of those in detail.
- 3.56 We first looked at the gains from switching available to customers in the prepayment meter segments and how they changed over time. As set out in Appendix 3.2, we estimated annual potential savings in the gas and electricity bills for customers of the Six Large Energy Firms at each quarterly snapshot from Q1 2012 to Q2 2015.
- 3.57 Figure 3.4 shows the trend of the annual potential savings (in absolute terms and as a % of bill) that dual fuel prepayment customers of the Six Large Energy Firms could have potentially made if they had switched to another supplier while staying on a prepayment meter.

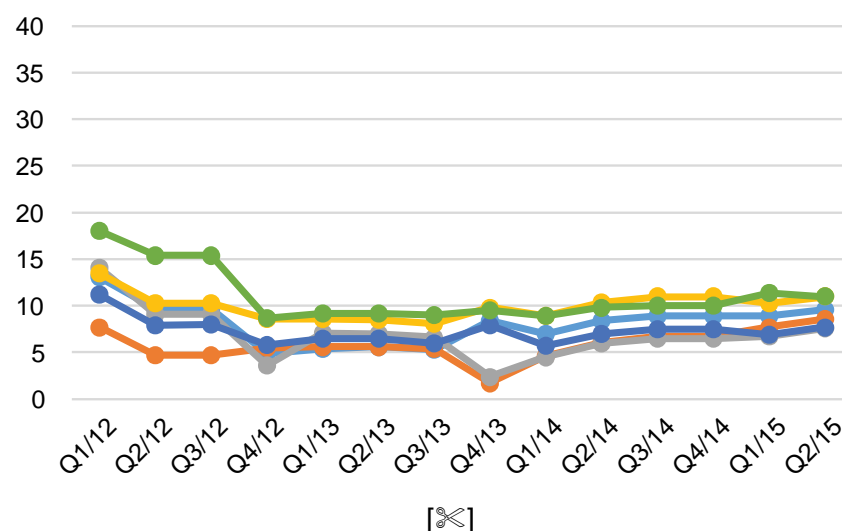
¹⁶³ See [E.ON's website: 'Smart Pay As You Go is coming'](#).

Figure 3.4: Weighted average potential savings (absolute and as a % of bill) available to prepayment meter dual fuel customers of the Six Large Energy Firms if they had switched to another supplier but to a prepayment meter tariff in each quarter Q1 2012 to Q2 2015

In GBP



As a percentage of the bill



Source: CMA analysis.

Notes:

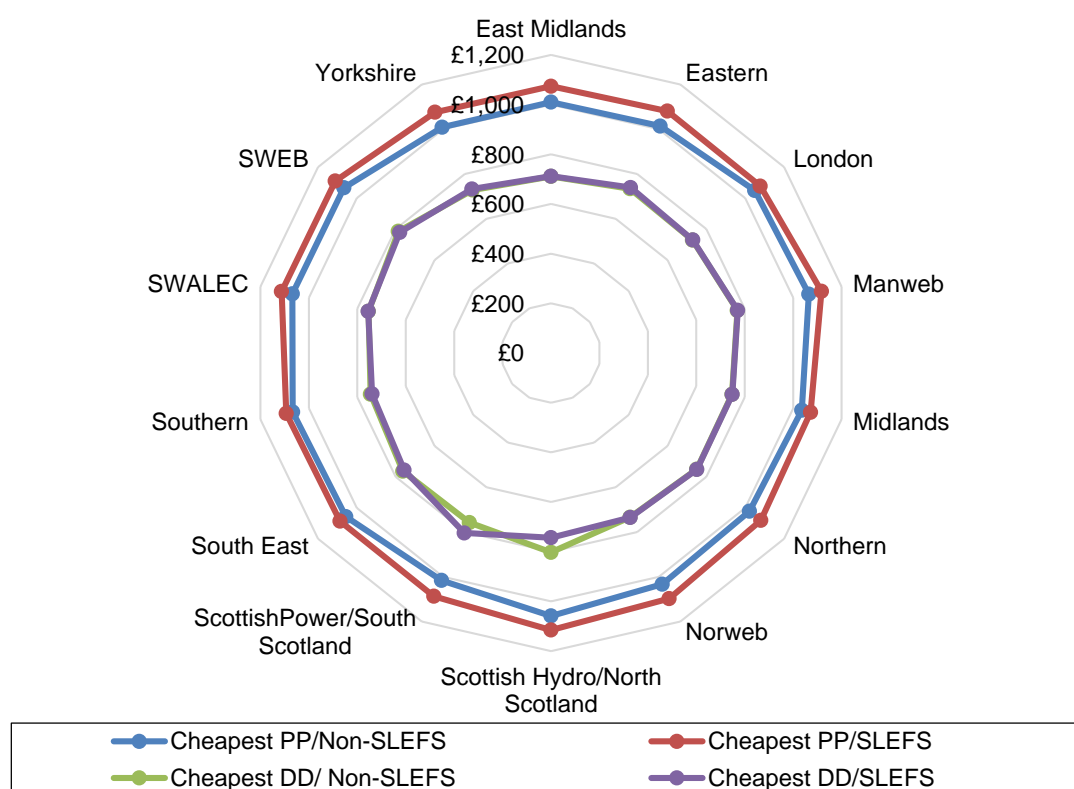
1. Within each quarter the weighted average has been calculated using data on the distribution of consumption and the weights reflect the number of accounts that belong to each tariff.
2. Base: all dual fuel prepayment customers.
3. Exit fees are not deducted from the annual potential savings where exit fees are charged by the current supplier.

3.58 For dual fuel customers the gains available from switching to the cheapest tariff in the prepayment meter segments appear fairly static over time, with a modest increase from the beginning of 2014. In Q2 2015, they ranged from just over £70 (or 8% of the annual bill) for dual fuel customers of [redacted] and of [redacted] to roughly £120 (or 11% of the annual bill) for dual fuel customers of [redacted]. This is in contrast with a sharp increase in the gains available to dual fuel prepayment customers if they were able to switch to a credit meter,

which doubled between 2013 and 2015, reaching between £290 and £370 as of Q2 2015, depending on the supplier.¹⁶⁴

3.59 We have also looked at the more recent pricing data by conducting a search on a PCW on 1 March 2016. Figure 3.5 below shows for every GB region the cheapest tariff offered by the Six Large Energy Firms and independent suppliers for both prepayment meters and credit meters on the PCW uSwitch.

Figure 3.5: Comparison of cheapest dual fuel prepayment meter bills and direct debit bills as at 1 March 2016 based on Ofgem medium typical consumption values, by region and by supplier type



Source: CMA analysis.

Notes:

1. Cheapest bills identified on uSwitch on 1 March 2016 based on Ofgem medium typical consumption values (12,500 kWh of gas and 3,100 kWh of electricity).
2. Monthly direct debit was used for direct debit bills.
3. Consistent with our approach taken elsewhere, Mid-tier Suppliers were used for non-Six Large Energy Firms in relation to direct debit. First Utility had the lowest bill in 13 regions for direct debit (First Fixed April 2017 v5) and Co-operative Energy in one region (Co-op Online March 2017).
4. For prepayment all non-Six Large Energy Firms on uSwitch were used. Robin Hood Energy had the lowest bills in seven regions (Robin Hood Energy Nottingham PAYG in East Midlands and Robin Hood Energy Evergreen elsewhere), Ovo Energy in four regions (Smart PAYG energy (all Online)) and Spark in three regions (Saver Fixed March 2018 – prepayment).
5. The relevant postcodes used were: DE23 3XX for East Midlands, CB2 3ET for Eastern, WC1B 4AD for London, L1 5HA for Manweb, B4 7QD for Midlands, YO31 7EH for Northern, LA1 1RH for Norweb, PH15 2EH for Scottish Hydro/Northern Scotland, TD7 5JB for Scottish Power/Southern Scotland, BN2 1QB for South East, SO17 3RY for Southern, CF24 3FL for SWALEC, TR18 4SY for SWEB and DN1 2QE for Yorkshire.
6. Eastern is also known as East Anglia, Manweb is also known as Merseyside and North Wales, Northern is also known as North East, Norweb is also known as North West, South East is also known as Seeboard, Southern is also known as Southern Electric, SWALEC is also known as South Wales and SWEB is also known as South West.

¹⁶⁴ This is based on all dual fuel prepayment customers and exit fees are not deducted from the annual potential savings where exit fees are charged by the current supplier.

- 3.60 In the majority of the regions the cheapest dual fuel prepayment tariff is offered by an independent supplier, though the difference from the cheapest of the Six Large Energy Firms' dual fuel prepayment tariffs is relatively small at roughly £26 to £71. The difference between the cheapest dual fuel prepayment and direct debit tariffs is very substantial, varying between £258 and £328, depending on the region.
- 3.61 The analysis above shows that switching to a credit meter is a choice which is likely to make financial sense to prepayment customers. However, Ofgem data from 2014 shows that about 130,000 electricity and 103,000 gas prepayment meter customers switched to credit meters in 2014, ie around 3% of all electricity and 3% of all gas prepayment meter customers.¹⁶⁵ We have identified several actual or perceived impediments to switching (over and above those identified in the domestic retail energy markets as a whole), including security deposits, credit checks and prepayment meter removal costs.
- 3.62 In response to the addendum the Six Large Energy Firms told us that there were many reasons why prepayment meter customers may not switch to credit meters including some not identified in the addendum. For example, Scottish Power told us that while prepayment meter removal costs and security deposits may be a barrier to switching in some cases, its figures did not suggest that these were large scale issues.¹⁶⁶ Alternative reasons for why prepayment meter customers may not switch to credit meters raised in response to the addendum included customer preferences,¹⁶⁷ perceptions of the complexity of the switching process,¹⁶⁸ landlord preferences for prepayment meters,¹⁶⁹ misalignment of monthly direct debit payments and benefit payments for some customers¹⁷⁰ and awareness of options.¹⁷¹
- 3.63 However, while there may be a number of reasons as to why there is very little switching from prepayment meters to credit meters, the low level of switching suggests that the tariffs available to customers on credit meters do not represent a significant competitive constraint on pricing strategies in the prepayment segments.

¹⁶⁵ Ofgem, Domestic Suppliers Social Obligations: 2014 annual report, p36.

¹⁶⁶ Scottish Power response to addendum, p2.

¹⁶⁷ For example, Centrica told us that customers may prefer prepayment meters as a way of budgeting, to avoid indebtedness or to repay debt at a manageable rate. Centrica response to addendum p13.

¹⁶⁸ Scottish Power response to addendum, p2.

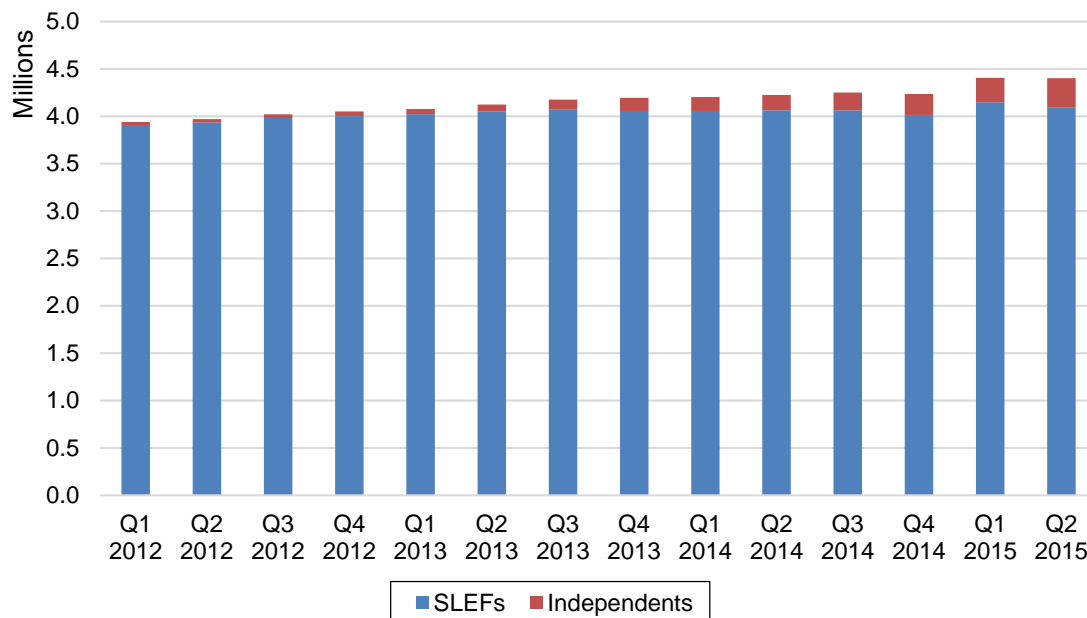
¹⁶⁹ E.ON response to addendum, p6, Centrica response to addendum, p13 and Good Energy response to addendum, p5. For a discussion of prepayment meters in rented accommodation see Appendix 6.4.

¹⁷⁰ Scottish Power response to addendum, p6.

¹⁷¹ SSE response to addendum, p5.

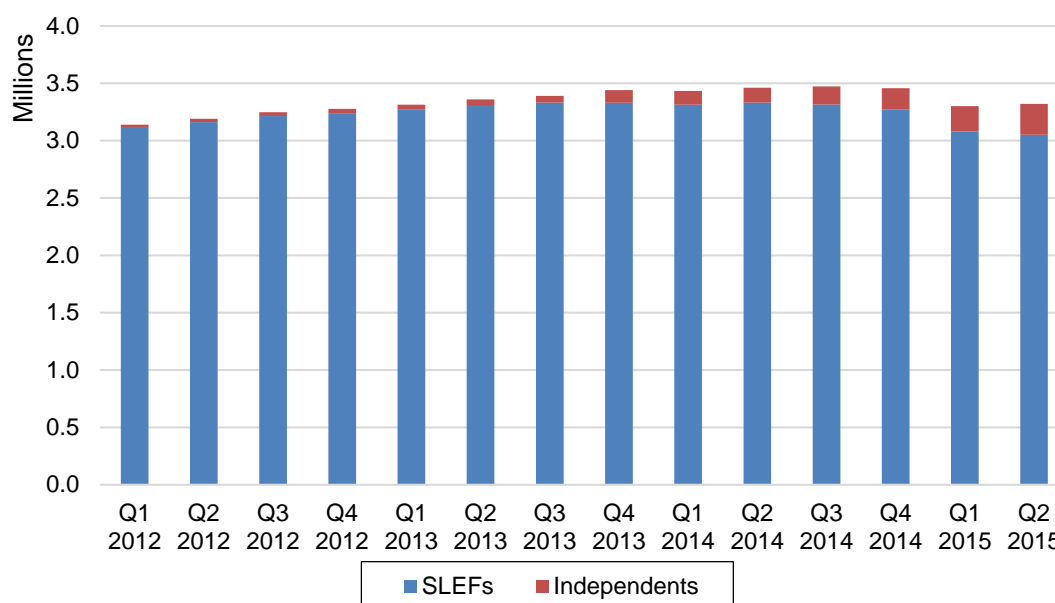
3.64 We also looked at the account numbers in the prepayment meter segments and how they changed over time, for both the Six Large Energy Firms and the independent suppliers. This is shown in Figure 3.6 and Figure 3.7 below.

Figure 3.6: Electricity account numbers in the prepayment meter segments for the Six Large Energy Firms and independent suppliers



Source: CMA analysis based on data from the Six Large Energy Firms, the Mid-tier Suppliers, Economy Energy and Utilita.
Notes: First Utility was not able to provide customer number data for electricity broken down by payment method. Therefore the tariff data used for the analysis of potential gains from switching was used to calculate the total number of accounts subscribed to tariffs at the end of each quarter by payment method. Based on this data, we estimated the proportion of accounts by payment method. These proportions were then applied to First Utility's customer number data for electricity which provided the total number of electricity customers by payment method.

Figure 3.7: Gas account numbers in the prepayment meter segments for the Six Large Energy Firms and independent suppliers



Source: CMA analysis based on data from the Six Large Energy Firms, the Mid-tier Suppliers, Economy Energy and Utilita. Notes: First Utility was not able to provide customer number data for gas broken down by payment method. Therefore the tariff data used for the analysis of potential gains from switching was used to calculate the total number of accounts subscribed to tariffs at the end of each quarter by payment method. Based on this data, we estimated the proportion of accounts by payment method. These proportions were then applied to First Utility's customer number data for gas which provided the total number of gas customers by payment method.

- 3.65 The share of the independent suppliers has been increasing over time and its growth appears to have accelerated somewhat in the last year. In Q2 2015, the share of the independent suppliers stood at 8.1% and 7.1% for gas and electricity, respectively.
- 3.66 We did not have data to compare how these shares have changed since Q2 2015. However, data for dual fuel customers shows that the number of dual fuel customers that are supplied by the independent suppliers has continued to grow at a high rate, roughly 35%,¹⁷² between Q2 2015 and Q4 2015. We will look to update these figures to understand how the share of the independent suppliers, separately concerning electricity and gas customers, has changed since Q2 2015. For dual fuel customers we note that this increase has largely been driven by two suppliers, namely [X], who have roughly [X]% and [X]% of dual fuel customers on smart prepayment meters respectively. However, we note that another supplier, [X], has also experienced significant growth over this period in relation to single fuel customers.

¹⁷² CMA analysis based on data from the Six Large Energy Firms, the Mid-tier Suppliers, Economy Energy and Utilita.

3.67 E.ON told us that after a recent pilot programme it would be rolling out SMART PAYG meters to customers in Q1 2016. These SMART PAYG meters will allow prepayment customers to access exactly the same E.ON tariffs as any other customer. Although this roll-out will eventually be nationwide we understand that currently it will only be available to existing E.ON prepayment customers who live in certain regions and that availability also depends on the customer's metering setup (for example, it is not available to all restricted meter customers or where a customer has more than one meter, either electricity or gas, and not all of these meters are prepayment meters).¹⁷³

3.68 We also understand that these smart meters are SMETS 1 meters and therefore, at present, may not retain smart functionality if a customer switches away from E.ON unless the new supplier uses E.ON's interoperability service offered via their head-end service. If this is not used, the meter would become dumb in relation to the new supplier or the new supplier would have to replace the meter. Further, some prepayment customers with SMETS 1 meters may be unable to use the prepayment setting on their meter if they switch. As a result, such customers may have to change their meter in order to switch supplier. However, once these SMETS 1 meters are enrolled and adopted into the Data Communications Company there would be no interoperability issues.

- *Provisional conclusions*

3.69 In light of the responses to the addendum, and the additional analysis that we have carried out to test some of the submissions, we remain of the provisional view that there are features specific to the prepayment meter segments that give rise to the Prepayment AEC. We have identified a number of constraints which have an adverse impact on the ability and/or incentives of suppliers, independent suppliers and the Six Large Energy Firms alike, to compete in the prepayment meter segments, and which are not present, or are present to a significantly lesser degree, in the rest of the domestic retail energy markets (ie concerning credit meters).

3.70 As noted in the addendum, some of those constraints seem to affect the independent suppliers significantly more than they affect the Six Large Energy Firms, for the following reasons.

3.71 Firstly, a supplier's ability to offer gas tariffs to customers on dumb meters (and consequently dual fuel tariffs) is determined by the number of gas tariff

¹⁷³ E.ON's website: 'Smart Pay As You Go is coming'.

pages it has (see the addendum, Appendix A, paragraphs 12 to 14). We have found that independent suppliers have encountered difficulties when they have tried to procure a gas tariff page in order to enter or expand their offering in the prepayment meter segments (see paragraphs 3.31 to 3.34). In particular, the shortage of available gas tariff pages restricts the ability of independent suppliers to compete effectively to supply customers on dumb prepayment meters using fixed tariffs (see the addendum, Appendix A, paragraphs 15 to 18), more so than is currently the case with the Six Large Energy Firms, which between them have a significant number of unused tariff pages (see the addendum, Appendix A, paragraphs 19 to 26). We also noted in the addendum that it would not be possible for any supplier, including the Six Large Energy Firms, to offer the same range of gas tariffs to prepayment customers as they do to customers on standard credit and direct debit.

- 3.72 The removal of the four-tariff rule would make it easier for a supplier to compete irrespective of the number of gas tariff pages that supplier had.¹⁷⁴ This is because the removal of the four-tariff rule would make it easier for a supplier to have prepayment meter specific tariffs not constrained by the tariffs it offers to customers with credit meters. However, a supplier with one gas tariff page would still be constrained to offer either one variable tariff with regional variation or more tariffs, which could include fixed tariffs, but with reduced regional variation for those tariffs. In particular, because costs vary by region and over time, a supplier constrained to offer reduced variation either over time and/or by region due to a shortage of gas tariff pages would be disadvantaged relative to an unconstrained supplier which would be able to adjust prices by region and introduce fixed tariffs more frequently in line with change in costs. Therefore a supplier's competitive offering to customers with prepayment meters is still constrained relative to its offering to customers with credit meters. We also noted that another aspect of the RMR rules (ie SLC 22B.7(b)) may contribute further to this issue (see Section 5 below).
- 3.73 We note that fixed tariffs, which typically vary by the 14 PES regions, are the main acquisition tool in the rest of the domestic retail energy markets, and that an SVT or tracker tariff, which require fewer tariff codes, are not good substitutes that could be used as effectively as fixed tariffs to acquire new customers given the nature of competition in the markets, which is based around offering the most competitive rates to new customers.

¹⁷⁴ We consider this interaction between our proposed remedies concerning the RMR AEC and the Prepayment AEC further in Section 8.

- 3.74 Secondly, in our addendum we found that new entrants face higher costs than the incumbent suppliers in relation to the current prepayment infrastructure. We consider that these higher costs reduce their incentives to compete in the prepayment meter segments. We have also found that there are costs to serve that are higher for the Six Large Energy Firms and the independent suppliers in the prepayment meter segments, relative to the equivalent cost to serve in the rest of the domestic retail energy markets, but we expect those costs to adversely affect the incentives of the independent suppliers somewhat more so than they do for the Six Large Energy Firms. We have received additional submissions from suppliers highlighting these costs (see paragraphs 3.38 to 3.51). The examples of these are costs related, among other things, to the process involved in administering the Debt Assignment Protocol and the need to use more expensive external telesales and face to face marketing channels in order to reach prepayment customers. We would expect there to be economies of scale in relation to these costs (including, for example, a larger company can more easily hire dedicated staff to deal with the Debt Assignment Protocol or have dedicated sales staff) such that these costs are less important to the Six Large Energy Firms when compared to new entrants or other independent suppliers.
- 3.75 While we have seen some recent increase in activity by the independent suppliers concerning supply to customers on dumb prepayment meters, [REDACTED] and [REDACTED], in particular, the tariffs offered by those suppliers are significantly more expensive than the acquisition tariffs¹⁷⁵ in the rest of the domestic retail energy markets (see paragraphs 3.59 and 3.60). Other independent suppliers appear to show little enthusiasm for competing to supply customers on dumb prepayment meters. For example, both [REDACTED] and Good Energy told us that the prepayment meter segments had a low priority in their commercial strategies.
- 3.76 The above observations support our provisional finding that suppliers in the prepayment meter segments, the independent suppliers and new entrants more so than the Six Large Energy Firms, have a limited ability and reduced incentives to compete to acquire customers with dumb prepayment meters. In combination with weak customer engagement in these market segments (customers on dumb prepayment meters are also affected by the provisional Domestic Weak Customer Response AEC),¹⁷⁶ our provisional view is that, absent remedial action, we are unlikely to see materially better outcomes for

¹⁷⁵ As defined in the [addendum](#), paragraph 4.

¹⁷⁶ See further paragraphs 3.85–3.112 below.

significant numbers of consumers on dumb prepayment meters in the short- to medium-term future.

- 3.77 We acknowledge that some aspects of the features that we have provisionally identified in the addendum giving rise to the Prepayment AEC apply only to competition in supply to customers on dumb prepayment meters. In particular the technical constraints relative to tariff codes and to higher metering costs do not apply to smart meters. It follows (see the addendum, paragraph 35) that suppliers may circumvent these issues by installing smart meters to existing customers or customers they acquire. However, at present, only two independent suppliers – Ovo Energy and Utilita – offer smart meters as an acquisition strategy on a nationwide basis.
- 3.78 Over all suppliers, the penetration of smart meters is currently low, at around 9% for dual fuel customers in the prepayment meter segments.¹⁷⁷ While we have seen some encouraging evidence in relation to the roll-out of smart meters in the prepayment meter segments – namely E.ON's rolling out of its smart PAYG to existing customers (which it is planning to make available eventually to all prepayment customers)¹⁷⁸ – we have not seen evidence that demonstrates that the rate of smart meter penetration in the prepayment meter segments as a whole is likely to change significantly in the near future.
- 3.79 We consider that this may particularly be a problem for some of the independent suppliers, as they may not find it financially viable to accelerate materially the roll-out of smart meters to the prepayment meter segments. Moreover, all suppliers, including the Six Large Energy Firms may not be incentivised to do so as a matter of priority.¹⁷⁹ Economy Energy is planning to make smart meters available to all prepayment customers during 2016. This is made possible in part due to an arrangement with its meter asset provider which is covering capital and installation costs of meters.¹⁸⁰
- 3.80 We have also examined more recent data to see, as was put to us by some of the respondents, whether competition in the prepayment meter segments has intensified recently, resulting in better outcomes for prepayment meter consumers than documented in the addendum.
- 3.81 We first looked at our extended gains from switching data set which covers the period from 31 March 2012 to 30 June 2015. We observed that the gains

¹⁷⁷ This is based on dual fuel customers as at Q4 2015. CMA analysis based on data from the Six Large Energy Firms, the Mid-tier Suppliers, Economy Energy and Utilita.

¹⁷⁸ See [E.ON's website: 'Smart Pay As You Go is coming'](#).

¹⁷⁹ We are minded not to proceed with this possible remedy. See paragraphs 5.191–5.194.

¹⁸⁰ We understand that Robin Hood Energy is also planning to make smart meters available to its existing and new customers, however, we note that as at 28 February 2015 it had [§] prepayment customers on supply and therefore we do not expect this to have a significant impact on the market.

from switching available to the prepayment customers within the prepayment meter segments have been fairly static, with a small uplift around Q1 2014. This is in contrast with a sharp increase in the gains available to prepayment customers from switching to a credit meter which doubled between 2013 and 2015, and were approximately three times bigger than the gains available in the prepayment meter segments at the end of Q2 2015.

- 3.82 We also conducted a search on a PCW in order to look at more recent pricing data. We found that there are large differences between the cheapest prepayment meter and direct debit tariffs, between £258 and £328, depending on the region. This is well in excess of our estimate of the cost differential between the two payment methods of £54, see Appendix 3.6. If the competitively priced tariffs were offered in the prepayment segments (ie equivalent to the lowest priced direct debit plus the cost-to-serve differential), prepayment customers would be able to make substantial gains from switching (by between £200 and £270, depending on the region) relative to the gains that are currently available in the prepayment segments.
- 3.83 Finally, we also looked at the customer numbers in the prepayment meter segments, and how they changed over time, for both the independent suppliers and the Six Large Energy Firms. We observed that there has been an increase in the share of independent suppliers over time, and we noted that in Q2 2015, the share of the independent suppliers stood at 8.1% and 7.1% for gas and electricity, respectively.
- 3.84 We do not have data to calculate how these shares have changed since Q2 2015. However, data for dual fuel customers shows that the number of dual fuel customers who are supplied by independent suppliers has continued to grow at a high rate, roughly 35%, between Q2 2015 and Q4 2015.¹⁸¹ We will look to update these figures to understand how the share of independent suppliers, separately concerning electricity and gas customers, has changed since Q2 2015.
- 3.85 Overall, therefore, while the independent suppliers continue to gain market share, albeit from a low base, we have seen little evidence of price competition being intensified recently in the prepayment meter segments, certainly when compared with the direct debit segments, and we have seen no evidence of improving outcomes for prepayment customers relative to the position set out in the Addendum.

¹⁸¹ CMA analysis based on data from the Six Large Energy Firms, the Mid-tier Suppliers, Economy Energy and Utilita.

Domestic Weak Customer Response AEC

- 3.86 We have also reviewed the available evidence on the extent to which the Domestic Weak Customer Response AEC applies to customers on prepayment meters.
- 3.87 Some parties have commented that weak customer engagement was as important a factor as – and potentially a more important a factor than – technical constraints in negatively affecting outcomes for prepayment customers. For example, EDF Energy submitted¹⁸² that the addendum raised issues that were largely complementary to the issue of weak customer engagement, noting that technical constraints were particularly problematic where weak customer engagement already existed as a problem. Further, Robin Hood Energy told us that its growth rate on prepayment was constrained by low levels of customer engagement.
- 3.88 In contrast, Scottish Power¹⁸³ noted that the switching rates for direct debit customers and prepayment customers were broadly similar despite lower gains from switching being available to prepayment customers, and this suggested that the regular activity of card or key top ups in advance of consumption may serve to improve engagement among prepayment customers.¹⁸⁴
- 3.89 We note that our own analysis of the gains from switching demonstrates that the average potential gains available to prepayment customers within the prepayment meter segments are substantially lower than those available to other customers, see paragraphs 3.57 and 3.58. We also note, however, that prepayment customers are generally on lower incomes than other customers (see Table 3.4 below) such that, considering potential gains relative to income, the disparity will be somewhat less marked. In relation to switching behaviour, we note that although prepayment customers are not significantly more or less likely to have switched supplier in the last year (11%) compared to either direct debit (15%) or standard credit (7%) customers,¹⁸⁵ there was a higher rate of switching in the last three years among direct debit customers (30%) compared to prepayment customers (22%), while prepayment customers were more likely to have switched

¹⁸² EDF Energy response to addendum to provisional findings (13 January 2016), paragraph 1.4/1.5.

¹⁸³ Scottish Power response to the addendum to provisional findings, p1.

¹⁸⁴ Ovo Energy told us that smartphone use was an important feature for its smart meter prepayment customers and that its customers interacted frequently with the Ovo Energy smartphone app, checking balances and credit several times a week on average.

¹⁸⁵ We note that direct debit customers are more likely to switch in the last year than standard credit customers. Derived from question E30. Bases differ for customer group. Prepayment customer base = 646, direct debit customer base = 5,121 and standard credit customer base = 973.

supplier in the last three years compared to standard credit customers (15%).¹⁸⁶ We note that our survey does not allow us to distinguish between those who actively switched and those who switched because, for example, they moved home, such that the length of time an individual has been at the same address may be one factor affecting results.

- 3.90 We also note that switching rates are just one of a range of engagement statistics in our survey which capture different aspects of customer engagement, some of which are unrelated to the available gains from switching. In this respect, other results from the survey support an inference that levels of engagement are particularly low for prepayment customers when compared to direct debit customers, but not standard credit customers, as shown in the table below.

Table 3.2: Measures of engagement by payment method

			%
	<i>Prepayment customers</i>	<i>Direct debit customers</i>	<i>Standard credit customers</i>
Shopped around in last 3 years	24*	43	26*
Never considered switching supplier	45*	26	47*
Switched supplier in last 3 years	22*	30	15*
Switched supplier in last year	11	15	7*
Likely to consider switching supplier in the next 3 years	29*	51	35*

Source: CMA analysis of survey data.

*These results are significantly different to those for direct debit customers based on 95% confidence intervals.

Notes:

1. Bases differ for customer group. Prepayment customer base = 646, direct debit customer base = 5,121 and standard credit customer base = 973.

2. Derived from questions E1, E2, E13, E17, E30 and F1.

3. Respondents are categorised based on their payment method. In particular, respondents are only included if they have the same payment method for all fuel types (that is, including those with only one fuel type).

- 3.91 In our provisional findings report and the addendum, we expressed a particular concern about the material numbers of customers who appear to be fundamentally disengaged from the domestic retail energy markets in the sense that they have not considered exercising choice in the markets. In this respect, prepayment customers exhibit materially higher levels of fundamental disengagement compared to direct debit customers. As the table above shows:

- (a) a significantly higher proportion of prepayment customers said that they had never considered switching supplier (45%) compared to direct debit customers (26%);

¹⁸⁶ Derived from question E30. Bases differ for customer group. Prepayment customer base = 646, direct debit customer base = 5,121 and standard credit customer base = 973.

- (b) a significantly lower proportion of prepayment customers said that they had shopped around in the last three years (24%) compared to direct debit customers (43%); and
 - (c) a significantly lower proportion of prepayment customers said that they were likely to consider switching supplier in the next three years (29%) compared to direct debit customers (51%).
- 3.92 These results can be interpreted as evidence of disengagement irrespective of the size of potential gains – since a customer who has never considered switching is not likely to be aware of the potential gains available, and the same could be said for a customer who has not shopped around in the last three years.
- 3.93 Furthermore, prepayment customers are less likely than both direct debit and standard credit customers to believe that it is possible to: change tariff within their current supplier (66% vs 79% and 75%); and change payment method (72% vs 83% and 82%). Prepayment customers are also less likely than direct debit customers, but not standard credit customers, to believe that it is possible to change supplier (82% vs 92%).¹⁸⁷ This is consistent with more recent evidence from Ofgem which shows that prepayment customers may not be as informed as direct debit customers concerning their right to switch supplier or tariffs.¹⁸⁸
- 3.94 Therefore the overall weight of evidence, on balance, supports a provisional finding that, despite similar levels of switching in the last year, a higher proportion of prepayment customers appear to be disengaged compared to direct debit customers. This evidence includes a range of disengagement statistics which are unrelated to the potential gains from switching, as well the evidence which shows that prepayment customers are less aware of their right to switch supplier or tariff than direct debit customers.
- 3.95 We next consider the extent to which lower engagement of prepayment customers may be correlated to their demographic and household characteristics, and certain factors that may restrict the ability of prepayment customers to access and assess information about switching.
- 3.96 In our provisional findings report we noted that the groups of respondents who were less likely to have switched supplier in the last three years were

¹⁸⁷ Derived from question E1. Bases differ for customer group. Prepayment customer base = 646, direct debit customer base = 5,121 and standard credit customer base = 973.

¹⁸⁸ The Ipsos MORI survey for Ofgem (Customer Engagement with the Energy Market: Tracking survey 2015) found that 63% of prepayment customer knew it was possible to switch to a different supplier, compared to 80% of direct debit customers.

those with any of the following characteristics: household incomes under £18,000 a year; living in rented social housing; without qualifications; aged 65 and over; with a disability or registered on the Priority Services Register (see our provisional findings report, paragraph 8.10).

- 3.97 Table 3.3 shows respondents' highest qualification by payment type. We find that, when compared with both direct debit and standard credit customers, prepayment customers are significantly: less likely to have a degree as their highest qualification; and more likely to have a GCSE as their highest qualification. Further, when compared with direct debit customers, prepayment customers are significantly more likely to have no qualifications.

Table 3.3: Highest qualification by payment type

	%		
	<i>Prepayment customers</i>	<i>Direct debit customers</i>	<i>Standard credit customers</i>
Degree	17	47	42
A Levels	20	19	16
GCSE	33	19	19
None	30	15	23

Source: CMA analysis of survey data.

Notes:

1. Bases differ for customer group. Prepayment customer base = 605, direct debit customer base = 4,902 and standard credit customer base = 914.

2. Respondents are categorised based on their payment method. In particular, respondents are only included if they have the same payment method for all fuel types (that is, including those with only one fuel type).

- 3.98 Table 3.4 shows respondents' income by payment type. We find that, when compared with both direct debit and standard credit customers, prepayment customers are significantly: less likely to have an income of over £36,000; and more likely to have an income below £18,000.

Table 3.4: Income by payment type

	%		
	<i>Prepayment customers</i>	<i>Direct debit customers</i>	<i>Standard credit customers</i>
<£18k	48	16	25
£18k - £36k	16	21	17
>£36k	6	29	18
Don't know/Refused	31	35	41

Source: CMA analysis of survey data.

Notes:

1. Bases differ for customer group. Prepayment customer base = 646, direct debit customer base = 5,121 and standard credit customer base = 973.

2. Respondents are categorised based on their payment method. In particular, respondents are only included if they have the same payment method for all fuel types (that is, including those with only one fuel type).

- 3.99 Table 3.5 shows respondents' age by whether that respondent was a prepayment customer or not. We find that, when compared with direct debit customers, prepayment customers are significantly: less likely to be aged over 65; and more likely to be aged between 18 and 35. Further, when

compared with standard credit customers, prepayment customers are significantly: less likely to be aged over 65; and more likely to be aged between 35 and 44 or 45 and 54.

Table 3.5: Age by payment type

			%
	<i>Prepayment customers</i>	<i>Direct debit customers</i>	<i>Standard credit customers</i>
18-35	27	15	23
35-44	22	18	14
45-54	24	20	16
55-64	14	15	13
65+	13	32	34

Source: CMA analysis of survey data.

Notes:

1. Bases differ for customer group. Prepayment customer base = 639, direct debit customer base = 5,050 and standard credit customer base = 959.

2. Respondents are categorised based on their payment method. In particular, respondents are only included if they have the same payment method for all fuel types (that is, including those with only one fuel type).

- 3.100 We also found that, when compared with both direct debit and standard credit customers, prepayment customers are significantly more likely to: be disabled (23% vs 10% and 11%); be a single parent (18% vs 5% and 8%); or be more than one of disabled, single parent and carer (10% vs 3% and 4%).¹⁸⁹
- 3.101 In relation to PCWs, we found that, of those respondents who had switched supplier in the last three years, prepayment customers, when compared with both direct debit and standard credit customers, were significantly less likely to have used a PCW for searching the last time they switched (34% vs 67% and 55%).¹⁹⁰
- 3.102 We also asked respondents about their confidence in using PCWs. We found that the percentage of prepayment customers who were confident that they would be able to find the right energy deal using a PCW (49%) was lower than the percentage for direct debit customers (59%), but not standard credit customers (46%). In addition the percentage of prepayment customers who have no access to the internet (25%) was significantly higher than the percentage of direct debit customers with no access to the internet (12%), but not standard credit customers (26%).¹⁹¹

¹⁸⁹ Bases differ for customer group. Prepayment customer base = 646, direct debit customer base = 5,121 and standard credit customer base = 973.

¹⁹⁰ Derived from question E32. Bases differ for customer group. Bases differ for customer group. Prepayment customer base = 141, direct debit customer base = 1,864 and standard credit customer base = 161.

¹⁹¹ Derived from questions H1 and H3. Bases differ for customer group. Bases differ for customer group. Prepayment customer base = 646, direct debit customer base = 5,121 and standard credit customer base = 973.

3.103 We have also considered respondents' tenure type by payment type. We find that, when compared with direct debit customers, prepayment customers are significantly: less likely to live in a property they own; and more likely to live in rented housing, both social and private, and other. In addition when compared with standard credit customers, prepayment customers are significantly less likely to live in a property they own outright; and more likely to live in rented social housing and other.

Table 3.6: Type of tenure by payment type

			%
	<i>Prepayment customers</i>	<i>Direct debit customers</i>	<i>Standard credit customers</i>
Own – outright	5	41	35
Own – mortgage	14	38	20
Rent – private	23	11	21
Rent – social	46	6	17
Other	12	4	7

Source: CMA analysis of survey data.

Notes:

1. Bases differ for customer group. Prepayment customer base = 646, direct debit customer base = 5,121 and standard credit customer base = 973.

2. Respondents are categorised based on their payment method. In particular, respondents are only included if they have the same payment method for all fuel types (that is, including those with only one fuel type).

3.104 As set out in Appendix 8.1 of our provisional findings report, living in rented social housing is associated with lower levels of engagement. We conducted a separate survey in relation to those who rent, which covered both private and social tenants (the 'Tenants Survey'), see Appendix 6.4. The Tenants Survey found that those who rent have low levels of engagement, in particular, over half (56%) of respondents had not considered switching supplier or tariff while living in their current home and nearly two-thirds (65%) said they had not switched supplier or tariff while living in their current home. We note that these results are not comparable to our main survey due to the questions asked.

3.105 The Tenants Survey also found that prepayment customers who rent may be as engaged as non-prepayment customers who rent.¹⁹² In particular the Tenants Survey found that, when compared to non-prepayment customers who rent, prepayment customers who rent are not significantly more or less likely:

¹⁹² For the purposes of the Tenants Survey results respondents were primarily classified as prepayment or non-prepayment, based on meter type rather than payment method. For the purpose of the Tenants Survey results reported here, prepayment customers are those who have a prepayment meter for at least one fuel, while non-prepayment customers are those without a prepayment meter or a smart meter for either fuel. Numbers of customers with a smart meter were low and not included in these comparisons.

- (a) to have not considered switching either supplier or tariff while living in their current home; or
 - (b) to have not switched either supplier or tariff when compared with non-prepayment customers.
- 3.106 In addition, when looking in more detail at evidence from our survey in relation to switching, prepayment customers appear more engaged than non-prepayment customers when controlling for certain demographics and household characteristics such as income (see Appendix 6.3).
- 3.107 Therefore, when compared to the entire population, prepayment customers are disproportionately represented within the socio-demographic groups that, in our survey, showed lower levels of engagement. However, when compared to non-prepayment customers belonging to the same demographic group, prepayment customers appear to be somewhat more engaged than non-prepayment customers. This may be because, as Scottish Power suggested, the regular activity of card or key top ups in advance of consumption may serve to improve engagement among prepayment customers relative to direct debit customers.
- 3.108 To sum up, we observe that prepayment customers are more likely (compared to domestic customers on direct debit):
 - (a) to belong to broad demographic and household characteristics such as tenure type, income, education level and disability, which may be expected to be correlated with lower levels of engagement in energy and other retail markets; and
 - (b) to be affected by factors that restrict their ability to access and assess information about switching (including relatively low access to the internet and confidence in using PCWs).

- *Provisional conclusion*

- 3.109 We have reviewed the available evidence on the extent to which the Domestic Weak Customer Response AEC applies to customers on prepayment meters. The evidence suggests that prepayment customers overall are less engaged than direct debit customers (but not less engaged than standard credit customers), particularly in terms of whether they have ever considered switching or are likely to consider switching in the next three years, and their awareness of their ability to switch (see paragraphs 3.89 to 3.94 above).
- 3.110 There are a number of factors that may explain this:

- (a) Prepayment customers face particular restrictions on accessing and assessing information about switching (including relatively low access to the internet and confidence in using PCWs).
- (b) Prepayment customers include higher proportions of individuals: with low levels of income; with low levels of education; living in social rented housing; and having a disability – demographic characteristics that we have found to be associated with low levels of engagement in retail energy markets. While the need to top up prepayment cards regularly is likely to increase awareness of energy markets among prepayment customers, low levels of engagement may have in part been influenced by the features giving rise to the Prepayment AEC – notably the lower gains from switching and the confusion surrounding rights to switch when the customer has outstanding debt.

3.111 The overall weight of evidence supports a provisional finding that disengagement and weak customer response is a more significant problem among prepayment customers compared with domestic customers on direct debit.

Customers on restricted meters

3.112 Restricted meters include any metering arrangement whereby a domestic customer's consumption at certain times and, in some cases, for certain purposes (for example, heating) is separately recorded.¹⁹³ These meters allow for customers to be charged lower rates for electricity used at times when demand is lower.

3.113 Where a restricted meter has more than one register the restricted meter has to be switched between recording usage on each register, similarly where a restricted meter only operates at certain times of the day the electricity supplied through that meter needs to be switched on and off. This switching process might be controlled remotely by radio signal (ie teleswitched) or locally (mechanically or electronically). Teleswitching can be either dynamic, static or semi-static. With dynamically teleswitched (DTS) meters the

¹⁹³ For example, a customer may have one meter covering all consumptions with two registers, a peak consumption register and an off-peak consumption register. Alternatively a customer may have two meters where one is for the space and water heating system and only operates at certain times of the day and the other is for all other electricity usage and operates at all times.

operational times might be changed – on the instructions of the host supplier¹⁹⁴ – in response to changes in market conditions.

- 3.114 There are currently over 4.3 million restricted meters (around 17% of all customer accounts) of which over 3.5 million are Economy 7 meters¹⁹⁵ (around 15% of customer accounts) and around 700,000 (about 2% of customer accounts) are non-Economy 7 restricted meters.¹⁹⁶
- 3.115 We have provisionally found that competitive outcomes for customers with Economy 7 meters are broadly similar to those customers with unrestricted meters. In particular, each of the Six Large Energy Firms and the Mid-tier Suppliers offers Economy 7 fixed-term tariffs which are advertised by suppliers and supported by PCWs and suppliers' own online search facilities. This is consistent with a recent Ofgem statement that most customers with restricted meters are on Economy 7 meters, for which the choice of tariffs and suppliers is similar to that for customers on unrestricted meters (ie meters with a single register and through which energy is continuously provided). Accordingly, in the rest of this section we have focused solely on the position of customers on non-Economy 7 restricted meters (and henceforth refer to this group as 'customers on restricted meters' unless otherwise specified).

Responses to provisional findings

- 3.116 In response to our provisional findings report, we received submissions in relation to restricted meters from the following consumer bodies: Changeworks; Highlands & Islands Housing Associations Affordable Warmth Group (HIHAAWG); and Energy Action Scotland. We also held a hearing with Citizens Advice and Citizens Advice Scotland; National Energy Action and Energy Action Scotland where restricted meters were raised.¹⁹⁷
- 3.117 These submissions were largely concerned with SSE and Scottish Power customers in Scotland with certain types of restricted and/or DTS meters. Parties said that SSE and Scottish Power had 'an effective monopoly' in Scotland in relation to customers on certain types of restricted meter. In

¹⁹⁴ DTS meters are switched using teleswitching codes where each code is controlled by a 'group code sponsor' or host where the incumbent supplier in a region is the host for DTS meters in that region. This means that in each region the incumbent supplier controls when DTS meters are switched. Ofgem (2013), [The state of the market for customers with dynamically teleswitched meters](#).

¹⁹⁵ For these purposes, White Meter 1 and White Meter 8 have not been included in Economy 7 meters. However, we note that Scottish Power told us that in Scotland these meters were equivalent to Economy 7 meters.

¹⁹⁶ Note that this will be an overestimate. This is because this figure is the number of meters as a percentage of the total number of electricity accounts, but some customers will have two restricted meters.

¹⁹⁷ These and other submissions are discussed in more detail in Appendix 3.1.

particular: SSE was said to have two unique tariffs, one of which was for customers with Total Heating Total Control (THTC) meters, and Scottish Power a similar tariff for customers with ComfortPlus meters. We note that there are two ComfortPlus meter types each with separate tariffs, ComfortPlus Control and ComfortPlus White Meter.¹⁹⁸ The other tariff was said to be SSE's tariff for customers with Economy 10 meters.^{199,200} Changeworks said that customers on these tariffs paid more for their heating and lighting than those on standard tariffs.²⁰¹

3.118 Parties also submitted that THTC meters were DTS meters and as such suppliers faced technical barriers in supplying customers with THTC meters (eg in relation to billing and when the heating meter was in operation). Further, parties told us that customers on THTC, ComfortPlus and Economy 10 meters faced barriers to switching. In particular:

- (a) suppliers other than SSE generally did not offer bespoke tariffs designed for customers with THTC meters; and
- (b) customers could not compare prices as those limited suppliers that did supply tariffs designed for THTC, ComfortPlus and Economy 10 meters, did not actively advertise tariffs compatible with these meters and they were not supported by PCWs.

3.119 At the hearing with Citizens Advice and Citizens Advice Scotland; and National Energy Action and Energy Action Scotland, a range of points were made including the following:

- (a) around 400,000 customers in Scotland are on a DTS tariff and these customers have no suitable alternative to SSE and Scottish Power tariffs;
- (b) the lack of options has persisted for so long that these customers are particularly disengaged;
- (c) these customers face an additional barrier due to the costs involved in switching away from a DTS meter (it requires the house being rewired);
- (d) previously suppliers had indicated that their billing systems prevent them from providing certain tariffs; and

¹⁹⁸ Note these are all dual MPAN meters.

¹⁹⁹ See [Changeworks](#) response to provisional findings and Remedies Notice.

²⁰⁰ Economy 10 meters can either be single MPAN or dual MPAN.

²⁰¹ See [Changeworks](#) response to provisional findings and Remedies Notice.

(e) the lack of access to the codes controlling DTS is a barrier to suppliers offering DTS tariffs.

- 3.120 In light of these submissions, we have assessed to what extent competition for customers on restricted meters is affected by the Domestic Weak Customer Response AEC (and, within that provisional AEC, whether particular features affect customers on restricted meters more acutely) and/or by supply-side constraints specific to restricted meters.

Domestic Weak Customer Response AEC

- 3.121 We have provisionally found that customers on restricted meters face particularly strong barriers to accessing and assessing information and barriers to switching supplier and/or tariff.
- 3.122 As regards facing specific barriers to accessing and assessing information, we have found that this is partly because restricted meter tariffs are not supported by PCWs or suppliers' online search tools. Further, if customers on restricted meters wished to switch to another restricted meter tariff or an Economy 7 tariff, they would need to understand not only their current tariff and the alternative tariffs available but also their usage patterns and consumption profile (including whether and how these might change over time), which can be difficult based on the information provided by traditional meters, see paragraph 12.5 of our provisional findings report.
- 3.123 As regards facing barriers to switching supplier and/or tariff, we have been told that many restricted meter customers (ie excluding customers with Economy 7 meters) do not have a choice of supplier offering bespoke tariffs (ie tariffs designed to support their specific type of restricted meter (see Appendix 3.1)). They can in principle switch to a single-rate or an Economy 7 tariff offered by their supplier or rival suppliers, but some suppliers would require their existing meter to be replaced with an unrestricted, Economy 7 or Economy 10 meter at a cost to the customer. Changing meters might also involve some rewiring in the home.
- 3.124 Further, a change of meter (particularly to an unrestricted meter) may entail a loss of functionality to the customer, and possibly higher tariffs in the future, with no option of reverting back to their old meter. As a consequence, customers face uncertainty in determining whether switching supplier is a good thing for them given the difficulties they face in both comparing the options available to them and taking into account the possible irreversible loss of the functionality of their installed space and water heating systems. In our view, this therefore demonstrates an additional perception of a barrier to switching for customers on restricted meters.

- 3.125 All this means that, for customers on restricted meters, understanding the options available to them and switching supplier is substantially more difficult than it is for customers on other meter types.
- 3.126 The customer survey that we conducted does not have sufficiently granular data to allow us to identify customers on restricted meters. However, we have reviewed research by Ofgem, which found that customers on restricted meters face additional barriers to engagement in the domestic retail energy markets compared to other consumers, which principally relate to such customers' awareness of, and interest in, their ability to switch energy supplier.²⁰² In particular it found that:
- (a) many consumers have a low awareness and understanding of their DTS arrangements and tariff;
 - (b) people find the inherently complex heating system difficult to understand fully and operate efficiently;
 - (c) there is a perceived lack of interest by suppliers in explaining metering arrangements to consumers and offering alternatives; and
 - (d) the consumer base is often vulnerable and many find it difficult to access information and exercise supplier or tariff choice, even when this is available.
- 3.127 The information we have received from suppliers also demonstrates that rates of switching supplier by customers on restricted meters are low (and lower than they are with customers on unrestricted or Economy 7 meters). One of the Six Large Energy Firms submitted that existing customers on restricted meters outside their incumbent regions were largely acquired through doorstep selling. We have received limited, if any, further evidence that either the Six Large Energy Firms or the Mid-tier Suppliers actively compete to acquire customers with restricted meters.
- 3.128 Table 3.7 shows the incumbent share of supply by PES region for restricted meters as at September 2015²⁰³ and separately for electricity (for all electricity meters including restricted meters) and gas as at July 2015. We note that the figures for restricted meters are only based on data for the Six Large Energy Firms while the figures for electricity and gas include all suppliers.

²⁰² November 2014 Ofgem published results of research on the experience of consumers who use DTS meters and tariffs. Ofgem (2014), [Dynamically Teleswitched meters and tariffs – Ofgem's views on the way forward](#).

²⁰³ Note that information provided for SSE is as at June 2015.

3.129 We have found that within each of the PES regions the incumbent electricity supplier, as at September 2015,²⁰⁴ supplied between 40% and 91% of electricity customers with restricted meters,²⁰⁵ with the incumbent share at over 70% in ten of the 14 regions.²⁰⁶ Across GB the incumbent share of supply in restricted meters is 79% which is significantly higher than the equivalent figure for all electricity (33%) and gas (37%) customers.²⁰⁷

Table 3.7: Incumbent share of supply by PES region

<i>Region</i>	<i>Non-Economy 7 restricted meters</i>	<i>Electricity (all)</i>	<i>Gas</i>
Great Britain	[X]	[X]	[X]
East Anglia	[X]	[X]	[X]
East Midlands	[X]	[X]	[X]
London	[X]	[X]	[X]
Merseyside and North Wales	[X]	[X]	[X]
Midlands	[X]	[X]	[X]
North East	[X]	[X]	[X]
North Scotland	[X]	[X]	[X]
North West	[X]	[X]	[X]
South East	[X]	[X]	[X]
Southern	[X]	[X]	[X]
South Scotland	[X]	[X]	[X]
South Wales	[X]	[X]	[X]
South West	[X]	[X]	[X]
Yorkshire	[X]	[X]	[X]

Source: CMA analysis.

Notes:

1. Figures for non-Economy 7 restricted meters are based on data provided by the Six Large Energy Firms for September 2015, except for SSE which is as at June 2015.

2. Figures for electricity and gas are based on Cornwall Energy data covering Q1 and Q2 2015.

3. Figures for electricity cover all types of electricity meter and therefore include non-Economy 7 restricted meters.

4. The incumbent gas supplier is British Gas. The incumbent electricity supplier is E.ON for East Midlands, East Anglia, North West; EDF for London, South East, South West; RWE for Midlands, North East, Yorkshire; Scottish Power for South Scotland, Merseyside and North Wales; SSE for North Scotland, Southern, South Wales.

²⁰⁴ Note that information provided for SSE is as at June 2015.

²⁰⁵ We note that the incumbency shares in the South East and South West regions are materially lower than in other PES regions. EDF Energy, the incumbent supplier in both of these regions, told us that, without access to the volumes of these meters from other suppliers and by region, it was not clear why the incumbency shares in these regions would be materially lower than in others. [X]. We will explore the extent to which the Six Large Energy Firms have installed non-Economy 7 restricted meters outside of their incumbency areas. In particular, if the Six Large Energy Firms have installed non-Economy 7 restricted meters outside of their incumbency areas incumbency shares could overestimate the level of switching.

²⁰⁶ CMA analysis based on data from the Six Large Energy Firms.

²⁰⁷ Figures for electricity and gas are based on Cornwall Energy data covering Q1 and Q2 2015.

- 3.130 In addition, for certain types of restricted meters, we have been able to identify the percentage of customers who, as at September 2015,²⁰⁸ continued to receive electricity from the same incumbent supplier that installed their restricted meter. These customers have meter types, and are on supporting tariffs, that when installed were unique to an incumbent electricity supplier. In particular, we have investigated SSE's THTC and SuperDeal meters, Scottish Power's ComfortPlus meters, E.ON's Heatwise meter,²⁰⁹ RWE's SuperTariff meter²¹⁰ and EDF Energy's WarmWise meter.
- 3.131 For customers on these types of restricted meter, the original incumbent supplier still supplies nearly [%] of such customers. In particular, the lowest incumbent share was [%] while for four of the seven meters the share was over [%].²¹¹ For example, in relation to THTC meters in North Scotland and ComfortPlus meters in South Scotland the incumbent supplier in each region (SSE and Scottish Power respectively) appears to be the only supplier that offers bespoke tariffs for these meters and each has [%] of the share of supply.²¹²
- 3.132 One potential explanation for the low levels of switching observed in these segments – which several suppliers submitted – is that restricted meter customers are generally already on the best deals available and so would not gain from switching. We note that customers on restricted meters are generally cheaper for suppliers to serve because their meters are designed to support space and water heating systems that operate in off-peak hours when wholesale costs of electricity are lower, and the electricity settlement system allows suppliers to benefit from such lower costs.²¹³ Therefore it is possible – if suppliers choose to pass such benefits on to their customers – that customers on restricted meters may indeed be on very favourable deals, such that there would be limited benefit from switching.

²⁰⁸ Note that information provided for SSE is as at June 2015.

²⁰⁹ E.ON told us that Heatwise meters were installed by E.ON specifically in the East Midlands region, however, it had no visibility in relation to whether other suppliers had installed Heatwise meters in any region.

²¹⁰ RWE npower told us that SuperTariff was a 'brand' tariff name used by Northern Electric, now part of the RWE group, in the North East. RWE npower noted that a [%] as incumbents in those regions offered their own tariffs with similar characteristics to SuperTariff.

²¹¹ For WarmWise the incumbent share was [%], for Heatwise [%], for SuperTariff [%], for ComfortPlus Control [%], for ComfortPlus White Meter [%], for THTC [%] and for SuperDeal [%]. We noted that RWE npower told us [%] and this is discussed in more detail at paragraphs 64 to 65 in Appendix 3.1 CMA analysis of data from the Six Large Energy Firms.

²¹² We understand that E.ON has some customers ([%]) on these three meters with the majority on E.ON's single-rate SVT tariff as E.ON does not offer a bespoke tariff for all these meters. However, E.ON does offer a bespoke tariff to a subset of the ComfortPlus meters, referred to as 'Weathercall' meters, and has [%] customers with these meters on a tariff called 'Electrical Heating Comfort Extra Control'. SSE has [%] customer on ComfortPlus meters all on a bespoke SVT tariff, however, we understand that this tariff is not available to new customers. RWE npower also has some customers on these meters ([%]).

²¹³ Appendix 3.1 provides further evidence on this question.

- 3.133 We have tested this hypothesis by comparing the bills paid by customers on restricted meters, roughly 89% of whom are on an SVT tariff bespoke to their specific type of restricted meter,²¹⁴ with those that they would have paid had they been on the cheapest single-rate electricity tariff in the markets.²¹⁵ When selecting our benchmark single-rate tariffs we selected from all direct debit tariffs available to all customers on unrestricted meters adjusted to take account of the differences in the cost to serve these customers, but not for any one-off switching costs such as the cost of changing meter or rewiring (for more information on these cost differences see Appendix 3.6 and for discussion of the benchmark used see paragraph 3.202. The analysis used tariffs in the market at the end of Q2 2015 and estimated annual consumption by meter as at Q2 2015.
- 3.134 We have found that 69% of customers would have lower bills if they were on the cheapest single-rate tariffs from across the Six Large Energy Firms and the Mid-tier Suppliers and that those who could have saved would have saved an amount equivalent to around 18% of their bill.²¹⁶ However, it should be noted that the results differ significantly depending on the supplier in question. For example, while for [X] customers, [X]% would have been better off on the cheapest single-rate tariff, for [X] were better off on their current meter-specific tariffs (for more information see Table 3.11 below and Appendix 3.1).
- 3.135 Overall, we consider that the evidence demonstrates that customers on restricted meters are subject to substantial barriers to accessing and assessing information to help them switch, over and above the barriers to accessing and assessing information that we identified in our provisional findings concerning the Domestic Weak Customer Response AEC. The evidence also demonstrates that such customers have additional barriers to switching to those identified in our provisional findings report concerning the Domestic Weak Customer Response AEC and this is supported by the observed low levels of switching, which is not attributable simply to such customers being on favourable tariffs. In paragraphs 3.192 to 3.198 below, we draw on this analysis in assessing the level of detriment arising from the heightened features we have identified concerning customers on restricted meters.

²¹⁴ This is based on the consumption data, before exclusions, collected as part of our restricted meter bills analysis, for more details see Annex B of Appendix 3.1. We note that: Centrica offers its Economy 7 tariffs to all restricted meter customers and therefore for Centrica when we refer to a meter-specific tariff we are referring to an Economy 7 tariff; and at E.ON restricted meter customers may also be on the single-rate SVT, in particular, where the customer has a restricted meter type for which E.ON does offer a bespoke tariff.

²¹⁵ In particular, our tariff information covered the Six Large Energy Firms, Sainsbury's Energy, Ebico, M&S Energy, Co-operative Energy, First Utility and Ovo Energy.

²¹⁶ The analysis is set out in more detail in paragraphs 3.199–3.205 below.

Supply-side constraints

- 3.136 We have considered whether the lack of switching we have observed could also be due to the existence of supply-side constraints. In this regard, we have explored two hypotheses:
- (a) that the fixed costs of developing new tariffs and the small number of customers on individual types of restricted meters means that it is not cost effective for suppliers to develop bespoke tariffs for them; and
 - (b) that, for meters operated in DTS mode, suppliers may be reluctant to offer tariffs for customers for whom certain operating parameters are controlled by another supplier.
- 3.137 In relation to the first hypothesis, we recognise that suppliers would incur additional costs in developing bespoke tariffs for customers on certain types of restricted meter and may not find it profitable to do so (and/or to market such tariffs proactively) if there are sufficiently low numbers of customers on those meters. However, this does not in itself explain the lack of switching to cheaper single-rate tariffs, as we would expect the incremental costs of making such tariffs available to restricted meter customers to be negligible.²¹⁷ Most of the Six Large Energy Firms and the Mid-tier Suppliers submitted that they did allow existing or new customers to switch to single-rate tariffs, although some required the replacement of the customer's existing meter.
- 3.138 We have also received submissions that DTS technology constitutes a supply-side constraint on competition. For example, in its 2013 'State of the market for customers with DTS' report, Ofgem said that when DTS meters were switched dynamically by the host supplier (ie the incumbent supplier), non-incumbent suppliers may face a DTS-specific barrier to entry due to the risk of imbalance between their supply and demand positions. In particular, this risk arises because non-incumbent suppliers may not know in advance the timing and duration of supply to heating circuits for these DTS customers. Therefore if a non-incumbent supplier has DTS customers then it may face unexpected periods of high or low demand.²¹⁸
- 3.139 However, while some suppliers told us that there may be difficulties in offering tariffs in relation to DTS meters, the Six Large Energy Firms²¹⁹

²¹⁷ For example, we would expect suppliers to be able to either sum consumption across different registers when calculating the bill or to be able to apply the same unit rate to different registers when calculating the bill.

²¹⁸ Ofgem (2013), [The state of the market for customers with dynamically teleswitched meters](#).

²¹⁹ These were EDF Energy, E.ON and RWE npower.

generally told us that the mechanism by which a restricted meter was controlled did not determine/limit the tariff choices available to customers.²²⁰ For example, Scottish Power told us that not all customers on its ComfortPlus White Meter tariff used DTS meters. Further, there are other non-Economy 7 restricted meters that are not DTS meters where the incumbent suppliers have similar shares.²²¹

- 3.140 Further, many Economy 7 meters are classed as DTS meters²²² – although we note in this regard that they do not appear to currently be operated dynamically – and this does not appear to be an impediment to competition.
- 3.141 We note that the roll-out of smart meters may address the issues outlined below in relation to customers on restricted meters. However, three of the Six Large Energy Firms²²³ told us that smart meter equivalents were not currently available for all restricted meter types such that the roll-out of smart meters for customers who wanted or needed to keep the capability of those restricted meters was therefore delayed until smart meter equivalents could be developed.²²⁴
- 3.142 Therefore, based on the assessment above, we think that the problems we have identified as affecting customers on restricted meters relate primarily to the demand side, and in particular derive from the existence of barriers to accessing and assessing information, and barriers to switching, which are additional to those that we have identified in our provisional findings report as being faced by customers on unrestricted meters concerning the Domestic Weak Customer Response AEC.

Provisional conclusion on features relating to customers on restricted meters

- 3.143 Our provisional view is that our additional analysis relating to restricted meters is consistent with, and reinforces, the Domestic Weak Customer Response AEC that we have provisionally identified in the domestic retail energy markets.
- 3.144 In our provisional findings report, we provisionally found that a combination of features of the markets for domestic retail supply of gas and electricity in

²²⁰ For example, EDF Energy told us [REDACTED].

²²¹ For example, for the Heatwise meter the incumbent share was [REDACTED]%, for the SuperTariff meter the incumbent share was [REDACTED]% and for the SuperDeal meter the incumbent share was [REDACTED]%. CMA analysis of data from the Six Large Energy Firms.

²²² Based on information provided by the Six Large Energy Firms, excluding E.ON, and the Mid-tier Suppliers we estimate that roughly 424,571 Economy 7 meters can be operated dynamically.

²²³ These were Centrica, EDF Energy and E.ON.

²²⁴ Centrica and EDF Energy told us that this would be at least until 2017.

GB give rise to the Domestic Weak Customer Response AEC. These features included the following:

- (a) customers have limited awareness of, and interest in, their ability to switch energy supplier;
- (b) certain customers face actual and perceived barriers to accessing and assessing information; and
- (c) certain customers face actual and/or perceived barriers to switching.

3.145 Our further analysis of the retail supply of electricity to domestic customers on restricted meters supports our provisional finding that the above features also affect domestic customers on restricted meters, and shows additional aspects of the domestic retail electricity market concerning customers on restricted meters that contribute to some of these features.

3.146 In particular, compared to customers affected by the Domestic Weak Customer Response AEC who are on unrestricted meters:

- (a) We consider that Ofgem's research concerning customers on restricted DTS meters demonstrates that customers on restricted meters have particularly limited awareness of, and interest in, their ability to switch energy supplier, which arises in particular from certain aspects of the domestic retail electricity market set out in paragraph 3.127 above.
- (b) We have provisionally found that customers on restricted meters face higher barriers to accessing and assessing information arising, in particular, from a general lack of price transparency concerning the tariffs that are available to them, which results from restricted meter tariffs not being supported by PCWs or suppliers' online search tools and also from low incentives on suppliers to invest in marketing to customers on restricted meters.
- (c) We have also provisionally found that customers on restricted meters face higher actual and/or perceived barriers to switching arising, in particular, from the following aspects of the domestic retail electricity market concerning customers on restricted meters:
 - (i) A requirement imposed by suppliers on some customers on restricted meters to replace their existing meter with an unrestricted, Economy 7 or Economy 10 meter at a cost to the customer.
 - (ii) The fact that changing meter might also involve some rewiring in the home.

- (iii) The uncertainty customers face in determining whether switching supplier is a good thing given the difficulties they face in both comparing the options available to them and taking into account the possible irreversible loss of the functionality of their meter.

3.147 We believe that these aspects of the domestic retail electricity market are relevant considerations for the design of our remedies and the assessment of their effectiveness and proportionality. In the section below, which sets out our update on the detriment arising from the Domestic Weak Customer Response AEC, we therefore explore further the nature and magnitude of the detriment arising from the Domestic Weak Customer Response AEC for customers on restricted meters.

Summary of updated analysis of features

3.148 Table 3.8 below summarises our view of how different categories of domestic customers (by meter type) are affected by the AECs we have provisionally identified in domestic energy markets.

Table 3.8: Summary of provisional AECs concerning domestic retail energy markets

<i>Provisional AECs</i>	<i>Categories of domestic customer affected</i>
Domestic Weak Customer Response AEC	Domestic customers on all meter types but: <ul style="list-style-type: none"> - for customers on restricted meters (other than Economy 7), particularly limited awareness of, and interest in, switching suppliers; higher barriers to accessing and assessing information - disengagement is a more significant problem among prepayment customers compared to customers on direct debit
Prepayment AEC	Customers on prepayment meters only.
Regulatory AECs <ul style="list-style-type: none"> - Simpler choices element of RMR - Electricity settlement - Gas settlement 	Domestic customers on all meter types.

3.149 Overall, we consider that the AECs vary in strength across different consumer categories and in some cases reinforce each other. In particular, we have provisionally found that:

- (a) weak customer response in the credit meter space affects part of the market (customers on SVTs) particularly strongly;
- (b) weak customer response is more pronounced for prepayment than for direct debit customers;
- (c) weak customer response is more pronounced for customers on restricted meters compared to customers on single rate meters; and

- (d) retail suppliers have reduced incentives (and, for some, ability) to compete to acquire prepayment customers (in particular, customers with an outstanding debt or a poor credit history) and to innovate by offering tariff structures that meet customers' demand.

3.150 In the next section we set out our updated thinking on the detriment that arises from these AECs for each of the above customer categories.

Analysis of detriment

3.151 To assist us in deciding on appropriate remedies, we have assessed the nature and extent of detrimental effects on domestic energy customers resulting from the AECs that we have provisionally identified in the domestic retail energy markets. This section sets out the results of the updated analysis of customer detriment that we have undertaken since the provisional findings report.

3.152 Our approach to assessing the scale of detriment has involved considering to what extent the outcomes that we have observed in the domestic retail energy markets are worse than we would expect to see in well-functioning competitive markets, including the extent to which domestic energy customers are, on average, paying higher prices than they would do in well-functioning competitive markets and receiving poorer quality of service. As set out in our Guidance, 'a well-functioning market' is one that displays the beneficial aspects of competition, notably rivalry between firms which seek to win customers' business through lower prices, improved quality or variety and/or introducing new or better products. It is not an idealised perfectly competitive market.²²⁵

3.153 We have considered three potential sources of detriment to consumers in the domestic retail energy markets:

- (a) that domestic energy customers are, on average, paying higher prices than they would do in well-functioning competitive markets;
- (b) that domestic energy customers receive a poorer quality of service than they would do in well-functioning competitive markets; and
- (c) that suppliers innovate less in products and services than they would do in well-functioning competitive markets, resulting in a more restricted range of products and services for domestic customers.

²²⁵ CC3, paragraphs 10, 12 & 320.

- 3.154 Most of our analysis has focused on the first source of detriment – excessive prices – as we believe that this is likely to be the most significant form of detriment suffered by energy customers, given the homogenous nature of gas and electricity.²²⁶ Further, it is easier to quantify robustly the extent to which prices are excessive than the extent to which quality of service is relatively poor or innovation relatively restricted. Nonetheless, we do give some consideration to these second two sources of detriment at the end of this section.
- 3.155 We have adopted two approaches to assessing the extent to which prices are excessive (ie have exceeded those we would expect in a well-functioning market):
- (a) A ‘direct’ approach, which involves comparing the average prices charged by different suppliers, while controlling for those exogenous differences in each supplier’s customer base that are likely to affect costs.
 - (b) An indirect approach, which involves assessing both:
 - (i) suppliers’ levels of profitability (and in particular whether the return on capital employed by suppliers exceeds their cost of capital); and
 - (ii) the extent to which suppliers have incurred costs inefficiently (ie whether costs are higher than we estimate an efficient supplier would incur).
- 3.156 The benefit of the direct approach is that it gives us a more direct measure of consumer detriment based on actual market prices – and prices are ultimately what matter to a consumer, rather than a supplier’s level of profitability or cost efficiency. Further, the direct approach allows for a much more granular breakdown of detriment, not just by supplier but by customer type, including type of tariff and payment method.
- 3.157 The indirect approach provides information on profitability and cost efficiency which can be a useful proxy for consumer detriment – indeed it is sometimes the only available means of quantifying consumer detriment. In this case, we believe that it can provide a useful independent cross check on our direct analysis, as it is based on a separate data set and methodology.
- 3.158 Our analysis has focused on the Six Large Energy Firms. We recognise that there may be harm to consumers from pricing policies of suppliers other than

²²⁶ See Section 7 of our [provisional findings report](#), paragraphs 7.10 & 7.11.

the Six Large Energy Firms and we will look to expand our analysis to consider this issue in time for the final report.

- 3.159 Finally, we note that detriment is a measure of outcome and that, in relation to the AECs we have provisionally identified in the domestic retail energy markets:
- (a) for customers on credit (ie non-prepayment) meters, observed detriment arises from the Domestic Weak Customer Response AEC (noting how the strength of features differ between different categories of customer); while
 - (b) for customers on prepayment meters, observed detriment arises from the Domestic Weak Customer Response AEC and Prepayment AEC.
- 3.160 The Regulatory AECs may also contribute in part to the detriment we identify in this section (through the dulling effect on competition arising from inaccurate settlement and aspects of the 'simpler choices' component of the RMR rules), although we note that specific aspects of the detriment arising from the Regulatory AECs are identified separately, in Section 5, where we consider the potential benefits arising from half-hourly settlement in electricity and the potential reduction in commission costs arising from keener competition between TPIs.
- 3.161 The next section sets out the results of our analysis. Further details of our analysis are provided in the following: Appendix 3.1, Appendix 3.3, Appendix 3.4 and Appendix 3.5.

Direct approach: analysis of average prices and bills

- 3.162 Our direct approach to assessing detriment has involved calculating the average prices offered by different suppliers to their customers and comparing these to a 'competitive benchmark price', which is constructed as the average prices offered by the most competitive suppliers. In making this comparison, we have adjusted for exogenous cost differences relating to network costs and the costs associated with different payment methods, to ensure the comparison is on a broad like for like basis.
- 3.163 The data set we have has allowed us to conduct this analysis for the vast majority (around 96%) of all GB domestic customers, over the period Q1 2012 to Q2 2015, and to break down the resulting detriment by a number of dimensions including: supplier; fuel; tariff type; and payment method.
- 3.164 The data set covers all the customers of the Six Large Energy Firms and the four Mid-tier Suppliers who are on single-rate or Economy 7 meters. For

customers on non-Economy 7 restricted meters (about 2% of the total customer base), we have conducted a separate, higher level exercise for Q2 2015, the results of which we summarise in paragraphs 3.199 to 3.205 below.

3.165 In the rest of this section we:

- (a) describe our methodology in more detail, including a justification of our choice of suppliers to construct the competitive benchmark and the approach we have adopted to adjusting for exogenous cost differences;
- (b) present the results of the benchmark analysis and detriment calculation;
- (c) describe a robustness test of the benchmark analysis;
- (d) consider the evidence on the financial sustainability of the suppliers we have used to construct the competitive benchmark; and
- (e) present the results of the high-level analysis of detriment that we have conducted for customers on restricted meters.

Methodology

3.166 Our competitive benchmark is a hypothetical construct, a 'supplier' that is a combination of the suppliers that we have identified as being the most competitive in the markets. The benchmark includes all tariff types weighted by the respective number of accounts within each of those suppliers. The payment method is set to direct debit (as explained below, we make an adjustment for payment method cost differentials where relevant).

3.167 Our methodology consists of five steps (a more detailed description is given in Appendix 3.3):

- (a) First we choose the suppliers that will provide the basis for our assessment of competitive benchmark prices.
- (b) Next, we adjust our data to account for exogenous cost differences between the suppliers.
- (c) We then compute the average bill for each supplier by payment type and the benchmark average bill, and use those to calculate the extent to which suppliers' bills are priced above the competitive level, as implied by the benchmark bills.

(d) After that, we calculate the overall detriment to domestic customers from the prices being set by the Six Large Energy Firms above the competitive level.

(e) Finally, we test the robustness of our findings by performing the analysis of bills at different consumption levels (this is explained in Appendix 3.3).

- *Choice of suppliers for the competitive benchmark*

3.168 In our provisional findings report, we concluded that weak customer response is an overarching feature which gives suppliers a position of unilateral market power concerning their inactive customer base which they are able to exploit through their pricing practices. Because of that, for the purpose of choosing our competitive benchmark we have focused on suppliers whose average price best reflects prices paid by active customers as we expect those customers to be on competitively priced tariffs.

3.169 We have estimated consumer detriment by comparing the average bills between the Six Large Energy Firms and two of the Mid-tier Suppliers, Ovo Energy and First Utility, using the latter as our competitive benchmark. We believe that this approach is justified for the following reasons:

(a) Both Ovo Energy and First Utility are competing primarily through acquisition tariffs where competition is focused on price, and where customers are acquired through PCWs, which is the main channel for the acquisition of active customers.

(b) Therefore, both Ovo Energy and First Utility have relatively few inactive customers, which means that we would expect their average price (or the 'system' price) to be close to a competitive level. This may not be the case with the Six Large Energy Firms which all have a high ratio of inactive to active customers (for example, see Appendix 8.1).

(c) While they may be more efficient, we have satisfied ourselves that Ovo Energy and First Utility do not enjoy significant exogenous cost advantages relative to the Six Large Energy Firms (once the adjustments made below are taken into account), and that their pricing is sustainable (sustainability is considered in more detail in paragraphs 3.193 to 3.197 below).

3.170 We did not include in our competitive benchmark the other two of the Mid-tier Suppliers: Utility Warehouse and Co-operative Energy.

3.171 Utility Warehouse acquired the majority of its existing customers through a deal with RWE npower rather than acquiring them through competition by

offering keenly priced tariffs in the way Ovo Energy and First Utility have done. We also note that Utility Warehouse does not advertise its tariffs through PCWs where customers can compare and identify the most competitively priced tariffs. Instead, it works in a partnership with independent (and part-time) distributors (known as 'Partners') who receive a small share of the revenues from each new customer they introduce. Another reason as to why Utility Warehouse may not be suitable for our benchmark is because their business model is focused on providing bundled services (energy and telecoms). It would therefore be more difficult for us to compare on a like for like basis their prices with those of the Six Large Energy Firms.

3.172 Although Co-op in principle uses multiple acquisition channels, including, at times, price comparison websites, a large number of its customers have been acquired from the members of the Midcounties Co-operative. Those who were not acquired in this way have also been given the option of becoming members, entitling them to a share in the profits it generates from all business streams, not just from the energy business. This would make it difficult to compare Co-operative Energy prices with that of the Six Large Energy Firms on a like for like basis. Another reason for not including Co-operative Energy in our benchmark is that it is a considerably smaller supplier than First Utility [X] and Ovo Energy [X] and may not yet be operating at an efficient scale. Further, unlike First Utility and Ovo Energy, Co-operative Energy is not yet fully subject to the costs of meeting environmental and social obligations.

- *Adjustment of data to reflect exogenous cost differences*

3.173 We recognise that suppliers' customer bases differ across a range of dimensions, including location, tariffs and payment method. This may give rise to cost differences between the suppliers over which they have little control (we call these 'exogenous' cost differences), and which we therefore needed to control for in our analysis in order be able to compare bills on a like for like basis. We have identified two such cost categories: network charges and the costs associated with different payment methods.

3.174 Network charges comprise distribution and transmission charges that vary across regions and fuels. They affect suppliers' costs in different ways, depending on their regional presence. We have computed the value of those charges by combining them with actual consumption data. We have then subtracted them from each electricity, gas and dual fuel bill in our sample.

3.175 The proportion of customers on different payment methods varies between suppliers. We have considered evidence from a variety of sources to reach a

decision on whether there are systematic differences in the costs of serving prepayment meter, standard credit and direct debit customers. Our analysis shows that prepayment meter and standard credit customers are more costly to serve than direct debit customers by approximately £54 and £82, respectively. Appendix 3.6 sets out the analysis we have conducted to inform this provisional conclusion. To account for these cost differences, we have subtracted the corresponding amounts from each prepayment meter and standard credit bill in our sample.

- 3.176 We note that there may be some differences in customer characteristics that have an impact on costs but that we have not explicitly controlled for in the above approach. For example, First Utility and Ovo Energy have had a higher proportion of engaged customers and customer acquisitions relative to their customer stock over the period, since they have been growing. Such customers are likely to be more costly to serve than those who do not switch either tariff or supplier for several years.²²⁷ On the other hand, the customers of the Six Large Energy Firms are more likely to be on the Priority Services Register, which entails certain additional costs for the supplier.²²⁸ Our provisional view is that the exclusion of these factors from our quantitative analysis does not introduce a systematic bias into the results.
- 3.177 In relation to the costs of environmental and social obligations, as set out in Appendix 7.1 of our provisional findings report, both First Utility and Ovo Energy were fully obligated under the Energy Company Obligation from the beginning of 2015²²⁹ and were partially obligated in previous years. Therefore, while their prices may reflect some differences in their cost bases in earlier periods,²³⁰ their 2015 prices will reflect a similar cost base in terms of environmental obligations. For this reason, and the fact that in more recent years both Ovo Energy and First Utility have been operating at a larger scale, we place greater weight on the results of the detriment analysis in more recent years.
- 3.178 Overall, our provisional view is that adjusting for network costs and the costs of different payment methods will allow for a comparison of suppliers' bills on a broadly comparable basis.

²²⁷ First Utility told us that the costs incurred by a supplier over the three-week period when a customer joined were [§].

²²⁸ As explained in Section 8 of our provisional findings report, under their licences, suppliers must maintain a Priority Services Register and put consumers from certain eligible groups on the register when they request it. The eligible groups include people of pensionable age, disabled people and those who are chronically sick. Suppliers must offer non-financial help and advice to these customers.

²²⁹ In the case of Ovo this was April 2015.

²³⁰ As note in Appendix 7.1 of our provisional findings report, the larger suppliers estimate the benefit of the full Energy Company Obligation exemption as being around £45–£60 per dual fuel account. DECC estimated that this is lower, around £36 for a dual fuel customer, taking into account the 2013 Autumn Statement changes.

- *Bills comparison*

3.179 We have estimated the degree to which suppliers' bills are priced above the competitive level using the following steps:

- (a) Step 1: We first compute the average bill (adjusted as discussed above) for each supplier/payment type weighted by the number of accounts for each tariff.
- (b) Step 2: We calculate the benchmark as the average bill of Ovo Energy and First Utility direct debit tariffs.
- (c) Step 3: We calculate the difference between the average bill for each supplier/payment type and the benchmark.

3.180 The comparison between the benchmark and suppliers' bills is made at Ofgem's Medium Typical Domestic Consumption Values (TDCV)²³¹ rather than at the consumption levels associated with tariff types. We have done this in order to strip out the volume effect and therefore allow for a like for like bills comparison between the suppliers and payment methods. The comparison presented is therefore equivalent to a difference in average price paid. We have also made this comparison at Ofgem's low and high TDCV to test the robustness of our findings (this is explained further below and in Appendix 3.3).

3.181 The tables below show our estimates of the extent to which suppliers' bills are priced above the benchmark level, split by payment type for dual fuel and single fuel customers. The results are averaged across the period between 2012 and 2015 as explained in Appendix 3.3.

3.182 There is a considerable variation in the extent to which individual suppliers have priced above the benchmark level. For dual fuel customers (the substantial majority of customers), the prices are highest for [X] and [X] among the Six Large Energy Firms and lowest for [X]. We note that the gap between the benchmark and suppliers' prices for single fuel gas customers is considerably higher than for single fuel electricity customers.

²³¹This is explained in Appendix 3.3.

Table 3.9: Comparison of dual, single fuel electricity and gas bills by supplier and payment method, calculated at Ofgem 2014 Medium TDCV

Dual fuel

Supplier	Average bill				Benchmark	Average difference (£)				Average difference (%)			
	DD	SC	PP	All		DD	SC	PP	All	DD	SC	PP	All
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
SLEFs	857	874	908	870	775	82	99	132	94	10%	11%	15%	11%

Single fuel electricity

Supplier	Average bill				Benchmark	Average difference (£)				Average difference (%)			
	DD	SC	PP	All		DD	SC	PP	All	DD	SC	PP	All
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
SLEFs	369	378	389	376	338	31	40	52	39	9%	11%	13%	10%

Single fuel gas

Supplier	Average bill				Benchmark	Average difference (£)				Average difference (%)			
	DD	SC	PP	All		DD	SC	PP	All	DD	SC	PP	All
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
SLEFs	540	533	534	536	445	95	88	89	91	18%	16%	17%	17%

Source: CMA analysis.

Note: SLEFs = Six Large Energy Firms, DD = direct debit, SC = standard credit, PP = prepayment.

3.183 Looking at differences by payment method, we note that for dual fuel and single fuel electricity, the difference between the benchmark and what customers pay is biggest for customers on prepayment meters (15% for dual fuel and 13% for single fuel electricity), followed by standard credit customers (11% for both dual fuel and single fuel electricity), and then direct debit customers (10% for dual fuel and 9% for single fuel electricity). For single fuel gas, the difference between payment methods is somewhat smaller than in the case of dual fuel and single fuel electricity (18% for direct debit; 17% for prepayment and 16% for standard credit).

- *Detriment calculations*

3.184 We have benchmarked suppliers' bills in the previous step using Ofgem's Medium TDCV to control for the volume effect. However, this approach risks overestimating or underestimating the overall detriment since it relies on a market-wide measure of consumption which may not be representative of the level of consumption of a particular supplier's customers.

- 3.185 To address this issue, we have adjusted our detriment figures using information on consumption levels provided by the suppliers. More specifically, we have used data on consumption levels by supplier, region, payment type and tariff type and quarter.
- 3.186 We have calculated the overall detriment figure using the following steps:
- (a) Step 1: We have computed both bill and benchmark at actual median consumption level of the corresponding tariff family;
 - (b) Step 2: We have computed the difference between the actual bill and the benchmark for each tariff;
 - (c) Step 3: We have multiplied this difference by the number of accounts for each tariff; and
 - (d) Step 4: We have aggregated across supplier/payment type to obtain the overall detriment figures.
- 3.187 We believe that this approach will result in an underestimate of detriment because it does not take into account that consumption is likely to be depressed due to prices being set above the competitive level. We expect that this effect will be the strongest in the prepayment segments because of the nature of the prepayment product, whereby consumption is curtailed when a customer runs out of credit.
- 3.188 Further, we note that the approach we have taken to adjust for the costs associated with different payment methods adopts a supply-side perspective in assessing detriment. Essentially, we are assuming that the proportion of customers on different payment methods will remain unchanged in a more competitive market, and recognising that the exogenous costs associated with those payment methods will need to be reflected in competitive prices. However, while justified from a supply-side perspective, this approach does somewhat understate the detriment faced by prepayment customers relative to standard credit customers. This is because customers paying by prepayment suffer additional costs (notably, the need to pay for energy in advance) than those paying by standard credit, (who benefit over flexibility of payment timing).
- 3.189 The table below shows how aggregate domestic customer detriment has evolved over the period 2012 to 2015.

Table 3.10: Detriment estimates

<i>Year</i>	<i>Fuel Type</i>	<i>£m</i>
2012	Dual fuel	212
	Electricity (single fuel)	285
	Gas (single fuel)	48
	Overall	544
2013	Dual fuel	1,223
	Electricity (single fuel)	291
	Gas (single fuel)	169
	Overall	1,683
2014	Dual fuel	1,550
	Electricity (single fuel)	331
	Gas (single fuel)	303
	Overall	2,184
2015*	Dual fuel	1,756
	Electricity (single fuel)	386
	Gas (single fuel)	310
	Overall	2,452
All years	Dual fuel	4,741
	Electricity (single fuel)	1,292
	Gas (single fuel)	829
	Overall	6,862

Source: CMA analysis.

*Based on information for the first two quarters.

3.190 Average detriment to domestic customers is assessed at £1.7 billion a year over the period as a whole. However, the table shows a marked upward trend, reaching almost £2.5 billion in 2015. Our provisional view is that this may represent not simply a deterioration in competitive conditions over time but also an emerging revelation of the scale of detriment, as the Mid-tier Suppliers have begun to operate at scale and reposition their tariffs through the process of price discovery. Therefore we attach somewhat greater significance to the more recent results.

Robustness check

3.191 As a robustness check we have carried out the comparison of bills using Ofgem's low and high TDCV. The results of this comparison are presented in Appendix 3.3. They are broadly similar to the results that we obtained using Ofgem's Medium TDCV reported in the tables above.²³²

Sustainability of the Mid-tier Suppliers

3.192 In terms of the sustainability of the Mid-tier Suppliers' tariffs, we have considered two arguments that were put to us by the Six Large Energy Firms, namely:

²³² [X]

- (a) Centrica submitted that the Mid-tier Suppliers' prices/profits were currently set below competitive levels, with the foregone profits in recent years representing an investment in future profits.²³³ SSE told us that the pricing of the Mid-tier Suppliers was not at a long-term sustainable level because of the stage of their business cycle.²³⁴
- (b) RWE npower told us that while a shorter hedging strategy, as adopted by the Mid-tier Suppliers over the relevant time period may have been cheaper, in an analogous rising market they would have had higher energy costs.²³⁵
- 3.193 We collected evidence on the financial performance of the Mid-tier Suppliers and their plans for their businesses in the future, as well as asking them for commentary on their performance in recent years. We observed that First Utility has earned a profit at the EBIT level in the last couple of years, earning an EBIT margin of 0.2% in 2013 and 1.9% in 2014.²³⁶ Our ROCE analysis indicates that energy suppliers require an EBIT margin of just under 1.5% in order to make a reasonable return on capital employed. Therefore, our current view is that First Utility's (average) prices are sustainable in the longer run.
- 3.194 In addition, First Utility told us that its customer base was currently largely composed of customers who were engaged and active in searching and switching. However, it had started to increase the proportion of its customers who were drawn from those in the market who were 'aware but not engaged'. First Utility told us that its data showed that engaged customers had a higher cost to serve than disengaged customers as the disengaged customer tended not to contact their energy supplier in relation to billing, did not change tariff frequently etc. In particular, First Utility noted that engaged customers incurred [X] for a supplier in terms of joining and leaving a supplier.
- 3.195 Ovo Energy first generated a profit in 2013 but then made a loss of £33 million in 2014.²³⁷ It told us that during 2014 the customers that it was acquiring were profitable and that its overall financial losses were due to a combination of the costs of scaling up its management function and those of

²³³ Centrica response to provisional findings, annex, paragraph 181.

²³⁴ SSE response to provisional findings, paragraph 3.5.23.

²³⁵ RWE response to provisional findings, paragraph 121.

²³⁶ First Utility Statutory Accounts, 2014.

²³⁷ Ovo Energy Ltd Statutory Accounts 2014.

acquiring a large number of customers over a relatively limited period of time. [✂]

- 3.196 This evidence indicates that Ovo Energy can expect to earn greater profits over the next few years – without increasing its prices – for two principal reasons. First, its customer acquisition costs can be expected to decline as a proportion of their total cost base.²³⁸ Second, as it grows its customer base, it should benefit from economies of scale, reducing its unit costs. Therefore, our current view is that Ovo Energy's current level of pricing (average prices) is likely to be sustainable in the longer run.
- 3.197 Next, we considered RWE's submission regarding the impact of hedging strategies. We agree with RWE that the shorter-term hedging strategy pursued by some of the Mid-tier Suppliers would, in a rising wholesale market, have resulted in them incurring higher wholesale energy costs than the Six Large Energy Firms (assuming the latter all pursued a longer-term hedging strategy). However, if the Mid-tier Suppliers raised their prices we would expect this to lead to the Six Large Energy Firms increasing their prices as well, as the competitive constraint from the Mid-tier Suppliers would have relaxed.

Analysis of detriment for customers on restricted meters

- 3.198 Customers on restricted meters are not included in our estimates of detriment. The 'direct' analysis above is based on a data set that includes only customers with unrestricted and Economy 7 meters. The detriment suffered by customers on restricted meters is not therefore captured in the results reported above in Table 3.10 and paragraph 3.190.
- 3.199 We have estimated the detriment suffered by customers on restricted meters using a higher level approach, and based on a snapshot as of Q2 2015. Our approach consists of comparing the bills paid by these customers with those that they would have paid had they been on the cheapest available single-rate direct debt tariff, adjusted for payment method. This analysis is based on tariffs in the market as at end Q2 2015 and estimated annual consumption by meter as at Q2 2015. For further details of the data we used and the methodology applied see Appendix 3.1.
- 3.200 Our approach to estimating detriment has, therefore, been to use competitively priced single-rate direct debit tariffs in the market as at Q2 2015 as a proxy for competitive prices for customers on restricted meters.

²³⁸ This can be expected to happen as its rate of customer acquisition naturally declines.

For customers paying by credit or prepayment this benchmark tariff is adjusted upwards to allow for higher indirect costs of serving these customers. The figures used are those set out in Appendix 3.6.

- 3.201 We note that a different competitive benchmark has been used to estimate detriment for customers on restricted meters when compared to the benchmark used to assess detriment for customers with single-rate and Economy 7 meters. In particular, the competitive benchmark used for customers on single-rate and Economy 7 meters is based on the tariffs offered by First Utility and Ovo Energy (see paragraph 3.170 and Appendix 3.3) whereas for customers on restricted meters we have used the cheapest single-rate meter tariff available in the markets.²³⁹ We consider this to be a reasonable approach for customers on restricted meters as we would expect, for the reasons set out in Appendix 3.1, the wholesale energy cost per kWh incurred by suppliers in supplying customers on restricted meters to be materially lower than for customers on standard meters. In a well-functioning market we would expect these cost differences to be reflected in the prices of tariffs offered to customers on restricted meters (even if we would not expect bespoke tariffs for different meter types, see paragraph 3.137, we would still expect lower tariffs overall to customers on restricted meters as a whole group).
- 3.202 The results of our analysis show that for around 69% of customers on restricted meters, their bills were higher than they would have been using the competitive single-rate tariff. On average the difference was around £161 per customer or 18% of their average annual bill. This shows a detriment in the order of £43 million a year.
- 3.203 Table 3.11 sets out these detriment results by supplier and our key results are as follows:
- (a) [REDACTED]
 - (b) [REDACTED]
 - (c) [REDACTED]

²³⁹ We note that for the purpose of this analysis we used three tariffs, two of which were Centrica white label tariffs and one which was a First Utility tariff. For more details see Appendix 3.1, Annex B.

Table 3.11: Detriment results for customers with restricted meters by supplier

	Supplier A	Supplier B	Supplier C	Supplier D	Supplier E	Supplier F
Percentage where single-rate bill cheaper	95%	95%	95%	95%	95%	95%
Number where single-rate bill cheaper*	1,234	1,234	1,234	1,234	1,234	1,234
Mean bill difference*	£1.23	£1.23	£1.23	£1.23	£1.23	£1.23
Bill difference as a percentage of restricted bill*	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
Total detriment*	£1,500	£1,500	£1,500	£1,500	£1,500	£1,500

Source: CMA analysis.

*There were some observations where customers could have made extremely large savings and these results were skewing the mean savings. Therefore when calculating the mean saving we excluded observations where the savings were over £500. This led to the exclusion of 4% of observations and the highest saving observed was £2,233.

3.204 Further details of our approach to estimating detriment and further results are set out in Appendix 3.1.

Indirect approach

3.205 The indirect approach allows us to estimate from the financial results of the Six Large Energy Firms the approximate level of prices that we might expect in a well-functioning market and therefore the extent to which there has been (price) detriment to customers over the 2007 to 2014 period. We carried out two separate types of analysis in order to estimate the level of (price) detriment to domestic and SME customers under the indirect method.

3.206 The first analysis sought to identify the level of profits in excess of the cost of capital earned by the Six Large Energy Firms over the period 2007 to 2014 by customer and fuel type. In order to do this, we have estimated the level of capital employed by the Six Large Energy Firms (by customer and fuel type). As set out in Appendix 3.4, we have made a number of assumptions. While we have sought to take a reasonable approach to each of these various assumptions, we note that the results should be taken to be indicative rather than precise estimates. However, we consider that our estimate of profits in excess of the cost of capital is conservative for two main reasons:

- (a) We have subtracted a trading fee from the Six Large Energy Firms' EBIT (in lieu of trading collateral costs) that have been informed by the level of such a fee currently paid by two of the Mid-tier Suppliers. Based on the evidence we have received, we provisionally believe that this may be materially above the level of costs that a large, stand-alone energy supplier would in fact incur.
- (b) We have included an additional cash balance as 'risk capital' for the Six Large Energy Firms in order to allow them to withstand shocks arising from the realisation of various business risks, such as unexpected weather conditions. This cash balance is in addition to the Six Large

Energy Firms' average working capital position and access to short-term financing.

3.207 To the extent that these adjustments overestimate the costs and capital that the Six Large Energy Firms actually incur in the retail supply of gas and electricity, they will result in an underestimate of the total level of profits in excess of the cost of capital earned over the period.

3.208 The results of this analysis are set out in Table 3.12.

Table 3.12: Profits in excess of the cost of capital/losses for the Six Large Energy Firms by customer and fuel, 2007 to 2014

Profits in excess of the cost of capital/(losses)	2007 – 2014 (£'m)						Total	Average per year	%
	[X]	[X]	[X]	[X]	[X]	[X]			
Domestic electricity	[X]	[X]	[X]	[X]	[X]	[X]	1,041	130	23
Domestic gas	[X]	[X]	[X]	[X]	[X]	[X]	884	111	20
SME electricity	[X]	[X]	[X]	[X]	[X]	[X]	1,763	220	39
SME gas	[X]	[X]	[X]	[X]	[X]	[X]	486	61	11
Domestic & SME total	[X]	[X]	[X]	[X]	[X]	[X]	4,175	522	92
I&C	[X]	[X]	[X]	[X]	[X]	[X]	351	44	8
Total	[X]	[X]	[X]	[X]	[X]	[X]	4,526	566	100

Source: CMA analysis.

3.209 This analysis shows that the large majority of the Six Large Energy Firms' profits in excess of the cost of capital are earned from domestic and SME customers, with less than 10% being earned on I&C customers. The average profits in excess of the cost of capital earned on domestic customers across the Six Large Energy Firms as a whole were around £240 million a year, compared with around £280 million a year on SMEs. However, there are significant differences in the level of profits in excess of the cost of capital earned by the Six Large Energy Firms, with Centrica [X] on its domestic and SME customers, while EDF Energy [X]. Full details of this analysis are set out in Appendix 3.4.

3.210 This variation in the level of profits in excess of the cost of capital could be due to differences in the prices charged by the Six Large Energy Firms, differences in the efficiency with which the firms operate (ie some may have higher costs and/or capital employed than others, and/or differences in the level of wholesale energy costs incurred).

3.211 The second piece of analysis we undertook was to compare the indirect cost bases of the Six Large Energy Firms in serving their domestic customers over the 2007 to 2014 period in order to control for potential differences in cost efficiency. We estimated the level of costs per customer account across the Six Large Energy Firms and then benchmarked these both within the Six

Large Energy Firms and against a number of the Mid-tier Suppliers. Our base case benchmark used the lower quartile of the Six Large Energy Firms' indirect costs per customer account. As a sensitivity we also estimated the Six Large Energy Firms' cost bases using the lowest cost supplier [redacted] as the benchmark.

3.212 We consider our analysis to be conservative for two main reasons:

- (a) First, we have only benchmarked the Six Large Energy Firms against one another, which assumes that one or more of them is operating efficiently. It is, however, possible that all of the Six Large Energy Firms have inefficient cost bases, in which case our estimates of inefficiency will be understated. For example, we observe that, as of 2014 Ovo Energy and First Utility had lower indirect costs per customer account than all of the Six Large Energy Firms except [redacted]. This was in spite of their (self-reported) inability to benefit fully from the economies of scale available to larger operators.
- (b) Second, we observe that, in spite of [redacted] indirect cost base is below the lower quartile level that we have used as our benchmark. This suggests that a benchmark that controlled for such 'legitimate' cost differences (ie those arising from customer mix) would be likely to be below our lower quartile benchmark.

3.213 The results of this analysis are set out in Table 3.13.

Table 3.13: Estimates of indirect cost inefficiencies by fuel for the Six Large Energy Firms, domestic customers

FY 2007-2014

	<i>Domestic electricity</i>	<i>Domestic gas</i>	<i>Total</i>
Combined Six Large Energy Firms' outturn indirect costs	14,644	13,445	
Restated using lower quartile	13,060	12,682	
Variance	1,584	763	2,347
Restated using [X]	10,755	10,535	
Variance	3,889	2,910	6,799
Lower quartile variance by supplier:			
Centrica	[X]	[X]	[X]
RWE npower	[X]	[X]	[X]
EDF Energy	[X]	[X]	[X]
SSE	[X]	[X]	[X]
E.ON	[X]	[X]	[X]
Scottish Power	[X]	[X]	[X]
Total	1,584	763	2,347
SSE variance by supplier:			
Centrica	[X]	[X]	[X]
RWE npower	[X]	[X]	[X]
EDF Energy	[X]	[X]	[X]
SSE	[X]	[X]	[X]
E.ON	[X]	[X]	[X]
Scottish Power	[X]	[X]	[X]
Total	3,889	2,910	6,799

Source: CMA analysis.

3.214 The base case comparison shows that the Six Large Energy Firms' indirect cost bases (as a whole) were £2.3 billion above the benchmark over the period (or £290 million per year). If the results of [X] and [X] are excluded, this increases to £3.3 billion over the eight-year period, or approximately £420 million a year. Our current view is that, to the extent that a firm has achieved a cost base that is below the benchmark, the difference should not be deducted from the total estimate of inefficiency in the industry. We consider that our benchmark is reasonably conservative – being set at the lower quartile level rather than at that of the lowest cost firm – such that those firms ([X] and [X]) which 'beat' the benchmark can be considered to be reasonably efficient, but should not be considered 'super-efficient'. Therefore, we have set their 'cost inefficiency' to zero in carrying out our analysis of detriment.

3.215 If the benchmark were set at the level of [X]'s indirect costs, the level of estimated inefficiency would increase to £6.8 billion over the period (or around £850 million a year).²⁴⁰ This benchmark gives an estimated level of inefficiency for [X] (see Appendix 3.5).

²⁴⁰ We have not used this lower benchmark as our base case as we note that there are differences in the mix of customers across the Six Large Energy Firms, with Centrica having a higher proportion of customers who are more expensive to serve (eg prepayment and standard credit customers). As a result, we might expect Centrica

3.216 This analysis was not carried out for SME customers due to material differences in the size of the Six Large Energy Firms' SME activities, with some firms having a significant market presence and others either not being active at all, or having a small presence, and the natural variations in customer size.²⁴¹ As a result, we have provisionally concluded that the results of any benchmarking analysis for SMEs are unlikely to be reliable. Full details of this analysis are set out in Appendix 3.5.

3.217 In order to estimate the total (price) detriment to domestic customers over the 2007 to 2014 period, we combined the results of these two pieces of analysis, as set out in Table 3.14. We increased the level of profits in excess of the cost of capital earned by our measure of the inefficiency of each firm (using zero for [X] and [X]), as explained in paragraph 3.214).

Table 3.14: Estimate of customer detriment for the Six Large Energy Firms by customer and fuel type, 2007 to 2014

Profits in excess of the cost of capital/(losses) plus domestic cost inefficiency							2007 – 2014 (£'m)	
	[X]	[X]	[X]	[X]	[X]	[X]	Total	Average per year
Domestic electricity	[X]	[X]	[X]	[X]	[X]	[X]	3,165	396
Domestic gas	[X]	[X]	[X]	[X]	[X]	[X]	2,107	263
Total	[X]	[X]	[X]	[X]	[X]	[X]	5,272	659
SME electricity	[X]	[X]	[X]	[X]	[X]	[X]	1,763	220
SME gas	[X]	[X]	[X]	[X]	[X]	[X]	487	61
	[X]	[X]	[X]	[X]	[X]	[X]	2,250	281
Domestic & SME total	[X]	[X]	[X]	[X]	[X]	[X]	7,522	940

Source: CMA analysis.

3.218 This analysis gives a total estimate of domestic customer detriment of around £660 million a year using the lower quartile efficiency benchmark (which we consider to be conservative). The estimate of domestic customer detriment would increase to around £1.1 billion a year if the lowest cost firm were used as the benchmark. These detriment figures equate to between £25 and £42 on each dual fuel customer account.

3.219 Although this analysis seeks to control for differences in the indirect cost bases of the Six Large Energy Firms, it suggests that there are significant differences across the firms in terms of the level of (price) detriment, with [X] continuing to account for a large proportion of total detriment and [X].

to have a higher cost base than SSE (and the other of the Six Large Energy Firms), without this indicating that Centrica has been inefficient.

²⁴¹ For example, within the SME category, some customers will purchase significantly more energy than others, with the differences running to an order of magnitude. As a result, we were concerned that differences in the mix of customers across firms could result in comparisons which were not materially 'like-for-like'.

As set out in paragraph 3.210, these (continuing) differences may arise due to the Six Large Energy Firms charging customers different prices (which we consider under the direct approach), or as the result of the Six Large Energy Firms incurring different levels of wholesale energy costs.

- 3.220 The evidence on wholesale energy costs indicates that this is an important source of differences in profitability across the Six Large Energy Firms. Table 3.15 sets out the average wholesale electricity costs incurred by the Six Large Energy Firms in each year over the period, while Table 3.16 sets out wholesale gas costs.

Table 3.15: Wholesale electricity costs for the Six Large Energy Firms (£/MWh)

<i>Six Large Energy Firms</i>	2007	2008	2009	2010	2011	2012	2013	2014	8YP Avg
Centrica	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
E.ON	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
EDF Energy	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
RWE	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Scottish Power	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
SSE	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Average	47	61	61	60	63	62	61	61	59

Source: CMA analysis.

Table 3.16: Wholesale gas costs for the Six Large Energy Firms (£/MWh)

<i>Six Large Energy Firms</i>	2007	2008	2009	2010	2011	2012	2013	2014	8YP Avg
Centrica	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
E.ON	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
EDF Energy	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
RWE	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Scottish Power	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
SSE	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Average	17	21	22	19	20	23	25	24	22

Source: CMA analysis.

- 3.221 These tables show significant differences, ie around 10%, in the average electricity and gas wholesale costs incurred by the Six Large Energy Firms over the eight-year period of review. These differences will have a substantial impact on the relative profitability of the Six Large Energy Firms. For example, if [REDACTED] had incurred the same average wholesale cost of electricity as [REDACTED] over the period, its profits [REDACTED] a year higher.

Overall provisional conclusion on excessive prices for domestic customers

- 3.222 We have noted substantial differences in the level of domestic customer detriment we have calculated under the direct and indirect approaches. In this section, we briefly consider the potential reasons for the differences observed and draw overall provisional conclusions.

- 3.223 While, in theory, the results generated from each approach should be the same – as they both seek to provide an estimate of customer detriment – in practice, we observe significant differences between the estimates of price detriment generated under each. The direct approach indicates that domestic customers may have paid around £1.7 billion a year more than could have been expected in a well-functioning market, compared with an estimate of around £660 million a year under the indirect approach.
- 3.224 There are a number of potential reasons for the difference. First, the analyses have been carried out over different time periods, with the indirect approach providing an annual average over the eight-year period from 2007 to 2014, while the direct approach has used data from 2012 to 2015. The ROCE analysis shows that several of the Six Large Energy Firms made returns below the cost of capital in 2007 and 2008, and returns in excess of the cost of capital thereafter. As a result, the estimate of customer detriment from the indirect approach would have been higher if a shorter period of time had been used. For example, if the period 2009 to 2014 were used, profits in excess of the cost of capital on domestic customers would be just over £420 million a year, ie around £175 million higher than the £240 million estimate that is based on the 2007 to 2014 period.²⁴² We also note from our analysis of bills that the calculated level of detriment increased substantially over the period 2012 to 2015.
- 3.225 Second, as set out in paragraphs 3.206 and 3.212, the indirect approach takes a conservative approach to identifying the level of profits in excess of the cost of capital made and the efficient indirect cost base of the Six Large Energy Firms. It also does not seek to identify the efficient level of wholesale energy costs. As discussed in paragraph 3.211, our base case uses the lower quartile of the Six Large Energy Firms' indirect costs as the benchmark. However, this may understate the actual level of inefficiency in the indirect cost bases of the Six Large Energy Firms.²⁴³ Second, the indirect approach uses the historic cost of wholesale energy purchases incurred by the Six Large Energy Firms, rather than making adjustments to reflect the 'opportunity cost' of such purchases, ie the market price of energy at the

²⁴² We observe that there appears to be a step-change in the profitability of the Six Large Energy Firms from 2009 onwards, which may be indicative of a change in competitive conditions in the GB retail energy markets. Using a shorter period does not materially change the average level of profits in excess of the cost of capital earned on SME customers.

²⁴³ As the example of SSE shows, it is possible for a large energy retailer to operate with a significantly lower cost base. Furthermore, we observed that the Mid-tier Suppliers were generally able to achieve similar levels of indirect costs to the better-performing of the Six Large Energy Firms, despite experiencing rapid growth over the period and not yet having achieved the economies of scale that could be expected from having a larger customer base. Separately, we note that the Mid-tier Suppliers generally have a more active customer base, which may incur higher costs as they switch suppliers more frequently (on average) than the customers of the Six Large Energy Firms.

point where prices are agreed. To the extent that the tariffs used as the benchmark under the direct approach reflect the efficient level of indirect costs incurred in supplying energy to domestic customers, and/or the opportunity cost of wholesale energy, this would be expected to give a larger estimate of detriment than the indirect approach.

- 3.226 Overall, we place greater weight on the results produced using the direct method. As noted above, it has several advantages over the indirect approach, the principal of which is that it gives us a direct measure of consumer detriment – prices are ultimately what matter to a consumer, rather than a supplier’s level of profitability or cost efficiency. We also note that the direct approach makes use of market data whereas the indirect approach infers detriment from accounting data which is subject to various adjustments. Further, the direct approach allows for a much more granular breakdown of detriment, not just by supplier but by customer type, including type of tariff and payment method.
- 3.227 We note also that detriment calculated under the direct approach is far in excess of the net profits earned by the Six Large Energy Firms from their sales to domestic customers (eg assessed detriment in 2014 is almost double the Earnings Before Interest and Tax from domestic sales of the Six Large Energy Firms in 2014). The implication is that there is a high degree of inefficiency in current prices.
- 3.228 Using this approach, the detriment we have calculated for domestic customers is substantial – around £1.7 billion a year over the period we assessed and more in the most recent years. We note that there is a marked variation in the level of detriment suffered by customers of each of the Six Large Energy Firms and that prepayment customers generally suffer more detriment than those who pay by direct debit or standard credit.
- 3.229 We draw on this analysis in developing our remedies and, in particular, in assessing the effectiveness and proportionality of the proposed package of remedies as a whole.

Non-price sources of detriment

Poorer quality of service

- 3.230 In the provisional findings report we set out a range of evidence that showed that the quality of service offered to domestic energy customers has been relatively poor in recent years:

- (a) results of suppliers' own consumer research on Net Promotor Scores (see Section 8 of our provisional findings report, paragraphs 8.64 to 8.66);
- (b) statistics on trends in the number of complaints and the reasons for the complaints; and
- (c) Ofgem enforcement activity where suppliers have been found to be in breach of licence conditions in their dealings with domestic customers.

3.231 We also note that, according to a survey conducted in October 2015 by Which? into customer satisfaction across the energy sector, all of the Six Large Energy Firms were in the bottom half of the table and two of them came last of the 22 energy companies included in the survey. We also note three of the Mid-tier Suppliers were in the top half including both Ovo Energy and First Utility.²⁴⁴

3.232 We recognise that there are difficulties in interpreting this information as we do not have benchmarks for what we might expect in a well-functioning market. Nevertheless our provisional view remains that there is evidence of the Six Large Energy Firms providing poor quality of service. In particular:

- (a) We have found that the smaller suppliers have achieved consistently higher net promoter scores than the Six Large Energy Firms (see our provisional findings report, paragraph 8.66).
- (b) Across the Six Large Energy Firms the number of recorded complaints increased fivefold between 2008 and 2013 with problems related to billing, customer service and payment accounting for the majority of complaints (see provisional findings report, paragraphs 26 and 2.164).
- (c) Since 2010 Ofgem has taken enforcement action against at least one of the Six Large Energy Firms for breach of standard licence conditions in their dealings with customers on 16 occasions, resulting in fines and customer redress totalling £90 million. The most common breaches of supply licence conditions have historically related to mis-selling and complaints handling.

²⁴⁴ A summary of results is available on the [Which? website](#).

Innovation

- 3.233 As above, it is difficult to determine the scale of detriment arising from lack of innovation as we do not have a benchmark against which to compare the recent performance of the Six Large Energy Firms.
- 3.234 We note that we have seen a limited degree of innovation in the retail domestic energy markets in recent years. Examples include:
- (a) The Six Large Energy Firms and smaller suppliers offering domestic customers lower prices to manage their energy supply in ways that reduce costs to serve. Some examples of such behaviour are paying by direct debit, signing up to tariffs online, and giving meter readings on line.
 - (b) The Six Large Energy Firms and smaller suppliers offering products supported by smart meters. Some examples are British Gas's Hive products which allow heating and hot water to be controlled remotely; and the recently launched E.ON and Ovo Energy pay-as-you-go prepayment products.
- 3.235 We provisionally found in our provisional findings report that some regulatory interventions have served to reduce innovation in recent years. For example, the recent RMR rules imposed by Ofgem have resulted in the withdrawal of innovative tariffs and discounts and have curtailed the ability of the Six Large Energy Firms to offer attractive tariffs to low volume users. Further, the absence of settlement systems that expose suppliers to the full costs of their customers' consumption has inhibited the development of time-of-use tariffs, which could bring substantial benefits in terms of reduced costs, as discussed in Section 5 below.
- 3.236 We would expect our proposed remedies to promote competition in the retention and acquisition of domestic customers and encourage retail energy suppliers to be more innovative in both the products and services they offer to their customers and in managing their retail activities so that they can offer cheaper prices and better quality of service.

Overall provisional conclusion on detriment

- 3.237 In this section we set out the evidence on the extent of customer detriment arising from the provisional AECs that we have identified in the domestic retail energy markets. We have considered three potential sources of detriment:

- (a) that domestic energy customers are, on average, paying higher prices than they would do in well-functioning competitive markets;
 - (b) that domestic energy customers receive a poorer quality of service than they would do in well-functioning competitive markets; and
 - (c) that suppliers innovate less in products and services than they would do in well-functioning competitive markets, resulting in a more restricted range of products and services for domestic customers.
- 3.238 We have quantified the detriment from higher prices directly by comparing the average prices charged by the Six Large Energy Firms with the prices charged by two of the most competitive and readily comparable of the Mid-tier Suppliers – Ovo Energy and First Utility – while controlling for exogenous cost differences, to ensure the comparison is on a broad like for like basis.
- 3.239 Using this approach, we have estimated the detriment from excessive prices to be about £1.7 billion a year on average higher than the benchmark over 2012 to 2015 (the entire period for which we had data). We have given this the greatest weight in terms of our estimate of the annual detriment arising from high domestic retail prices, but we consider that this is likely to be an underestimate, particularly for prepayment segments, for the reasons explained in paragraphs 3.187 and 3.188 above, and overall for the year 2012, for the reasons explained in paragraph 3.190.
- 3.240 We have also considered the extent to which the scale of excessive pricing by the Six Large Energy Firms varies between different payment methods. For dual fuel customers (the majority of all the customers of the Six Large Energy Firms) and single fuel electricity customers (31% of their electricity customers), we found that the difference between the average price across all of the Six Large Energy Firms and the benchmark is biggest for prepayment customers (15% for dual fuel and 13% for single fuel electricity) followed by standard credit customers (11% for both dual fuel and single fuel electricity) and then direct debit customers (10% for dual fuel and 9% for single fuel electricity). For single fuel gas customers (19% of their gas customers), the difference between payment methods is somewhat smaller than in the case of dual fuel and single fuel electricity (18% for direct debit; 17% for prepayment and 16% for standard credit).
- 3.241 The ‘direct’ analysis above is based on a data set that includes only customers with unrestricted or Economy 7 meters. We have estimated the detriment suffered by customers on restricted meters using a higher level approach, and based on a snapshot as of Q2 2015. The results of our analysis show that for around 69% of customers on restricted meters their

bills were higher than they would have been using the most competitive single-rate tariff. On average the difference was around £161 per customer or 18% of their average annual bill. This amounts to a detriment in the order of £43 million a year.

- 3.242 We have also estimated customer detriment from excessive prices indirectly from the financial results of the Six Large Energy Firms which involved assessing both suppliers' levels of profitability and the extent to which suppliers have incurred costs inefficiently. For the reasons explained in paragraph 3.227 above, we place greater weight on the results produced using the direct method, but consider the indirect approach as a useful independent cross check as it is based on a separate data set and methodology.
- 3.243 The analysis using the indirect approach yields a total estimate of customer detriment from excessive prices of between £660 million and £1.1 billion a year, depending on the choice of the benchmark. There are a number of reasons why the indirect approach gives a lower estimate of detriment than the direct approach, including that the indirect approach covers a longer time span which includes two years when several of the Six Large Energy Firms' retail businesses (in aggregate) made losses, and that the indirect approach takes a conservative approach to identify the level of profits in excess of the cost of capital made and the efficient indirect cost base of the Six Large Energy Firms.
- 3.244 In relation to quality of service, we have observed that there are various metrics which suggest that energy customers receive a poorer quality of service from the Six Large Energy Firms than they would do in well-functioning competitive markets. Those include the data which shows that the smaller suppliers have achieved consistently higher net promoter scores than the Six Large Energy Firms, and that there has been a marked increase in recorded customer complaints between 2008 and 2013 which resulted in a number of enforcement actions by Ofgem against the Six Large Energy Firms.
- 3.245 We have also found that some regulatory interventions, in particular the recent RMR rules, have served to reduce innovation in recent years, and that the current status of the electricity settlement system has inhibited the development of time-of-use tariffs which could bring substantial benefits in terms of reduced costs, as discussed in Section 5 below.
- 3.246 Overall, we consider that our updated analysis supports our provisional finding of a material customer detriment arising from the provisional AECs that we have identified in the domestic retail energy markets. We have

estimated that the customer detriment associated with high prices was approximately £1.7 billion a year on average for the period 2012 to 2015 with a marked upwards trend. We have also found evidence that is indicative of harm to consumers from poor quality of service and restrictions on innovation. However, we note that by its nature this type of harm is less readily quantifiable.

4. Domestic retail: overview of remedies package

- 4.1 As set out in the previous section, we have provisionally identified five AECs affecting the domestic retail energy markets – the Domestic Weak Customer Response AEC, the Prepayment AEC, and three AECs relating to the regulatory framework, namely, the systems of electricity and gas settlement (the Settlement AECs)²⁴⁵ and aspects of the ‘simpler choices’ component of the RMR reforms (the RMR AEC). We estimate that the detriment arising from these AECs is very substantial – at around £1.7 billion per year over the last three and a half years for the Domestic AECs,²⁴⁶ with a marked increase in detriment year on year over the period.
- 4.2 In this section we set out a wide-ranging package of remedies to address the features contributing to these provisional AECs, based on the principles of: creating a framework for effective competition; and helping customers to engage. We believe that, as a whole, the package of remedies represents an effective and proportionate response to these AECs and will substantially reduce detriment in the long term.
- 4.3 However, we note that the remedies will take some time to implement and that substantial detriment is likely to remain during the transitional period. We have provisionally concluded that there is a need for a remedy to reduce detriment directly during this transitional period, through the introduction of a price cap for customers on prepayment meters. Prepayment customers have suffered and are continuing to suffer particularly high levels of detriment as a result of the Domestic AECs.
- 4.4 At a high level, then, our proposed package of remedies for domestic customers comprises three strategic components:
- (a) creating a framework for effective competition;
 - (b) helping customers to engage to exploit the benefits of competition; and
 - (c) protecting customers who are less able to engage to exploit the benefits of competition.
- 4.5 We believe that competition is at its most effective when companies are free to compete within an efficient regulatory framework and when customers are appropriately engaged – that is, informed about the choices available to them and free to exercise choice without undue restrictions. There is, therefore, a close synergy between the first two strategic components of our

²⁴⁵ The Settlement AECs concern the SME retail energy markets as well as the domestic retail energy markets.

²⁴⁶ The Domestic Weak Customer Response AEC, the Prepayment AEC and the RMR AEC.

remedies package. We are also aware that there are potential tensions between the third component and the first two – controlling outcomes directly through regulatory interventions can be necessary where consumer detriment is high, but runs the risk of undermining the positive consumer outcomes to which effective competition can lead. In this section we set out the synergies between different elements of the remedies package and explain how we propose to manage potential tensions.

4.6 In the rest of this section we:

- (a) summarise our proposed remedies designed to help create a framework for effective competition;
- (b) summarise our proposed remedies designed to help customers engage;
- (c) assess the interrelationship between these two components of the package;
- (d) highlight the key importance of the roll-out of smart meters and its implications for the AECs,²⁴⁷ the features we have identified and the remedies we have proposed;
- (e) set out the timescales over which we would expect our remedies package to have an impact on the AECs, the features we have identified and to reduce the associated consumer detriment;
- (f) set out the expected benefits of our remedies package when it is fully implemented, comparing them to the costs; and
- (g) summarise our proposed remedy to reduce detriment directly during the transitional period, by imposing a cap on the prices paid by prepayment customers.

4.7 In Sections 5 to 7 we present a more detailed assessment of our individual remedies, before considering the overall effectiveness and proportionality of the package of remedies addressing the AECs and associated detriment in Section 8. A full, comprehensive list of all remedies is presented in Section 11.

Creating a framework for effective competition

4.8 If competition in retail energy markets is to serve customers' interests, it is vital that the regulatory and technical framework allows suppliers to compete

²⁴⁷ Namely, the Settlement AECs and the Domestic AECs.

effectively. Provided customers are sufficiently engaged, this will help drive down prices and improve quality of service.

4.9 We have identified a number of aspects of the regulatory framework that we believe undermine effective and efficient competition and propose three categories of remedy that we believe will help improve this framework:

- (a) Reform of the settlement systems for gas and electricity.
- (b) Measures to address the technical and regulatory constraints impeding competition for prepayment meter customers.
- (c) The withdrawal of aspects of the simpler choices component of the RMR rules.

4.10 Essentially, the remedies we are proposing to introduce aim, at a high level, to improve the framework for competition in one of two ways:

- (a) by ensuring that suppliers bear the full costs that they and their customers impose on the system, thereby strengthening incentives to compete to reduce these costs, to the ultimate benefit of customers through lower prices and higher quality of service (electricity and gas settlement reform); or
- (b) by overcoming technical and regulatory constraints that restrict the extent of competition for domestic customers (prepayment tariff slots, debt assignment protocols for prepayment customers, and the withdrawal of aspects of the simpler choices component of the RMR rules).

Settlement reform

4.11 Energy suppliers generally attempt to purchase in advance the electricity and gas that they expect their customers to consume, to help them manage price and volume risks. But both gas and electricity demand are driven by a range of factors that are difficult to predict accurately, such that there will always be some disparity between the volumes of energy covered by suppliers' contracts and the volumes their customers actually use in real time. Settlement is the system by which such disparities are identified, reconciled and paid for.

4.12 Accurate and timely settlement is fundamental to well-functioning retail energy markets, since without this, suppliers will not have the right incentives to minimise the overall costs of energy – which are ultimately borne by customers. However, in our provisional findings report we

expressed concerns that elements of the settlement systems of both gas and electricity lead to inaccuracies and delays that distort competition between energy suppliers concerning supply to domestic and microbusiness customers.

Electricity settlement reform

- 4.13 Electricity settlement takes place every half hour but the majority of domestic and microbusiness (profiles 1 to 4) customers do not have meters capable of recording half-hourly consumption. Therefore, their consumption must be estimated on an ex ante basis. This is done by assigning customers to one of four²⁴⁸ profile classes, which are used to estimate a profile of consumption over time and allocate energy used to each half-hour period.
- 4.14 Our main concern in relation to electricity settlement is that such estimates fail to charge suppliers for the true cost of their customers' consumption. This means that suppliers are not incentivised to encourage their customers to change their consumption patterns, as the supplier will be charged in accordance with their customers' profile regardless of their customers' actual consumption behaviour. This in turn distorts suppliers' incentives to innovate and bring in new products and services such as time-of-use tariffs, which reward customers for shifting consumption away from peak periods.
- 4.15 In principle, smart meters should remove the need for profiling in electricity, since they provide accurate half-hourly meter reads which could be used for settlement. However, we remain concerned that there are currently no concrete proposals for using half-hourly consumption data in the settlement of domestic electricity customers, even after the full roll-out of smart meters.
- 4.16 Further, the Smart Energy Code currently prohibits suppliers from collecting consumption data with greater than daily granularity unless a customer has given explicit consent to do so (opt-in). We believe that this opt-in clause effectively precludes mandatory half-hourly settlement (which by definition requires the use of all customer data for settlement, not just the data of those customers who have opted in) and is therefore a major barrier to the development of static and dynamic time-of-use tariffs.
- 4.17 Our proposed remedies package in relation to electricity settlement comprises recommendations: to DECC that it consult on amending the provisions of the Smart Energy Code; to Ofgem that it conduct a full cost benefit analysis of the move to half-hourly settlement and consider options

²⁴⁸ There are eight profiles in total, profiles 5 to 8 relate to I&C customers and a small number of SMEs.

for reducing the costs of elective half-hourly settlement; and to DECC and Ofgem that they publish and consult jointly on a plan setting out timescales and responsibilities relating to the introduction of half-hourly settlement.

Gas settlement reform

- 4.18 Our concern in relation to the current system of gas settlement is that it leads to an inefficient allocation of costs to parties and creates scope for gaming, which reduces the efficiency and, therefore, the competitiveness of domestic retail gas supply.
- 4.19 We note that a modification process currently underway – Project Nexus – is likely to address most of the current inefficiencies in the gas settlement system. However, we were concerned that even after implementation of Project Nexus, the gas settlement process would still be characterised by the presence of a residual amount of unidentified gas, inefficiencies in the allocation of the cost of this residual unidentified gas, as well as incentives that shippers face to place a higher priority on adjusting annual quantities down.
- 4.20 Our proposed remedies in relation to gas settlement comprise: a recommendation to Ofgem to ensure implementation of Project Nexus by 1 October 2016; an order on gas suppliers to submit all meter readings for non-daily metered supply points in GB to Xoserve as soon as they become available and at least once per year, save for non-daily metered supply points with a smart or advanced meter, which must be submitted monthly; and a recommendation to Ofgem to take responsibility for the development and delivery of a performance assurance framework concerning unidentified gas as soon as reasonably practicable.

Remedies to address constraints on competition for prepayment customers

- 4.21 For the reasons set out in Section 3 above, we believe that, in addition to the RMR AEC, there are features of the domestic retail energy markets that give rise to two distinct, but related, AECs concerning prepayment meter customers: one on the demand side (the Domestic Weak Customer Response AEC), and one principally concerning the supply side (the Prepayment AEC).
- 4.22 In relation to the constraints imposed by the dumb prepayment infrastructure, we are proposing a range of remedies that will make better use of the available tariff slots, so as to reduce the impact of the dumb prepayment meter technical constraints on the ability of suppliers, and in

particular new entrants, to innovate by offering tariff structures that meet demand from prepayment meter customers who do not have a smart meter.

- 4.23 The proposed remedies include a recommendation to Ofgem that it take responsibility for the efficient allocation of gas tariff pages. Moreover, we are proposing to seek undertakings from the Six Large Energy Firms (and, absent such undertakings, recommend that Ofgem change gas suppliers' standard licence conditions) so as to (i) set up a cap on the number of gas tariff pages that a supplier can hold; (ii) set up an obligation for suppliers to provide relevant information for Ofgem to monitor the allocation of the gas tariff codes; and (iii) enable Ofgem to mandate the transfer of unused gas tariff codes to another supplier.
- 4.24 To further mitigate the impact of tariff codes on competition for customers on dumb prepayment meters, we recommend that Ofgem change SLC 22B.7(b) to allow suppliers to set prices to prepayment customers with no obligation to apply the regional cost variations that are applied to other payment methods within the same core tariff. As a result, suppliers would be able to make better and more efficient use of the tariff codes that have been allocated. We also recommend that Ofgem deprioritise potential enforcement action against suppliers in relation to this licence condition pending the change. This will allow suppliers to make better use of their limited tariff codes.
- 4.25 We are also proposing a remedy to enhance prepayment customers' ability and incentives to engage in the markets and to switch to other suppliers (including by switching to tariffs available on standard meters) which, in turn, will partly address suppliers' softened incentives to compete to acquire prepayment customers. This takes the form of a recommendation to Ofgem to take appropriate steps to ensure that changes to the Debt Assignment Protocol are implemented by the end of 2016, and in particular in areas relating to objection letters, complex debt and issues relating to multiple registrations.

Withdrawal of the simpler choices component of the RMR rules

- 4.26 In the provisional findings report we set out evidence on the impact that the 'simpler choices component' of the RMR rules has had on the ability and incentives of suppliers to compete on the range of tariffs and discounts offered to domestic customers. We also consider that the simpler choices component of RMR rules (in particular the four-tariff rule) limits the scope for competition between PCWs for customers switching energy suppliers to exert downward pressure on energy prices.

- 4.27 We are therefore proposing a remedy, the aim of which is to:
- (a) promote competition and innovation between retail energy suppliers in the retention and acquisition of domestic customers by allowing them to offer a wider range of tariffs than permitted by the simpler choices component of the RMR rules, including tariffs designed to appeal to certain customer groups; and
 - (b) facilitate competition between PCWs by allowing them to negotiate exclusive tariffs with domestic energy suppliers and to offer discounts funded by the commissions they receive from suppliers.
- 4.28 The proposed remedy takes the form of a recommendation to Ofgem to remove a number of standard licence conditions relating to the simpler choices component of the RMR rules. These include: the ban on complex tariffs; the four-tariff rule; the ban on certain discounts; and the ban on certain bundled products.²⁴⁹

Helping customers engage to exploit the benefits of competition

- 4.29 Engaged customers are an essential component of well-functioning energy markets. If customers are not fully aware of the options available to them, unable to make an informed choice about the relative merits of those options or, having made a choice, are unable to switch, then competitive pressures on suppliers to reduce prices and improve quality of service will be substantially reduced.
- 4.30 In our provisional findings report we found that considerable numbers of customers were disengaged, leading to our provisional finding of a Domestic Weak Customer Response AEC. From our customer survey we found that 34% of respondents said they had never considered switching supplier, while 56% of respondents said they had never switched supplier, did not know if it was possible or did not know if they had done so.
- 4.31 We also note that currently around 70% of customers are on the relatively expensive default tariff – the standard variable tariff (SVT) – and that there are material, persistent gains from switching supplier, tariff and/or payment method that go unexploited by many customers. As discussed in Section 3,

²⁴⁹ Our proposed recommendation also provides for the removal of the Whole of the Market Requirement included in Ofgem's Confidence Code, and the introduction of a requirement for accredited PCWs to be transparent over the market coverage they provide to domestic customers. In order to mitigate any potential unintended consequences arising from a potentially significant increase in the number of tariffs on offer, we also propose to introduce an additional Standard of Conduct into retail suppliers' standard licence conditions that would require suppliers to have regard in the design of tariffs to the ease with which customers can compare 'value-for-money' with other tariffs they offer.

our updated gains from switching analysis shows that the gains available to customers have increased over time and, for the dual fuel SVT customers of the Six Large Energy Firms (representing about 50% of their electricity customers and 55% of their gas customers), average savings as of Q2 2015 were equivalent to between 22% and 25% of the annual bill depending on the supplier.

4.32 We have proposed a wide range of remedies that attempt to improve domestic customer engagement by addressing aspects of the features contributing to the Domestic Weak Customer Response AEC.²⁵⁰ We propose five broad categories of remedy, which focus on the role of different participants in the retail markets – namely, Ofgem, the customer’s own supplier, TPIs, and rival suppliers – in strengthening domestic customer engagement.

4.33 In particular, the proposed remedies provide for:²⁵¹

- (a) the establishment by Ofgem of a programme to provide customers – directly or through their own suppliers – with information to prompt them to engage;
- (b) Ofgem making greater use of principles rather than prescriptive rules in addressing potential adverse supplier behaviour concerning the comparability of their tariffs;
- (c) enhancing the ability and incentives of TPIs to promote customer engagement in the retail energy markets;
- (d) creating an Ofgem-controlled database of ‘disengaged customers’ on default tariffs, to allow rival suppliers to prompt these customers to engage in the retail energy markets (the Database remedy); and
- (e) requiring all suppliers to make all their single-rate tariffs available to domestic customers on any type of restricted meter, without making switching conditional on a restricted meter being replaced, and to provide additional information to customers on restricted meters.

²⁵⁰ Since the Domestic Weak Customer Response AEC affects all domestic customers, including prepayment customers, the proposed remedies can be expected, once they become effective, to also enhance suppliers’ incentives to compete for prepayment customers. There will therefore be a strong interaction between the proposed remedies concerning the Domestic Weak Customer Response AEC and the Prepayment AEC.

²⁵¹ A complete list of our proposed remedies is set out in Section 11.

- 4.34 The different market participants identified above differ substantially in terms of the incentives they have to engage customers and their ability to do so and our range of proposed remedies reflects this.

Regulatory interventions to improve engagement/mitigate incentives to keep customers disengaged

- 4.35 We consider that customers' current suppliers have the ability to engage their customers – through the regular communications they send to them – but are likely to face limited incentives to do so in a way that encourages customers to engage in the markets. Indeed, as those customers that have not engaged in the markets recently are both less likely to switch and generally on higher tariffs than those who have recently engaged, their suppliers are likely to face a financial incentive to keep them as disengaged as possible.
- 4.36 In these circumstances, we recognise that there is an argument for Ofgem to intervene directly to facilitate customer engagement, through influencing the form, content and frequency of communication between suppliers and their existing customers. Ofgem has also recognised the importance of clear information in facilitating customer engagement and introduced the 'clearer information' component of the RMR rules in an attempt to ensure that suppliers' routine communications to customers were clear, easy to understand and personalised to them.
- 4.37 However, our concern with these provisions is that they were not subject to adequate testing prior to (or after) their introduction. Without adequate testing it is not possible to know which approach will work best in practice. Further, even if testing is conducted ex ante, changes in technology and cultural practices are likely to mean that what works changes over time.

Ofgem-led programme

- 4.38 Our proposed remedies therefore call for a more evidence-based approach to developing such interventions in the future, through the use of rigorous testing and trialling, where appropriate through randomised controlled trials, with a recommendation to focus such trials on a shortlist of measures. If such trials are to provide relevant information that can provide a robust basis for regulatory changes, it is essential that suppliers be required to participate, where the trial design requires it, and our remedies therefore seek to ensure such participation.
- 4.39 In particular, the remedies comprise: a recommendation to Ofgem to establish an ongoing programme of identifying, testing and implementing

measures to promote engagement in the domestic retail energy markets; and an invitation for all suppliers to offer undertakings to participate in the programme (failing which we would pursue alternative methods of ensuring compliance such as the use of our order making powers, changes to licence conditions or legislative change).

Principles rather than rules

- 4.40 Our remedies also place a greater emphasis on the use of principles rather than detailed rules in seeking to address potential adverse supplier behaviour concerning the comparability of tariffs. This reflects our concern that prescriptive rules seeking to ban confusing tariffs can never be fully exhaustive and risk encouraging gaming behaviour on the part of suppliers. In particular, we recommend that Ofgem introduces an additional standard of conduct into SLC 25C that would require suppliers to have regard in the design of tariffs to the ease with which customers can compare ‘value for money’ with other tariffs they offer.

Harnessing the incentives of rival suppliers and TPIs to engage customers

- 4.41 Where market participants have an active incentive to engage customers – this category includes rival suppliers and TPIs such as PCWs – the proposed remedies serve to enhance these parties’ ability to engage domestic customers. The proposed remedies seek to achieve this through:
- (a) lifting certain regulatory restrictions that dull PCWs’ incentives to compete to engage customers (amending provisions of the PCW confidence code that undermine incentives for them to be active in the retail energy markets); and
 - (b) liberalising access to data by:
 - (i) giving PCWs access to the ECOES and SCOGES databases and bolstering the Midata programme to allow TPIs to make more effective use of customer data; and
 - (ii) creating an Ofgem-controlled database of ‘disengaged customers’ who have been on the default tariff for three years or more, to allow rival suppliers to prompt these customers to engage in the retail energy markets.

Enhancing the ability and incentives of TPIs to promote customer engagement

- 4.42 We consider that TPIs such as PCWs are an important means by which customer engagement can improve and effective competition can develop in the domestic retail markets. PCWs have a strong commercial incentive to engage with domestic customers and provide access to their services both online and by telephone. PCWs are also well placed to: raise awareness among customers of their ability to switch and the potential benefits from doing so; reduce search costs for customers; and exert competitive pressure on energy suppliers by enhancing price transparency and facilitating the purchasing process for customers.
- 4.43 Our aim in our proposed remedies relating to TPIs in the domestic retail markets is to help ensure that this potential for PCWs to promote competition to the benefit of customers can be realised by removing regulatory burdens that inhibit this role.
- 4.44 To strengthen PCWs' role in facilitating switching our remedies take the form of: orders to Gemserv and Xoserve to give PCWs access upon request to the ECOES and SCOGES databases respectively on reasonable terms and subject to satisfaction of reasonable access conditions.
- 4.45 To strengthen PCWs' incentives to engage customers, we are proposing to recommend to Ofgem that it remove the Whole of the Market Requirement in the Confidence Code and introduce a requirement for PCWs accredited under the Confidence Code to be transparent over the market coverage they provide to energy customers. Further, we are proposing to recommend to DECC several changes to the Midata programme that (subject to customer consent) would give PCWs increased access to more customer data and, in so doing, enable PCWs to monitor the market on behalf of their customers and advise them of savings.
- 4.46 We are aware of the concerns around trust that led to the Confidence Code requirement that PCWs list all tariffs on the market rather than just those for which they earn a commission. We believe that such concerns around trust can be addressed – without undermining TPIs' incentives to engage customers – in two ways.
- 4.47 First, there should be greater clarity around the role of PCWs – effectively acting as brokers offering their customers good deals and facilitating switches rather than repositories of all available tariffs. Second, we considered recommending that Ofgem establishes a non-transactional PCW listing all tariffs to meet. We note, however, that Citizens Advice is now

operating a non-transactional PCW that lists all tariffs through a web-based service, which we believe will meet the needs of those customers who wish to see the whole of the market (and therefore do not propose to pursue a recommendation that Ofgem provide such a service).

Ofgem-controlled database of ‘disengaged customers’

- 4.48 As noted above, the substantial majority (around 70%) of the domestic customers of the Six Large Energy Firms are on the standard variable tariff default tariff – ie a tariff that, for many, they did not actively choose. In our provisional findings report, we found that over 30% of the standard variable tariff customers of the Six Large Energy Firms had been on the standard variable tariff with the same supplier for more than five years.²⁵²
- 4.49 In order to enable suppliers to prompt domestic customers of rival suppliers on default tariffs, our proposed remedy would require energy suppliers to disclose certain details of their domestic customers (on any meter type)²⁵³ who have been on their standard variable tariff (or any other default tariff) for three or more years (the ‘Disengaged Domestic Customers’) to Ofgem, and would recommend that Ofgem retains, uses, and discloses this data (via a centrally managed database) to rival suppliers. The Disengaged Domestic Customers would have the option to opt out of the disclosure process at any point in time.
- 4.50 The aim of the proposed remedy would be to enable rival retail energy suppliers to identify the Disengaged Domestic Customers that have not opted out and prompt such customers to engage in the markets. The ultimate aim of this proposed remedy would be to partly address two of the features identified in the provisional findings report that give rise to the Domestic Weak Customer Response AEC (and resulting detriment), ie that domestic customers have limited awareness of, and interest in, their ability to switch energy supplier and that domestic customers face actual and perceived barriers to accessing and assessing information.
- 4.51 We recognise that there is a trade-off between the benefits of liberalising channels of engagement and the need to protect consumers from excessive and/or misleading marketing. In relation to communication with customers on the default tariff database, customers will have the right to opt out

²⁵² [Provisional findings report](#), Table 7.1.

²⁵³ This proposed remedy would apply to domestic customers on unrestricted meters (including prepayment meters), restricted meters and Economy 7 meters.

beforehand to avoid receiving communications by post, and will only be contacted electronically if they explicitly opt in to such communications.

- 4.52 Any communications from suppliers will be subject to standards regarding the form they must take to ensure they are sufficiently clear and informative and we suggest in Section 6 that a failure to comply with these standards may result in access to the database being withdrawn by Ofgem.

Remedies for customers on restricted meters

- 4.53 We believe that the above proposed remedies will help customers on any meter type engage effectively in the retail energy markets. Further, to address the specific problems faced by customers on restricted meters in shopping around for better deals and in switching, we propose a set of additional remedies that require all suppliers to make all their single-rate tariffs available to any domestic customers on any type of restricted meter, without making switching conditional on a restricted meter being replaced; and ensure that domestic customers on restricted meters have access to information on the options available to them.

Synergies and interactions between different elements of the remedies package

- 4.54 Each individual remedy we are proposing to introduce needs to be considered in the context of the overall package of remedies that we are proposing, as there are important synergies and interactions between individual components of the package. In this section, we set out some of the key interactions and synergies, as well as highlighting how potential tensions are resolved.
- 4.55 Most fundamentally, we consider that the overall aims, objectives and effects of the components of the package designed to create a framework for effective competition on the one hand and to improve customer engagement on the other, are mutually reinforcing. Even if suppliers are able to operate in a market free of inefficient regulatory and technical restrictions, if customers are not sufficiently engaged, outcomes will be suboptimal. Similarly, even if customers are fully aware of the options available to them and confident in their ability to switch, if the prices available to them are inefficiently high, outcomes again will be suboptimal, resulting in consumer detriment.
- 4.56 Therefore, at a fundamental level, we consider that both of these strategic components of our remedies package are necessary if we are to see material, sustained reductions in detriment.

- 4.57 The mutually reinforcing nature of supply- and demand-side problems is perhaps seen most clearly in the prepayment segments of the domestic retail energy markets, where the features of the Domestic Weak Customer Response AEC also affect prepayment customers, and combine with and contribute to the features of the Prepayment AEC and the RMR AEC.²⁵⁴ As discussed in Section 3, the technical constraints imposed by the dumb prepayment meter infrastructure are all the more important in conjunction with the particular engagement problems we have observed with prepayment customers. The levels of disengagement that we have observed among prepayment customers are in part due to the demographic characteristics that those customers have, but for some, they may also reflect the historical absence of competitive prices. Similarly, on the supply side, suppliers' incentives and abilities to compete to acquire prepayment customers are affected not just by the technical and regulatory problems we have identified, but also the degree of disengagement of some prepayment customers. Further, some aspects of the simpler choices component of the RMR rules and the Debt Assignment Protocol are likely to have exacerbated the technical constraints we have identified.
- 4.58 We therefore consider that addressing the problems faced by these customers is likely to require both measures to directly address the technical constraints and engagement measures. By improving engagement among prepayment customers, suppliers could be expected to have enhanced incentives to compete for such customers. In this way, the domestic engagement remedies and exclusively supply-side remedies will mutually reinforce to address the detriment for prepayment customers that derives from the Prepayment AEC and the Domestic Weak Customer Response AEC.
- 4.59 We also consider that, given the mutually reinforcing nature of the problems we have identified, it may take some time for prices to fall for a substantial number of such customers even after application of our remedies, raising the potential need to address detriment directly over a short-term period – an issue that we discuss in Section 7 below.
- 4.60 There are several elements of the reform package that will have beneficial effects on both the conditions for effective competition and consumer engagement. Electricity settlement reform, for example, will have a supply-side effect in the first instance, by exposing suppliers to the true costs their customers impose on the system, improving the efficiency of price signals to

²⁵⁴ See Section 8, where we discuss how each proposed remedy addresses one or more features of the Prepayment AEC, the Domestic Weak Customer Response AEC and/or the RMR AEC.

suppliers. This change, in turn, will incentivise suppliers to offer a wider range of time-of-use tariffs to customers, who will have access to a greater range of potential savings, increasing engagement for those customers who wish to take up such tariffs.

- 4.61 Similarly, the remedies to improve the incentives and ability of TPIs to compete will also primarily benefit customer engagement (in particular, in light of the withdrawal of aspects of the simpler choices component of the RMR rules). But it will also, by increasing competitive pressures on suppliers and TPIs, serve to bear down on costs, notably the commissioning costs of acquiring customers.
- 4.62 We also note that there are broader synergies between the remedies we discuss here and those we consider in Section 10, on the governance of the regulatory framework. We have identified several aspects of the regulatory regime applying to the domestic (and SME) retail energy markets that have had an adverse effect on both the supply and demand side of these markets. These relate both to regulations introduced by Ofgem and regulations governed under the industry codes. While we believe our package of remedies will effectively address these regulations, the policy environment governing energy is a dynamic one, such that there is a risk that new regulations will be introduced in the future that do not serve customers' interests. It is for this reason that we consider our reforms to governance arrangements – which we believe will serve to increase the chances of decisions being adopted that are in the long-term interests of consumers – to be an essential part of the overall package of remedies for the energy sector.
- 4.63 We also note that there are some areas where there are potential tensions between aspects of our remedies and we have ensured, in the remedy design, that any such tensions can be managed. For example, as discussed earlier, we have provisionally decided that aspects of the simpler choices component of the RMR rules should be withdrawn, as they undermine effective competition between suppliers and between PCWs. We recognise that Ofgem introduced these particular rules in an attempt to make it easier for customers to make better choices by stripping away unnecessary complexity in tariff choices, but believe that any unintended adverse consequences from the withdrawal of the simpler choices component of the RMR rules can be addressed through the measures we are putting in place to improve customer engagement.
- 4.64 In particular, one of our proposed remedies introduces a new Standard of Conduct that places a greater emphasis on the use of principles rather than rules in seeking to address potential adverse supplier behaviour. Further,

our proposed remedies call for a more evidence-based approach to developing interventions to facilitate customer engagement in the future, through the use of rigorous testing and trialling.

- 4.65 Potentially, the greatest tension could be between our engagement and competition remedies on the one hand, and measures to control prices on the other. As set out at the end of this section and in Section 7 below, it is our provisional view that the direct remedies and engagement measures we propose to introduce will not fully address the levels of detriment we have identified for prepayment customers in a sufficiently timely fashion, and that a proposed remedy to address the detriment directly – through imposing a temporary cap on the prices paid by prepayment customers – is necessary until the roll-out of smart meters has been concluded. We have been mindful, in designing the cap and setting its level, to allow for effective competition to coexist with the cap, as explained in Section 7. Further, once smart meters have been fully rolled out and our other remedies fully in force, the cap will end, helping to minimise any tensions between the remedies.²⁵⁵
- 4.66 The synergies and interactions noted in paragraphs 4.53 to 4.64 are further discussed in Section 5 (measures to create a framework for effective competition), Section 6 (measures to improve customer engagement), Section 7 (measures to protect customers who are unable to engage to exploit the benefits of competition) and Section 8 (our assessment of the effectiveness and proportionality of the package).

The importance of metering arrangements and the smart meter roll-out

- 4.67 Metering is an essential part of well-functioning, competitive domestic retail energy markets. Because gas and electricity are consumed in real time, while billing and payment take place at periodic intervals, reliable and accurate meters play a vital role in determining exactly how much energy customers have consumed – and therefore how much they must pay suppliers.
- 4.68 We have found that current metering arrangements have contributed to several of the problems we have identified in both the supply side and the demand side of the domestic retail energy markets and note that smart meters, which are currently being rolled out, have the potential to address some of these problems. In this section, we consider the potential impact of smart meters, present our views on the importance of current timescales for the roll-out of smart meters being adhered to, and explain how our proposed

²⁵⁵ See further Section 7.

remedies will help ensure that the full benefits of the smart meter programme are realised in practice.

The impact of metering arrangements on the AECs and features

- 4.69 Several of the problems that we have provisionally identified as affecting competition for domestic customers relate to the metering arrangements that customers have in place. Section 3 above highlights the particular technical constraints affecting suppliers to prepayment meter customers and customers on restricted meters, for example.
- 4.70 Further, in our provisional findings report we identified traditional meters as a fundamental characteristic of one of the features contributing to the Domestic Weak Customer Response AEC. In particular, we found that traditional meters and bills are a fundamental characteristic that gives rise to inaccurate and confusing information for customers which dissuades them from engaging and considered that this at least partly explains why we see such a significant proportion of domestic customers who are not engaged.
- 4.71 First, traditional meters are not very visible or immediately informative to the customer, as a result of which customers are generally not aware of how much gas and electricity they consume, when they consume it and which uses require the most energy.²⁵⁶ Furthermore, meters are traditionally read infrequently by the customer or the supplier, which adds considerably to the complexity and opacity of gas and electricity bills.²⁵⁷ Overall, we found that for many customers, the combination of these factors may be leading to considerable confusion as they try to understand and assess the relationship between the energy they consume and the amount they ultimately pay for it.

The impact of smart meters on competition and engagement

- 4.72 The introduction of fully-functional (SMETS 2) smart meters will address the technical constraints arising from the dumb prepayment infrastructure. Notably, the problems arising from tariff slots, and their allocation between suppliers, will cease to exist.
- 4.73 We also consider that smart meters should address the specific barriers to engagement experienced by customers on restricted meters, although we note that smart meter equivalents are not currently available for all restricted

²⁵⁶ [Provisional findings report](#), paragraph 8.88.

²⁵⁷ [Provisional findings report](#), paragraph 8.89.

meter types such that the roll-out of smart meters for customers on those restricted meters is likely to be delayed.

- 4.74 In relation to customer engagement more generally, in view of the fundamental characteristic identified above relating to traditional meters, we consider it likely that smart meters will help improve customer engagement by making the relationship between prices and consumption more visible and improving the accuracy of bills, although the extent of this effect remains uncertain.
- 4.75 There is limited evidence on the impact of smart meters on engagement in the domestic retail energy markets – and our review of the international experience of smart meter roll-out (see Appendix 5.2) did not identify any studies that have specifically addressed this question.
- 4.76 However, we are aware of recent evidence concerning GB that suggests that smart meters may improve customer understanding of bills and confidence in choosing the right tariff and supplier. The ‘Smart energy outlook’ survey conducted in February 2016 found that, compared to those without a smart meter, customers with a smart meter were more likely to:
- (a) understand their energy bills (75% compared to 61%);
 - (b) think they have the information they need to choose the right energy supplier (77% as opposed to 59%); and
 - (c) think they have the information they need to choose the right tariff (72% as opposed to 57%).
- 4.77 We therefore think that fully functional smart meters are likely to have a substantial, positive impact on both competition and engagement, although we note that the extent of impacts on engagement are more uncertain.
- 4.78 However, we also note that the current generation of SMETS1 smart meters have the considerable disadvantage of losing smart functionality when the customer switches supplier, which may have the effect of discouraging switching. Further, we understand that some prepayment customers with SMETS1 meters may be unable to use the prepayment setting on their meter if they switch supplier. As a result, such customers may have to change their meter in order to switch supplier.
- 4.79 This emphasises the importance of a timely roll-out of the new generation of SMETS2 smart meters, which will be fully interoperable between suppliers. We consider this timetable in the next section.

The roll-out programme and timetable

4.80 We understand the timetable for the roll-out of smart meters is as follows:²⁵⁸

- (a) The Data Communications Company is due to go live on 1 August 2016. DECC considers that suppliers will start installing SMETS2 meters from this date.
- (b) SMETS1 meters installed until 1 August 2017 (the 'SMETS1 end date' – 12 months following the Data Communications Company live date) will count towards suppliers' smart meter roll-out targets; beyond this point they will not.²⁵⁹ As a result, it is unlikely that suppliers would install further SMETS1 beyond this date.
- (c) We understand that SMETS1 meters will be adopted into the Data Communications Company at some point in the future, but that this is unlikely to be completed before 2018. Following this, customers with SMETS1 meters will no longer face the loss of smart functionality when switching supplier.
- (d) DECC considers that the 868 MHz home area networks that are required to install smart meters in some tall buildings are unlikely to be available until mid-2017 at the earliest.²⁶⁰ DECC estimates that the 2.4 GHz home area networks (already available) will enable suppliers to install smart meters in 70% of households; the 868 MHz solution will increase this to 96.5% of households, with the remaining households requiring 'alternative home area network' solutions (with the timetable for availability of these solutions currently unclear).²⁶¹
- (e) DECC is proposing to put in place an obligation on suppliers not to fit dumb meters to customers requiring a new or replacement meter: the New and Replacement Obligation. This is due to come into force in mid-2018.
- (f) The roll-out of smart meters to domestic customers²⁶² is due to be completed by the end of 2020.

²⁵⁸ Appendix 5.1 gives further details of the roll-out programme and timescales.

²⁵⁹ DECC (2015), *Smart Metering Implementation Programme: Government response to the Smart Metering Rollout Strategy consultation*.

²⁶⁰ DECC (2015), *Consultation on Home Area Network (HAN) Solutions: Implementation of 868MHz and Alternative HAN solutions*.

²⁶¹ DECC (2015), *Government Response on Home Area Network Solutions: Implementation of 868MHz*.

²⁶² Suppliers are under an obligation to take all reasonable steps to ensure that a smart metering system is installed on or before 31 December 2020 at each domestic premise and most microbusiness (profiles 3 & 4) it supplies.

- 4.81 In view of the benefits of SMETS2 smart meters for competition and engagement, and more specifically for helping to address some of the features we have identified, we believe it is vitally important that the prescribed timetable for their roll-out is adhered to.
- 4.82 We spoke to DECC and energy suppliers about the smart meter roll-out programme. We are aware that it is a complex logistical programme involving substantial levels of investment and therefore inevitably involves some delivery risk. We have also reviewed international experience of smart meter roll-out programmes²⁶³ and note that GB is unusual in having adopted a supplier-led model, and that some have argued that this has added to the complexity and cost of roll-out.²⁶⁴
- 4.83 Whatever the merits of the roll-out model that has been adopted, we believe that a key focus of DECC and Ofgem should be to ensure delivery to the agreed timetable. We are aware that Ofgem has the power to impose penalties on suppliers in the event that the prescribed timetables are not met and, in view of the importance of smart meters in addressing the competition concerns we have identified, we would expect it to use these tools effectively to ensure that suppliers comply with their obligation to take all reasonable steps to complete the roll-out by 2020.
- 4.84 We believe it is equally important that DECC and Ofgem give adequate focus to ensuring that the potential benefits of the smart meter programme for competition and engagement are delivered in practice, including ensuring that the wider changes needed to realise the faster switching and time-of-use benefits are driven to fruition. Several of our remedies relate to these benefits, as set out in the next section.

The importance of our remedies in the context of the smart meter roll-out programme

- 4.85 In the context of the smart meter roll-out, our proposed remedies aim to ensure both: that the broader benefits of the smart meter programme can be delivered in practice; and that any adverse effects arising from dumb meters can be managed during the period of roll-out.
- 4.86 In relation to the broader benefits of smart meter roll-out, a potentially significant benefit from smart meters comes from load shifting but this can only arise at scale through the introduction of half-hourly settlement and changes to the provisions of the Smart Energy Code that currently require suppliers to gain consent to access consumption data with greater

²⁶³ See Appendix 5.2 on the international experience of smart meter roll-out.

²⁶⁴ See Appendix 5.1.

granularity than daily. Our proposed remedies serve to address both of these issues, unlocking the considerable potential for load shifting from domestic customers.

- 4.87 In relation to the transitional period during the roll-out of smart meters, our proposed remedies to liberalise access to dumb prepayment meter tariff slots and to require suppliers to offer customers on restricted meters access to their single-rate tariffs will serve to mitigate competition and engagement problems arising from dumb meters during this period. Further, we propose to recommend that Ofgem considers options for reducing the costs of elective half-hourly settlement before mandatory half-hourly settlement is introduced.

Timelines for the implementation of remedies

- 4.88 Given the scale of the detriment we have identified, we believe that it is vital to ensure that our remedies are implemented as rapidly as practicable. To assess the effectiveness of the proposed remedy package in addressing the features we have provisionally identified – and to assess the need for remedies to control outcomes while these features are being addressed – we have considered the timescales over which these remedies are likely to be implemented. We have also considered when they are likely to start to take effect in addressing the relevant features and, ultimately, reducing domestic customer detriment. These timelines are set out in detail in Section 8.

Summary of timeline

- 4.89 Drawing on the assessment set out in Section 8, we would expect the overall timescale for the implementation of remedies to be broadly as follows:
- (a) In 2017, a number of remedies would be implemented, and in particular:
- (i) Regarding the framework for effective competition: gas prepayment tariff codes would be reallocated; SLC 22B.7(b) would be amended; the Project Nexus performance assurance framework would be in place.
 - (ii) Regarding consumer engagement: the relevant elements of the simpler choices component of the RMR rules would be formally withdrawn and the revised standard of conduct in place; the reforms to increase the incentives and ability of TPIs to improve customer engagement would all be in place.

- (b) In 2018, suppliers would be able to access the database of Disengaged Domestic Customers who had not opted out, which would be updated every six months, and, towards the end of the year the first intervention from the Ofgem-led programme would be implemented.
 - (c) In 2019, we would expect further interventions arising from the Ofgem-led programme to be progressively implemented.
 - (d) In 2020, mandatory half-hourly settlement would be in place for domestic customers. We also note that the national programme for the roll-out of smart meters is scheduled to be substantially completed.
- 4.90 Overall, some of our remedies could be implemented relatively quickly, but the two major engagement remedies – the database and the Ofgem-led programme – would start to take effect in 2018/19. The remedies are intended to work as a package and, given the lag between the implementation of remedies and features being addressed, and between features being addressed and material reduction in detriment, we would expect to see substantial reductions in detriment beginning in 2019/20, broadly coinciding with the full roll-out of smart meters.

Expected costs and benefits of our remedies package

- 4.91 In this section, we consider the likely costs and benefits of our proposed remedies package. Drawing on the analysis of the preceding section, we have distinguished between those measures that will have an effect solely during the transitional period of the smart meter roll-out and those that will have an enduring effect, particularly from around 2019/20 onwards.²⁶⁵

Remedies that will have an effect solely during the transitional period

- 4.92 Some of our proposed remedies will apply only during the period before the substantial completion of the roll-out of smart meters (expected by the end of 2020) or earlier. These are:
- (a) the remedies relating to the allocation of gas tariff pages (since there will be no need for tariff pages or codes once all prepayment customers have smart meters);
 - (b) the remedies giving TPIs access to the SCOGES and ECOES databases (since TPIs would have access to meter number information

²⁶⁵ A more detailed assessment of the costs of individual remedies is provided in Sections 5, 6, 7 and 8.

through Phase Two of Midata, when implemented, subject to implementation of our proposed remedy); and

- (c) the remedies designed to improve engagement for customers on restricted meters (since we consider that the specific barriers faced by customers on such meters will disappear with the full roll-out of smart meters).

- 4.93 We consider that the costs of implementation of the above remedies are very low. In relation to the first two, there would be a minimal administrative cost for Ofgem, Genserv and Xoserve respectively. In relation to the third, there would be a small additional cost for suppliers arising from the need to aggregate consumption volumes in different registers for the purposes of single rate billing. We are also calling for Citizens Advice to offer advice to customers in relation to their ability to switch, given this new regime, but this is a role it already has, so this involves no additional cost.
- 4.94 Given the short space of time over which these remedies will be relevant and the inevitable lag between the implementing of the remedy, effectively addressing the relevant aspect of the feature and reducing detriment, we do not expect that these remedies alone will have very substantial effects in terms of reducing customer detriment. However, given the scale of the total customer detriment that we have identified for prepayment customers almost £500 million in 2015²⁶⁶ and customers on restricted meters around £40 million in Q2 2015, even very small reductions in prices during the transitional period would lead to benefits that would far exceed any implementation costs.
- 4.95 We have noted above that we consider it essential that the prescribed timescales for the roll-out of smart meters are adhered to, but should there be any delay, the impacts and benefits accruing from these remedies would be expected to increase.

Remedies that will have an enduring effect

- 4.96 The other remedies that we have proposed – settlement reform, the withdrawal of aspects of the simpler choices component of the RMR rules and the engagement remedies other than the transitional measures discussed above – would work together on an enduring basis as a package. We have accordingly considered their benefits jointly, while noting their

²⁶⁶ See Section 7, paragraph 7.12.

relative contribution to the package and identifying their costs, where material, on an individual basis.

- 4.97 We first assess costs and benefits for electricity settlement reform separately, as this reform has benefits in terms of load shifting that are additional to those of the package as a whole (although we consider that they would also make a contribution to improving customer engagement).

Electricity settlement reform

- 4.98 As set out in more detail in Section 5, there are potentially substantial savings from domestic peak load shifting, arising primarily from reductions in the cost of generation and distribution. One recent study estimated savings from the introduction of time-of-use tariffs within the domestic retail markets of between roughly £50 million and £100 million in 2020 and between roughly £100 million and £350 million a year by 2025.²⁶⁷ Expected savings increase with the roll-out of automated and dynamic time-of-use tariffs (for which settlement reform is necessary) and with increased penetration of low carbon technologies. We note in relation to this latter factor that the demand and supply of heat pumps, smart appliances and electric vehicles will be driven in large part by the availability of opportunities to exploit within-day price differentials. Therefore we would argue that a move to half-hourly settlement will be a necessary step in achieving the higher end of potential benefits from demand-side response.
- 4.99 In terms of implementation costs, we consider that these are very low for distribution network operators and Elexon (more specifically, [X]). Suppliers indicated to us that the reform would involve substantial upfront and ongoing costs, although we have not received sufficient information from enough firms to build a consistent, robust picture of the likely costs.
- 4.100 Our recommendation is that Ofgem conducts a full cost benefit analysis of the move to mandatory half-hourly settlement, but overall, and based on the evidence we have seen, there are good reasons to expect the benefits from half-hourly settlement to outweigh the costs of its implementation by a substantial degree.

²⁶⁷ Baringa and Element Energy, Electricity System Analysis - future system benefits from selected DSR scenario (August 2012).

Rest of the package

- 4.101 In relation to the rest of the package, we consider that the main enduring benefit will accrue from improving customer engagement and therefore overcoming the Domestic Weak Customer Response AEC.
- 4.102 Given the fact that, almost fifteen years after full price liberalisation, the substantial majority around 70% of the domestic customers of the Six Large Energy Firms are on the default tariff, despite very large and growing potential gains from switching – equivalent to between £310 and £360 a year for non-prepayment dual fuel standard variable tariff customers as of Q2 2015 – we have considered very carefully whether our proposed remedies are likely to succeed where other interventions have failed. We believe that they will, for two reasons.
- 4.103 First, past interventions have been based largely on a priori reasoning, with little attempt systematically to test hypotheses through rigorous trials or other forms of testing before the intervention is implemented. And yet the reasons customers have for failing to engage in the presence of substantial gains from switching are likely to vary both between different types of customer and over time – in our survey over a third of respondents said that they had simply never considered switching supplier.²⁶⁸ It follows that the best methods of raising awareness among such customers are also likely to vary between customers and over time.
- 4.104 In this context, a priori reasoning can provide useful insights into the sorts of interventions that may help, but rigorous evidence is needed to ensure that only those interventions that are most likely to make a difference for given customers at a given point in time are implemented. We have ourselves identified some ideas for increasing customer engagement, which we recommend should be subject to trials. If the evidence from such trials suggests that a particular initiative will not work, it should be rejected. The Ofgem-led programme that we propose to recommend is therefore essential to ensure that future interventions are based on what works in practice.
- 4.105 Second, our proposed remedies seek to harness the incentives of TPIs and rival suppliers to unlock customer engagement, by giving them greater access to the data they need to perform this role more effectively and at a lower cost. TPIs have grown considerably as an acquisition channel over the past few years and we believe that through our remedies they can continue

²⁶⁸ [Provisional findings report](#), paragraph 7.64.

to grow in importance, lowering acquisition costs for suppliers and lowering search costs for consumers.

- 4.106 In relation to the Database remedy, we recognise that any proposal to free up access to customer data may be controversial, but we believe that such measures are necessary if customers who have not engaged for years are to consider switching in the future. We propose to put in place safeguards to ensure that such data is used appropriately.
- 4.107 Overall, allied to the changes that will be brought about through the full roll-out of smart meters and the move to next day switching, we believe that our remedies will bring about a substantive important improvement to customer engagement.
- 4.108 In relation to the costs of implementing the remedies, these are generally very low compared to the size of the detriment. For example, in relation to the Database remedy, we have estimated that the costs of setting up a secure cloud database in which to store details of the Disengaged Domestic Customers that have not opted out could be in the region of £50,000 to 100,000. We do not think it would be an expensive web-based application to build and maintain because it would not require significant, or complex, functionality.
- 4.109 The largest cost would be imposed by the Ofgem-led programme, as it would require an ongoing system of testing and trialling interventions. The Behavioural Insights Team told us that the costs of the trials that it had conducted to date had been [£] although we note costs may vary substantially, depending on the size and complexity of the trial. In designing the programme and, in particular, the extent of any supplier participation that might be needed, we propose to recommend Ofgem to assess the proportionality of the various stages involved in the programme, including the testing involved in each specific proposed measure. In this regard, we would expect Ofgem to take into account issues such as the potential costs incurred by suppliers as part of its proportionality assessment.
- 4.110 We believe that the benefits of our proposed remedies will be seen in part through a reduction in the gains from switching that go unexploited by customers. However, crucially, this would not be achieved by a levelling up of prices (a potential risk of regulatory interventions that seek to constrain price differences) but by a gradual reduction in prices towards the competitive benchmark level, as more efficient suppliers gain customers from the less efficient.

- 4.111 Given the size of the detriment we have identified (about £1.7 billion a year since 2012, with an upwards trend), it would only take a very small (less than 1%) reduction in this detriment to offset the costs of even a highly comprehensive, onerous set of trials conducted through the Ofgem-led programme. We believe that our package of remedies will be much more effective than this in reducing customer detriment on a sustained basis, and that it therefore represents an effective and proportionate response to the problems we have identified.

Remedy to reduce detriment directly during the transitional period

- 4.112 As set out above, we believe that competitive retail energy markets, in which energy suppliers operate free of inefficient technical and regulatory restrictions, and customers make informed decisions about the range of choices available to them, represent the best long-term approach to delivering positive outcomes for energy customers.
- 4.113 Notwithstanding the substantial problems that we have identified, there have been some positive developments in the domestic retail energy markets over the last few years, including the increasing market share of new entrant suppliers, several of which have been able to offer prices substantially below the average prices offered by the Six Large Energy Firms. Indeed, the average prices that such suppliers have been able to offer have given us valuable insights into the competitive benchmark tariff and hence the average prices that should be achievable.
- 4.114 We have identified substantial problems on both the supply- and the demand-side of the retail energy markets, and we believe that our remedies package will provide a long term solution to them, by putting downwards pressure on prices towards the competitive benchmark level, as more efficient suppliers gain customers from the less efficient.
- 4.115 However, as noted above, our proposed remedies will take time to implement before they start to address the features that we have identified and, in turn, reduce the detriment to domestic customers arising from them. As a result, we expect that the detriment arising from the Domestic AECs we have provisionally identified will persist in substantial form for the next few years. Given the size of the detriment we have observed, of around £1.7 billion a year over the last three and a half years, with a marked increase in detriment year on year, we have therefore considered the need to intervene to address domestic customer detriment directly in this transitional period, through a price cap.

- 4.116 Given the interventionist nature of a price cap remedy, and the potential for adverse consequences, particularly risks for the emergence of a long-term competitive outcome, we have considered very carefully both the need for, and the appropriate scope of, a price cap remedy. We have given particular consideration to two possible remedies that we identified in our Remedies Notice and in our Second Supplemental Remedies Notice: a cap on customers on prepayment meters; and a cap on all standard variable tariff customers.

Assessment of the case for a prepayment price cap

- 4.117 We have provisionally concluded that a price cap should apply to domestic customers on prepayment meters for a transitional period (2017 to the end of 2020). In reaching this provisional decision, we have given particular consideration to the following:

- (a) the Domestic AECs we have provisionally identified, the features giving rise to them and the relative strength of those features as they apply to different categories of customer;
- (b) the scale of the detriment that we have observed from the Domestic AECs, and the extent to which the detriment differs between different categories of customer;
- (c) the potential for adverse consequences from the introduction of a price cap, and how these might be expected to differ according to the scope, design and duration of the price cap remedy; and
- (d) the practicability of implementing a cap on a sufficiently timely basis to address the detriment during the period while our other remedies take effect.

- 4.118 In relation to the Domestic AECs, we have taken account of, in particular, the strength of the features contributing to the Prepayment AEC and the Domestic Weak Customer Response AEC as it applies to prepayment customers.

- 4.119 Regarding the Prepayment AEC, prepayment customers have been able to access much lower gains from switching than other customers, even though they pay on average higher prices. We note that this has been due in part to the effect of technical restrictions arising from the dumb prepayment infrastructure, that smart meters should not be subject to such restrictions and that recently there has been an increase in the share of independent suppliers offering smart tariffs. However, we have yet to see significantly lower prices or, most importantly, evidence of a substantial reduction in

detriment. We believe that our prepayment remedies will help improve the conditions for competition in the prepayment segments, but these may take some time to have an effect on detriment. In relation to the Domestic Weak Customer Response AEC, we note that in our survey prepayment customers were considerably less likely to have ever considered switching or to consider switching in the next three years than direct debit customers.

- 4.120 The level of detriment suffered by prepayment customers is particularly high. Over the period 2012 to Q2 2015, detriment expressed as a proportion of the bill for prepayment customers was higher than that for direct debit and standard credit customers for both dual fuel customers (15% for prepayment, 11% for standard credit, 10% for direct debit) and single fuel electricity customers (13% for prepayment customers, 11% for standard credit and 9% for direct debit). For single fuel gas customers, the levels of detriment are uniformly high for the three payment types (between 16% and 18%). Further, we note that, unlike other customers, where prepayment customers pay too high a price, part of the detriment is likely to be felt in abruptly curtailed consumption. The detriment we have calculated for prepayment customers is also increasing, reaching almost £500 million per year for all prepayment customers in 2015.
- 4.121 We assess the potential for adverse consequences arising from a price cap in Section 7, in the section on design considerations, and its interaction with our other proposed remedies in Sections 7 and 8. However, we note that in principle, a cap covering a relatively restricted proportion of customers, such as prepayment customers (about 16% of the total customer base) is likely to be less prone to adverse consequences than a cap covering a broader group.
- 4.122 The practicability of a price cap is also closely linked to its detailed design, but we consider that, in principle, the use of an easily identifiable criterion for qualification (such as being on a prepayment meter) will help ensure that the remedy is easily implementable within a short period of time. This is in contrast, for example, to potential approaches based on the use of data matching through the benefits system to try to target customers with particular demographic characteristics.

Assessment of the case for a price cap across all standard variable tariff customers

- 4.123 While the detriment suffered by prepayment customers is particularly high, we note that other domestic customers will also suffer from detriment during the transitional period, and have therefore given consideration to the application of a price cap to broader categories of customers, notably all standard variable tariff customers.

- 4.124 In the Remedies Notice we outlined a possible transitional ‘safeguard regulated tariff’ remedy for disengaged domestic customers. The Remedies Notice outlined that, under this remedy, the maximum price level for default tariffs would be set by either the CMA or Ofgem – we refer to this remedy in this document as the SVT Price Cap Remedy. We noted the risks inherent in remedies which seek to control outcomes and how the scale of these risks relates to the form and scope of the safeguard tariff being contemplated. A number of respondents provided detail of particular risks associated with the SVT Price Cap Remedy, with many respondents identifying a risk of distorting incentives and unintended consequences across the domestic and SME retail energy markets.²⁶⁹
- 4.125 Our provisional view is that the costs of attempting to address the detriment of all SVT customers through a price cap would likely be disproportionate. We believe that attempting to control outcomes for the substantial majority of customers (around 70% of the domestic customers of the Six Large Energy Firms as of Q2 2015) would – even during a transitional period – run excessive risks of undermining the competitive process, potentially resulting in worse outcomes for customers in the long run. This risk might occur through a combination of reducing the incentives of suppliers to compete and reducing the incentives of customers to engage.
- 4.126 As set out above, we believe that competition can work in the interests of energy consumers, providing they are sufficiently engaged, and that with our proposed remedies we can materially improve engagement and overcome impediments to effective competition. We have therefore considered very closely the risks that a broader cap may create for competition and have provisionally decided, on balance, not to propose an intervention to control prices across a broad range of customers.

Design of the prepayment price cap remedy

- 4.127 We have considered a range of options for the design of the PPM Price Cap Remedy, which we have evaluated against several key design criteria, notably:
- (a) practicability (whether the cap is easy to implement on a timely basis, easy to calculate in an objective way and easy to comply with and monitor);

²⁶⁹ See Appendix 7.1.

- (b) impacts on supplier incentives (whether the design minimises the scope for perverse incentives and encourages competition);
 - (c) accuracy (whether the cap accurately reflects changes in competitive market conditions over time, and any changes in the costs that an efficient supplier would be expected to bear); and
 - (d) impacts on customers and suppliers (whether the cap reduces prices for prepayment customers while allowing efficient suppliers a reasonable opportunity to recover their costs).
- 4.128 Sections 7 and 8 provide further details of this assessment. In summary, we have provisionally decided to implement a 'reference price and cost index approach', which would involve setting an initial level of the prepayment cap based on our competitive benchmark analysis and then allowing the cap to change over time according to movements in exogenous cost indices.
- 4.129 We consider that this design has benefits, relative to alternatives, against our design criteria:
- (a) **Practicability:** our preferred approach is easier to implement than alternatives, and less burdensome for both Ofgem and suppliers. It is therefore capable of swift implementation – a key design criterion given the interim nature of the cap.
 - (b) **Supplier incentives:** there appears to us to be minimal scope for perverse incentives under the preferred approach, unlike approaches based on reference prices, which create the potential for the cap to be manipulated and competition to be undermined.
 - (c) **Accuracy:** our preferred approach will accommodate actual changes in wholesale and network costs relatively simply. In relation to policy costs, we have provisionally concluded that the best way to accommodate these within our preferred approach is to use annual estimates of the costs arising from such policies produced by the Office for Budget Responsibility.
- 4.130 In considering the design and stringency of the cap, we have been particularly mindful of the need to avoid distortions to competition, while reducing customer detriment. Notably the design – unlike alternatives we considered – does not lead to a risk of perverse incentives on the part of suppliers. Further, the fact that the cap is strictly time-limited and will be implemented according to an objective formula, will help minimise the risk of regulatory gaming behaviour.

- 4.131 At the current proposed level, we anticipate that the cap will materially reduce detriment for prepayment customers. Had it applied in Q2 2015, it would have reduced prepayment customer detriment – and, equivalently, supplier revenues – by about £300 million per year. We have provisionally decided to include headroom of £25 per fuel per year in determining the overall level of the cap (ie £50 headroom in a dual fuel cap). This will mitigate the risk that the cap does not allow for the recovery of efficient costs and help ensure that competition in the prepayment segments can coexist with the cap.
- 4.132 We anticipate that, as our remedies to address supply-side constraints and improve customer engagement begin to take hold towards the end of the cap and as smart meter roll-out increases, competition rather than the cap will be determining the prices paid by most customers. There will therefore be a graduated glide path to the termination of the cap at the end of 2020.
- 4.133 Our provisional view is that the costs of attempting to address the detriment of all customers on the standard variable tariff through a price cap would likely be disproportionate. We believe that attempting to control outcomes for the substantial majority of customers would – even during a transitional period – run excessive risks of undermining the competitive process, likely resulting in worse outcomes for customers in the long run. This risk might occur through a combination of reducing the incentives of suppliers to compete, reducing the incentives of customers to engage and an increase in the perception of regulatory risk.
- 4.134 Since, as noted above, a large part of the detriment we have observed manifests itself in excess profits and/or costs inefficiency, we believe the best, most sustainable approach to reducing this detriment in the long term is through fully competitive markets. Having considered very closely both the short-term benefits to customers and the longer-term risks that a broader cap may create, set against the features of the Domestic Weak Customer Response AEC, we have provisionally decided, on balance, not to propose an intervention to control prices across all customers on standard variable tariffs.

Summary

- 4.135 Overall, we consider that our proposed package of remedies represents an effective and proportionate response to the Domestic and Settlement AECs and associated detriment we have provisionally identified. Our proposed remedies to create a framework for effective competition and improve customer engagement will begin to address the features we have identified over the next few years and we expect they will start to reduce detriment

materially from around 2019/20. In the transitional period, we propose to introduce a cap on the prices paid by customers on prepayment meters, who have suffered particularly high levels of detriment, and have been subject to additional supply-side constraints that have restricted the choices available to them.

4.136 In the following sections, we analyse our proposed remedies in more detail:

- (a) In Section 5, we assess our proposed remedies to create a framework for effective competition.
- (b) In Section 6, we assess our proposed remedies to improve customer engagement.
- (c) In Section 7, we assess our proposed remedy to introduce a price cap for customers on prepayment meters.
- (d) In Section 8, we assess the effectiveness and proportionality of the overall package of remedies for domestic customers.

5. Domestic retail: creating a framework for effective competition

- 5.1 If competition in retail energy markets is to serve customers' interests, it is vital that the regulatory and technical framework allows suppliers to compete effectively. Provided customers are sufficiently engaged (an issue we consider in Section 6), this will help drive down prices and improve quality of service.
- 5.2 We have provisionally found that a number of features give rise to AECs by undermining the framework for effective competition in the supply of domestic and/or microbusiness gas and/or electricity customers. These are as follows:
- (a) The absence of a firm plan for moving to half-hourly settlement for domestic and the majority of microbusiness electricity customers, and of a cost-effective option of elective half-hourly settlement, which gives rise to an AEC through the distortion of suppliers' incentives to encourage their customers to change their consumption profile, which overall reduces the efficiency and, therefore, the competitiveness of domestic and microbusiness retail electricity supply (the Electricity Settlement AEC).
 - (b) The current system of gas settlement, which gives rise to an AEC through the inefficient allocation of costs to parties and the scope it creates for gaming, which reduces the efficiency and, therefore, the competitiveness of domestic and microbusiness retail gas supply (the Gas Settlement AEC).
 - (c) A combination of technical constraints that limit the ability of all suppliers, and in particular new entrants, to innovate by offering tariff structures that meet demand from prepayment customers who do not have a smart meter; and softened incentives for all suppliers, and in particular new entrants, to compete to acquire prepayment customers (due to actual and perceived higher costs to engage with, and acquire, prepayment customers compared with other customers; and a low prospect of successfully completing the switch of indebted customers, who represent about 15% of prepayment customers) (the Prepayment AEC).
 - (d) The 'simpler choices' component of the RMR rules, which gives rise to an AEC through reducing retail suppliers' ability to innovate in designing tariff structures to meet customer demand, in particular, over the long term, and by softening competition between PCWs (the RMR AEC).

- 5.3 In this section, we set out three categories of proposed remedy that we believe will help address the features leading to these provisional AECs and improve the framework for effective competition:
- (a) Reform of the settlement systems for gas and electricity.
 - (b) Measures to address the technical and regulatory constraints impeding competition for prepayment customers.
 - (c) The withdrawal of aspects of the simpler choices component of the RMR rules.
- 5.4 In the rest of this section we provide a detailed assessment of each of these proposed remedies. In terms of the interaction between these remedies and our remedies for domestic customers:
- (a) We set out in Section 4 our high level assessment of how we expect each of these proposed remedies to interact with the other components of our remedies package, notably proposed measures to help customers engage to exploit the benefits of competition and proposed measures to protect customers who are less able to engage to exploit the benefits of competition.
 - (b) In Section 8, we present a more detailed assessment of the effectiveness and proportionality of the remedies package for domestic customers concerning, in particular, the Prepayment AEC, the RMR AEC and the Domestic Weak Customer Response AEC.

Reform of electricity and gas settlement

- 5.5 Energy suppliers generally purchase in advance the bulk of the electricity and gas that they expect their customers to consume, to help them manage price and volume risks. But both gas and electricity demand are driven by a range of factors that are difficult to predict accurately, such that there will always be some disparity between the volumes of energy covered by suppliers' contracts and the volumes their customers actually use in real time.²⁷⁰ Settlement is the system by which such disparities are identified, reconciled and paid for.²⁷¹

²⁷⁰ For settlement purposes 'real time' means half hour by half hour for electricity, while for gas settlement is defined on a daily basis.

²⁷¹ Equally, the settlement system is used to identify, and assign a price to, any disparities between generators' contracted volumes and the volumes they produce in practice.

- 5.6 Accurate and timely settlement is fundamental to well-functioning retail energy markets since, without this, suppliers will not have the right incentives to minimise the overall costs of energy – which are ultimately borne by consumers. However, in our provisional findings report we expressed concerns that elements of the settlement systems of both gas and electricity lead to inaccuracies and delays that distort competition between energy suppliers. In this section, we provide a summary of the Electricity Settlement AEC and the Gas Settlement AEC and assess our proposed remedies.
- 5.7 In the case of both electricity and gas settlement, we are encouraged to note that reforms are already in hand to address some of the concerns we have identified, and we reflect on these reforms in our consideration of remedies.

Electricity settlement reform

- 5.8 Electricity settlement takes place every half hour but the majority of customers do not have meters capable of recording half-hourly consumption. Therefore, their consumption must be estimated on an ex ante basis. This is done by assigning customers to one of eight profile classes, which are used to estimate a profile of consumption over time and allocate energy used to each half-hour period.
- 5.9 Our main concern, as set out in the provisional findings report, in relation to electricity settlement is that such estimates fail to charge suppliers for the true cost of their customers' consumption. This means that suppliers are not incentivised to encourage their customers to change their consumption patterns, as the supplier will be charged in accordance with its customers' profile regardless of their actual consumption behaviour. This in turn distorts suppliers' incentives to innovate and bring in new products and services such as time-of-use tariffs, which reward customers for shifting consumption away from peak periods.
- 5.10 In principle, smart meters should remove the need for profiling in electricity, since they provide accurate half-hourly meter reads which could be used for settlement. However, we remain concerned that there are currently no concrete proposals for using half-hourly consumption data in the settlement of domestic electricity customers, even after the full roll-out of smart meters.
- 5.11 Accordingly, we provisionally found that the absence of a firm plan for moving to half-hourly settlement for domestic and the majority of microbusiness electricity customers and of a cost-effective option of elective half-hourly settlement is a feature of the markets for domestic and SME retail electricity supply in Great Britain that gives rise to an AEC through the

distortion of suppliers' incentives to encourage their customers to change their consumption profile, which overall reduces the efficiency and, therefore, the competitiveness of domestic and microbusiness retail electricity supply.²⁷²

- 5.12 In our Remedies Notice we consulted upon a possible requirement for domestic and SME electricity suppliers and relevant network firms to agree a binding plan for the introduction of a cost-effective option to use half-hourly consumption data in the settlement of domestic and SME customers.

Aim of the remedy

- 5.13 The aim of this proposed remedy is to ensure that, within a reasonable timetable, half-hourly consumption data is used to settle electricity customers falling into profile classes 1 to 4.
- 5.14 Accordingly, the ultimate aim of the proposed remedy is to address the feature of the GB electricity retail markets relating to the absence of a firm plan for moving to half-hourly settlement for domestic and the majority of microbusiness electricity customers, and of a cost-effective option of elective half-hourly settlement, as it gives rise to an AEC through the distortion of suppliers' incentives to encourage their customers to change their consumption pattern.

Estimates of the potential benefits and costs of half-hourly settlement

- 5.15 The introduction of half-hourly settlement would have a number of benefits, the most substantial of which arise from the incentives it provides to electricity suppliers to encourage demand-side responses from domestic and SME customers such as peak load shifting, thus helping to reduce the overall costs of supplying electricity.
- 5.16 In this section, by way of background, we set out some of the available evidence on the potential benefits of load shifting, other benefits that might be expected to arise from settlement reform and the costs of reform.

- *The link between settlement reform and load shifting*

- 5.17 The main mechanism by which suppliers can encourage load shifting and other forms of demand-side response is through the introduction of time-of-use tariffs. Time-of-use tariffs can take the form of:

²⁷² See [provisional findings report](#), paragraph 8.286.

- (a) Static time-of-use tariffs, which use prices that vary according to the time of day to incentivise consumers to shift their energy consumption from peak to off-peak times. The price structures of such tariffs are fixed ex ante – ie they do not vary according to real-time network conditions. Economy 7 tariffs are a simple form of static time-of-use tariff.
- (b) Dynamic time-of-use tariffs, which offer consumers variable prices depending on network conditions – for example, during a period of plentiful wind, consumers may receive an alert that electricity will be cheaper for the next few hours. This could include critical peak pricing, where alert of a higher price is given usually one day in advance, for a pre-established number of days per year.
- (c) Automated time-of-use tariffs, which provide for an automated customer response, for example through remote control of appliances by a third party or programmable appliances. The response could be driven by price or non-price factors (such as network conditions). Automated time-of-use tariffs are likely to provide the largest potential for load shifting.

5.18 We note that suppliers can opt, for some meter systems, to introduce basic forms of static time-of-use tariffs within the current settlement system, through a process known as ‘chunking’.²⁷³ However, Elexon told us that in the absence of significant changes to existing settlement processes to provide for dynamic feedback from suppliers, settlement did not facilitate dynamic time-of-use tariffs or critical peak pricing for non-teleswitched meters. These limitations precluded the use of non-static time of use tariffs.²⁷⁴ Further, since such an approach is optional, it does not ensure that suppliers take full account of the costs their customers impose on the system.

5.19 In contrast, half-hourly settlement would expose all suppliers to the full costs that their customers impose on the system (thus incentivising them to reduce these costs), and enable the provision of dynamic time-of-use tariffs which will more closely match the cost of procuring energy in the wholesale market and conditions on the transmission and distribution networks. For example, customers might be incentivised to use electricity when there is plenty of renewable generation available.

²⁷³ Chunking allows the energy recorded on non-half-hourly electricity meters with at least two registers to be allocated to specific times of the day. Meter read data is then processed and aggregated for all suppliers’ customers on the new configuration and submitted to the settlement system. The settlement system processes will then be used to ‘allocate’ the number of units used between meter readings for all customers, on the new configuration to a load profile according to the times that each meter register is active. See Elexon letter to the CMA, 20 November 2015.

²⁷⁴ Elexon submission to the CMA, 20 November 2015.

5.20 Dynamic time-of-use tariffs such as load control and critical peak pricing will play a more important role as the penetration of electric motor vehicles, heat pumps, other automation technologies (load control technologies) and generation from intermittent sources increases.

5.21 In summary, we would expect a move to half-hourly settlement to be necessary for any form of dynamic or automated time-of-use tariffs and for the introduction of static time-of-use tariffs at scale.²⁷⁵

- *The savings from domestic peak load shifting*

5.22 The main potential cost savings from peak load shifting are:

- (a) Reductions in the short-run marginal costs of generation: if demand is shifted from peak to off-peak periods, savings will arise due to differentials between the marginal costs of generating electricity at peak and off-peak times.
- (b) Reductions in the costs of investing in new generating capacity: shifting demand from peak to off-periods will reduce the need for investing in certain type of new generation capacity in the future.
- (c) Reductions in the costs of investing in the distribution network: peak load shifting will also reduce the need to invest in new distribution network capacity.
- (d) Reductions in environmental costs: lower peak demand could also lead to reductions in greenhouse gas emissions and emissions having a harmful impact on air quality, since the generation mix during peak times tends to be more carbon-intensive (and have a worse impact on air quality) than off-peak generation.

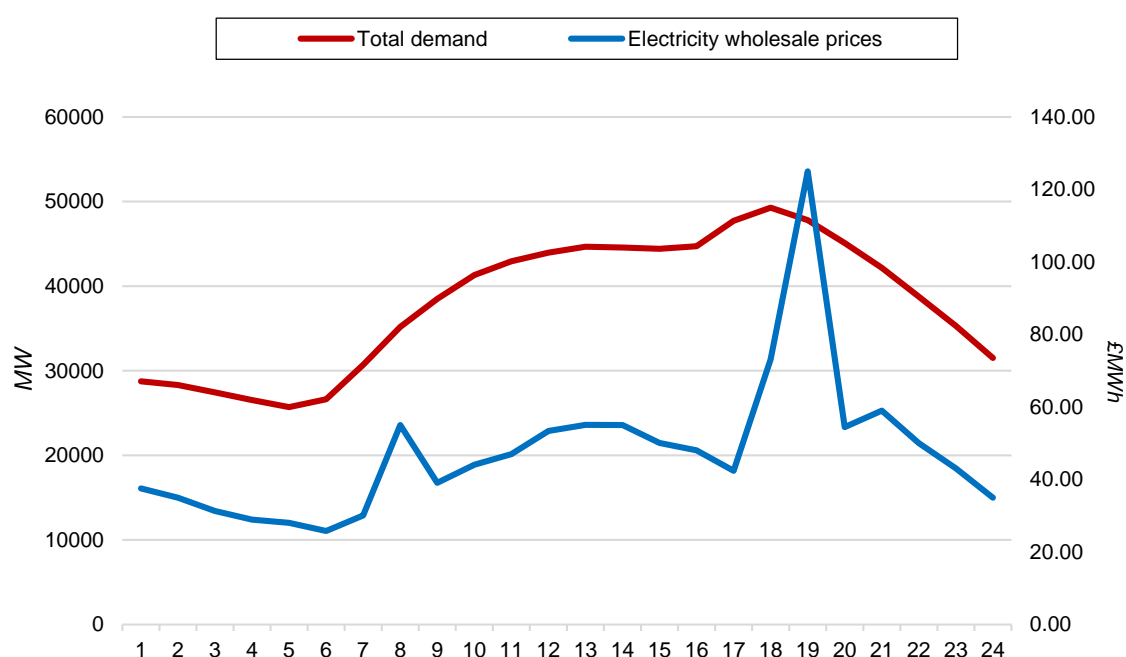
5.23 The potential savings from these effects are substantial. In our provisional findings report we conducted an analysis of the costs incurred by the Six Large Energy Firms in supplying domestic electricity customers. This analysis showed that wholesale energy costs, which currently make up

²⁷⁵ We note that DECC's Impact Assessment concerning the introduction of smart meters assigns relatively modest benefits to load shifting – around £900 million in net present value terms. It has subsequently clarified to us that these estimates reflect the amount of load shifting that could be expected to occur in the absence of settlement reform. After the introduction of half-hourly settlement, they would expect the potential for load shifting to be much greater. See [DECC Impact Assessment, Smart meter roll-out for the domestic and small and medium non-domestic sectors \(GB\)](#).

around 45% of the overall costs of supplying electricity, are the single biggest cost item, followed by network costs (25%).²⁷⁶

- 5.24 In relation specifically to potential savings in the wholesale costs of electricity, the chart below shows total electricity demand and wholesale prices by time of day for a typical weekday in winter in Great Britain. Electricity demand peaks between 5pm and 8pm. Over the peak period, the wholesale price increases from around £40/MWh to around £120/MWh, such that, if 2 GW of peak demand (less than 5% of total demand) were shifted to non-peak times, the savings would be of the order of £0.5 million a day.

Figure 5.1: Electricity demand and wholesale electricity prices for a typical weekday in winter (2 January 2013)



Source: National Grid (demand) and N2EX auction prices (electricity wholesale prices).

- 5.25 We would expect daily wholesale price differentials to increase in the future, due to the increasing deployment of intermittent and zero marginal cost plant and the use of subsidy regimes that will increase the likelihood of negative prices at certain times of day. The fact that more intermittent wind will be on the system will not only increase daily price differentials, but will tend to make price peaks and troughs more erratic and more difficult to predict far in advance. The implication is that dynamic and automatic time-of-use tariffs (as noted above, half-hourly settlement is a prerequisite for the introduction

²⁷⁶ See [provisional findings report](#), Figure 7.2.

of such tariffs) will become increasingly important to allow such price differentials to be exploited.

- 5.26 Various studies have been conducted in an attempt to estimate both the potential for domestic load shifting in Great Britain in the future and the extent to which demand-side response might be expected to arise from domestic customers from the introduction of different types of time-of-use tariffs.
- 5.27 In terms of technical potential, Sustainability First and the Brattle Group have estimated the technical potential for load shifting in 2025 for domestic, industrial and commercial customers, using 2010/11 as a baseline. Their results suggest that potentially 'shiftable' electricity demand may reach as high as 10GW in the domestic sector in 2025.²⁷⁷
- 5.28 Other studies have produced more conservative estimates. For example, Baringa (2013)²⁷⁸ estimated that by 2031, the peak load reduction from domestic customers would vary between 2.1 and 7.9 GW depending on the time-of-use scenario modelled. Frontier Economics (2015),²⁷⁹ in its recent review of the potential for demand-side response to 2035, suggested that the greatest potential for demand-side response will occur in the future, if and when technologies such as heat pumps, electric motor vehicles and electrical energy storage systems reach mainstream acceptance.
- 5.29 We are aware of one study that has attempted to value the amount of peak demand reduction expected to arise through different types of time-of-use tariffs. Baringa and Element Energy²⁸⁰ (2012) estimated the potential for demand-side responses from domestic and SME customers and attempted to monetise benefits from load shifting under a number of different scenarios, relating both to:
- (a) the uptake of different types of time-of-use tariffs (static, automated and dynamic including critical peak pricing); and
 - (b) the penetration of different types of low carbon technologies such as heat pumps, electric vehicles and smart appliances.
- 5.30 They estimated savings within the domestic sector of between roughly £50 million and £100 million a year by 2020 and between roughly £100

²⁷⁷ Sustainability First and The Brattle Group (2014), [Impact of demand reduction and demand shifting on wholesale prices and carbon emissions](#).

²⁷⁸ Baringa (2013). Smart Metering Load Shifting Analysis, p7, Figure 7.

²⁷⁹ Frontier Economics, LCP (2015), [Future potential for DSR in GB](#). A report prepared for DECC by Frontier Economics with support from LCP and Sustainability First. See p3.

²⁸⁰ [Electricity System Analysis- future system benefits from selected DSR scenario \(August 2012\)](#).

million and £350 million a year by 2025. Expected savings increase with the roll-out of automated and dynamic time-of-use tariffs (for which settlement reform is necessary if efficiencies are to be fully and accurately realised) and with increased penetration of low carbon technologies. We note in relation to this latter factor that the demand and supply of heat pumps, smart appliances and electric vehicles will be driven in large part by the availability of opportunities to exploit within-day price differentials. Therefore we would argue that a move to half-hourly settlement will be a necessary step in achieving the higher end of potential benefits from demand-side response.

- *Other benefits arising from settlement reform*

5.31 A number of additional benefits and cost savings might be expected to arise from the implementation of half-hourly settlement. These include the following:

(a) Improved data quality and faster settlement – suppliers could face less financial uncertainty in the allocation of imbalance charges as meter readings would be more accurate and submitted to settlement sooner, and the costs that suppliers incur as a result of errors in consumption data could fall.

(b) Lower administration charges – load profiles would no longer be necessary, so the costs currently incurred by suppliers and Elexon in supporting the current profiling system would be saved.

(c) Better forecasting of demand, which results in a lower cost of balancing the electricity system.

- *The costs of reforming the settlement system*

5.32 In relation to costs, we would expect that the implementation of half-hourly settlement for profile classes 1 to 4 will require changes to the systems employed by Elexon, distribution network operators and electricity suppliers. Therefore we asked Elexon, distribution network operators and electricity suppliers to estimate how much it would cost to implement half-hourly settlement.

5.33 In terms of implementation costs, we consider these to be low for distribution network operators and Elexon.

5.34 Elexon submitted that a move to half-hourly settlement for profile classes 1 to 4 would result in additional upfront costs ranging [£] thereafter.

- 5.35 Four distribution network operators responded to our request. Their estimates of the costs of implementing half-hourly settlement, both upfront and ongoing [X]. This is based on the assumption that half-hourly settlement for profile classes 1 to 4 is introduced on an aggregated basis where all customers on the same distribution use of system tariffs are grouped together in the bill sent to the suppliers.²⁸¹ Electricity North West submitted that costs for implementing half-hourly settlement for profile classes 1 to 4 had already been incurred as part of two previous industry modification proposals.
- 5.36 In relation to electricity suppliers, only two of the Six Large Energy Firms ([X] and [X]) and one other supplier ([X]) were able to provide estimates of the upfront and ongoing costs from the implementation of half-hourly settlement within the required timescale. While the estimates of the upfront and ongoing costs that they provided were substantial – running into several millions of pounds – they were not provided with sufficient supporting detail (or from a sufficient number of firms) to allow us to build a consistent, robust picture of the likely costs.
- *Distributional implications*
- 5.37 There is limited evidence on the distributional implications arising from half-hourly settlement. While we accept the argument that some customers might not be able to shift their consumption from peak to off-peak periods, there is limited evidence to suggest that these are more likely to be vulnerable or low-income consumers. We note that in the Northern Ireland Powershift trial, consumers in the trial group, who mostly had low incomes, were found to benefit from the lower off-peak prices in the time-of-use tariff passively (that is, without having to change their behaviour), as a lot of their electricity use was already at off-peak times.
- *Our views regarding the potential costs and benefits of settlement reform*
- 5.38 Overall, and based on the evidence we have seen, there are good reasons to expect the benefits from half-hourly settlement to outweigh the costs of its implementation by a substantial degree. However, a full cost-benefit analysis has not been possible within the time available to us and, in particular, we have not conducted our own modelling of benefits or collected a comprehensive and robust set of data on costs.

²⁸¹ An alternative would be the introduction of site-specific settlement whereby energy suppliers will be billed separately for each specific customer that is connected to a distribution network. The cost of site-specific settlement would be significantly higher than aggregate settlement.

- 5.39 We believe Ofgem should conduct such an exercise as part of its plans to introduce elective and mandatory half-hourly settlement for profile classes 1 to 4 (for the reasons set out below), including with a view to determining when half-hourly settlement should become mandatory for all domestic and SME customers.

Parties' views

- 5.40 A number of companies (EDF Energy,²⁸² RWE,²⁸³ Northern Powergrid,²⁸⁴ and Ovo Energy²⁸⁵) considered that a plan for moving domestic and SME electricity customers to half-hourly settlement was needed.
- 5.41 Scottish Power²⁸⁶ said that it was sensible for the CMA to consider whether any additional intervention was required to ensure that industry delivered half-hourly settlement in a well-planned and cost-effective manner. It added that in defining a plan for the introduction of half-hourly settlement two dates should be considered: (a) the earliest date at which the systems for half-hourly settlement were available and suppliers elected to settle individual customers based on half-hourly consumption; and (b) the date by which suppliers were obliged to settle all customers on a half-hourly basis.
- 5.42 However, two of the Six Large Energy Firms, SSE²⁸⁷ and Centrica²⁸⁸ considered such plans premature given the early stages of the smart meter roll-out, and warned that an early implementation of half-hourly settlement might risk costs outweighing benefits.
- 5.43 SSE²⁸⁹ said that once the smart meter roll-out was sufficiently advanced, a plan could be put in place to introduce half-hourly settlement.
- 5.44 Centrica²⁹⁰ submitted that while half-hourly settlement was ultimately desirable, it was premature to commit the industry to developing a binding plan in the short to medium term. It added that:
- (a) a full cost-benefit analysis of half-hourly settlement was needed before any implementation plan could be agreed;

²⁸² EDF Energy response to Remedies Notice, p47.

²⁸³ RWE response to Remedies Notice, p120.

²⁸⁴ Northern Powergrid response to Remedies Notice, p3.

²⁸⁵ Ovo Energy response to Remedies Notice, p29.

²⁸⁶ Scottish Power response to Remedies Notice, p46, paragraphs 13.1 & 13.3.

²⁸⁷ SSE response to Remedies Notice, p94.

²⁸⁸ Centrica response to Remedies Notice, p95.

²⁸⁹ SSE response to Remedies Notice, p94.

²⁹⁰ Centrica response to Remedies Notice, p95.

- (b) the incremental benefits half-hourly settlement brings are likely to be limited in the foreseeable future, meaning it is likely to be too early to consider implementing half-hourly settlement for profile class 1 to 4 sites; and
 - (c) implementation of half-hourly settlement would take significant resources and therefore risk undermining other important projects occurring now and in the future.
- 5.45 We provide a more detailed summary of the responses provided by parties, and in particular the views they expressed on the specific questions we asked in relation to this remedy, in Appendix 5.3.

Design considerations

- 5.46 In our Remedies Notice, we observed that the introduction of half-hourly settlement was a substantial reform that would take some time to plan and implement. Our concern was that, despite the fact that the reform has the potential to deliver significant benefits, beyond those taken into consideration by DECC in its smart meters impact assessment,²⁹¹ there was no concrete plan in place to move to half-hourly settlement for domestic and SME customers.
- 5.47 As noted in Section 11 of our provisional findings report, we consider that governance processes have failed several times to deliver certain policy objectives, in particular when requiring an industry code modification process, even in circumstances where benefits to customers were clear. In view of the nature of the changes, and the likely impact on stakeholders (eg the costs of implementation), implementation of half-hourly settlement will be in many ways similar to major projects such as Project Nexus and P272 (implementation of half-hourly settlement for profiles 5-8).
- 5.48 We therefore consider that without sufficient planning and strong project management, the necessary preparations for the implementation of half-hourly settlement for profile classes 1 to 4 are likely to suffer the same problems we reported for Project Nexus and P272, including an unnecessarily long lead time and difficulties with implementation (see also our proposed remedies relating to code governance in Section 9).
- 5.49 We have been encouraged to note that, since the publication of our provisional findings report, substantive progress has been made by both

²⁹¹ DECC's impact assessment contains only modest estimates of the potentials from load shifting. See paragraph 5.21.

DECC and Ofgem towards developing a concrete plan for the introduction of half-hourly settlement. We summarise these developments in the next section, before setting out certain issues that we consider should inform the development of such a plan.

- *Recent developments*

- 5.50 Following the publication of our provisional findings report, the Secretary of State for Energy and Climate Change wrote to us stating that she shared our views about the importance of half-hourly settlement in facilitating greater innovation in time-of-use tariffs and would shortly be bringing forward proposals for pre-legislative scrutiny that would seek to give Ofgem greater powers in order to deliver settlement reform more quickly.²⁹²
- 5.51 In January of this year, DECC consulted on proposed powers – for the purposes of pre-legislative scrutiny – to be given to Ofgem to allow it to implement switching and settlement reforms in a timelier and more cost-effective manner.²⁹³ The proposed powers will enable industry codes to be modified directly by Ofgem rather than industry so as to facilitate expeditious and coordinated changes to industry codes. This is because DECC considers that the current significant code review process (see discussion of this process in Appendix 9.4) will not deliver the policy objectives (enhanced competition and increased consumer engagement) of the switching and settlement reforms in a timely and cost-effective manner that ensures the best outcomes to consumers.²⁹⁴
- 5.52 Under the current draft legislation, the proposed power(s) will be time-limited to five years from commencement and scope-limited to the switching and settlement reform programmes only. In view of the concerns set out in paragraphs 5.47 and 5.48, and the potential impacts of half-hourly settlement on consumers' interests and/or competition, we believe that an Ofgem-led process could be more appropriate than the normal industry-led process to implement half-hourly-settlement. To this extent, these proposed powers are consistent with our remedies relating to the Codes AEC set out in Section 10.²⁹⁵ We consider, however, that once the half-hourly settlement reform is implemented, further modifications to the relevant codes should

²⁹² Letter of 31 July 2015, available on [GOV.UK](http://gov.uk).

²⁹³ DECC (2015), [Draft Measures: Fast and reliable switching and Half-hourly settlement power\(s\)](#), p10, paragraph 42.

²⁹⁴ *ibid*, p10, paragraph 47.

²⁹⁵ See in particular our proposed remedy that Ofgem should have the power (call-in power) to take control of the development and implementation of strategically important modification proposals in certain exceptional circumstances (see paragraphs 10.430–10.433).

follow the normal code governance process (as amended pursuant to our proposed remedies set out in Section 10).

- 5.53 The proposed power(s) will also introduce the ability for Ofgem to reduce the 56-day period between the notice of a licence modification being published and the modification coming into effect. We consider that such a provision could be useful to ensure that Ofgem is able to implement half-hourly settlement in a more timely manner.
- 5.54 Ofgem has recently agreed (in a letter published on 17 December 2015) to take forward a project to reform the electricity settlement arrangements in Great Britain.²⁹⁶ The project's aim is initially to remove barriers to elective half-hourly settlement for domestic and microbusiness customers and then eventually mandate half-hourly settlement for all customers. We comment on the respective merits of elective and mandatory half-hourly settlement in paragraphs 5.62 to 5.69 below.
- 5.55 Ofgem envisages that elective half-hourly settlement will be enabled by the first half of 2017²⁹⁷ and that central systems and industry rules to facilitate mandatory half-hourly settlement will be in place by the first half of 2018. It plans to launch a Significant Code Review on mandatory half-hourly settlement in early 2016. It has not yet indicated what the timescale might be for the introduction of mandatory half-hourly settlement.
- 5.56 In undertaking this project Ofgem will be supported by Elexon²⁹⁸ (letter published on 17 December 2015), which in addition to preparing a report to the BSC Panel on the barriers to elective half-hourly settlement in February, has committed to deliver specific pieces of work for Ofgem.

- *Issues to consider*

- 5.57 We think that the recent steps that DECC and Ofgem have taken towards half-hourly settlement for domestic customers are positive, and we welcome them. In this section we set out some additional considerations that, in our view, should inform the development of a concrete plan for implementing half-hourly settlement.
- 5.58 We have identified several issues that would need to be taken into account when developing a plan for half-hourly settlement:

²⁹⁶ See Ofgem (2015), [Half-hourly settlement: the way forward](#).

²⁹⁷ Ofgem considers that to introduce cost-effective arrangements for elective half-hourly settlement it will need to review meter operator, data processing and data aggregation rules and make changes to industry codes.

²⁹⁸ See Ofgem's letter to Elexon: [Half-hourly settlement – Elexon's role](#).

- (a) access to half-hourly consumption data by energy suppliers;
- (b) the respective costs and benefits of mandatory and elective half-hourly settlement;
- (c) alternative options for institutional design regarding settlement;
- (d) the conduct of the cost-benefit analysis; and
- (e) the need for a formal, joint plan between DECC and Ofgem.

5.59 We discuss these in turn below.

- *Supplier access to half-hourly data*

5.60 The Data Access and Privacy Framework for smart metering, which has been transposed into the Smart Energy Code, prohibits suppliers from collecting consumption data with greater granularity than daily unless a customer has given explicit consent to do so (opt in).²⁹⁹

5.61 We believe that this opt-in clause effectively precludes mandatory half-hourly settlement (which by definition requires the use of all customer data for settlement, not just the data of those customers who have opted in) and is therefore a major barrier to the development of static and dynamic time-of-use tariffs. We acknowledge that data privacy is a controversial area, and we think the government needs to explain clearly why access to half-hourly data is necessary if major demand-side response – with associated benefits for consumers – is to be achieved.

- *Elective vs mandatory half-hourly settlement*

5.62 In relation to the merits of mandatory as opposed to elective half-hourly settlement, we note that Ofgem's letter implies that the first stage of its work will be focused on removing the barriers to elective half-hourly settlement and that it proposes to draw on the experience of elective half-hourly settlement in developing its views on mandatory half-hourly settlement.

5.63 We would express some caution about the sequencing implicit in this approach. In our provisional findings report, we noted that there were barriers to elective half-hourly settlement – notably that it was prohibitively costly under the current system – and if a simple, cost-effective way can be found to reduce these costs, we would support this.

²⁹⁹ See Appendix 5.1: Smart meter roll-out in Great Britain.

- 5.64 However, in our view, elective half-hourly settlement is unlikely to be an effective substitute for full, mandatory half-hourly settlement. This is because under mandatory settlement, all suppliers bear the full costs that their customers impose on the electricity system. This, in turn, will both reduce overall costs per head and give stronger financial incentives to suppliers to engage all of their customers, in an attempt to shift their consumption to cheaper periods. In contrast, under the status quo, suppliers have a financial incentive to keep their customers disengaged, since they are generally on higher tariffs and have a lower propensity to switch. Elective half-hourly settlement would not change this incentive as greatly as mandatory settlement.
- 5.65 We are also mindful of some of the comments made by parties in relation to the costs and risks associated with elective half-hourly settlement. SSE³⁰⁰ has submitted that with elective half-hourly settlement the customer population as a whole would have paid for a system that would only be used by some and that this outcome would negatively impact a cost-benefit analysis on moving to mandatory half-hourly settlement. EDF Energy³⁰¹ and SSE³⁰² said that mandatory settlement would eliminate the need to maintain both non-half-hourly and half-hourly regimes (other than as an exception process) which would reduce costs compared with maintaining both regimes. EDF Energy stated that it did not believe it would be possible to implement a cost-effective industry solution for half-hourly settlement until the end of the smart metering roll-out. EDF Energy³⁰³ added that maintaining both regimes could become a barrier to switching.
- 5.66 Further, Centrica³⁰⁴ submitted that optional half-hourly settlement would create the risk of gaming whereby suppliers would settle half-hourly those customers whose difference from a profiled usage benefited the supplier's imbalance and trading position. Centrica,³⁰⁵ Citizens Advice,³⁰⁶ Good Energy³⁰⁷ and Ofgem³⁰⁸ all agreed that mandatory half-hourly settlement would reduce this risk.

³⁰⁰ SSE response to Remedies Notice, p96.

³⁰¹ EDF Energy response to Remedies Notice, p48.

³⁰² SSE response to Remedies Notice, p96.

³⁰³ EDF Energy response to Remedies Notice, p48.

³⁰⁴ Centrica response to provisional findings report and Remedies Notice, p97.

³⁰⁵ Centrica response to provisional findings report and Remedies Notice, p97.

³⁰⁶ Citizens Advice response to Remedies Notice, p59.

³⁰⁷ Good Energy response to Remedies Notice, p10.

³⁰⁸ Ofgem response to Remedies Notice, p97.

- 5.67 We note that other suppliers – notably E.ON,³⁰⁹ RWE,³¹⁰ First Utility³¹¹ and Scottish Power³¹² – supported a move to optional half-hourly settlement in the first instance.
- 5.68 In relation to costs, if, for example, Ofgem’s further analysis of this issue suggested that substantial additional resources would be needed to develop and maintain a viable option of elective half-hourly settlement, this would suggest that such resources would be better used accelerating the implementation of mandatory half-hourly settlement.
- 5.69 In relation to the scope for gaming, we acknowledge that having a choice of settlement system may lead to a risk of cherry picking (ie simply opting for elective settlement for those customers whose consumption profile means they would be cheaper to serve). While this would result in a reduction in costs to the supplier, overall system costs would not fall and the potential efficiencies of half-hourly settlement would not be realised. We believe it is only through behavioural change that settlement reform will lead to expected benefits.
- *Alternative options for institutional design regarding settlement*
- 5.70 Some parties have submitted that a centralised system for data collection and aggregation would reduce the cost of half-hourly settlement by delivering economies of scale and overall efficiencies which would result in lower costs for customers. A few parties suggested that the DCC could perform the role of data collector/aggregator and could pass the aggregated data directly to the settlement administrator (Elexon). While we have not reached any view on possible design options for half-hourly settlement, we believe that in theory a centralised system for half-hourly settlement could lower costs for customers and suggest that Ofgem assess this in its development of a plan for mandatory half-hourly settlement.
- *Cost-benefit assessment*
- 5.71 In relation to the cost-benefit assessment that Ofgem proposes to undertake, we consider that this should both draw on the available estimates of costs and benefits from studies already conducted – including those we have

³⁰⁹ E.ON, response to provisional findings report and Remedies Notice, p76.

³¹⁰ RWE response to Remedies Notice, p125.

³¹¹ First Utility response to provisional findings report and Remedies Notice, p50, paragraph 3.142.

³¹² Scottish Power response to Remedies Notice, p48, paragraph 13.10.

reviewed in this report – and involve original analysis. The original analysis should include:

- (a) modelling of benefits, considering technical potential, the likely variability of wholesale prices in the future and different scenarios regarding the roll out of time-of-use tariffs and low carbon technologies (noting that the latter two factors are likely to be strongly influenced by the timing of the move to mandatory half-hourly settlement);
- (b) more disaggregated and consistent information on the upfront costs of implementing half-hourly settlement and the costs and savings expected to accrue on an ongoing basis from the introduction of half-hourly settlement; and
- (c) an understanding of distributional impacts, noting potential mitigating measures.

5.72 As noted above, firming up estimates of costs, benefits and distributional impacts will take time. We have provisionally decided to recommend that Ofgem start this analysis as soon as possible. The outcome of this work would be a firm date for the move to mandatory half-hourly settlement.

- *The adoption of a joint plan between DECC and Ofgem*

5.73 In our provisional findings, we identified a number of situations in which the implementation of policy goals had been delayed or suboptimal due to a lack of coordination between DECC, Ofgem and the industry. We noted, as an example, the difficulty in implementing modification proposal P272 (half-hourly settlement for certain categories of customer under profiles 5-8). Since ‘load shifting’ contributes to the case in favour of the roll-out of smart meters in DECC’s impact assessment, as highlighted in our provisional findings (paragraph 8.280), we consider that DECC and Ofgem should have agreed on a set of concrete actions to ensure such benefits would be delivered, including clear responsibilities to take forward proposals for settlement reform (see Section 10).

5.74 We consider that the half-hourly settlement reform for customer profiles 1-4 presents very similar potential benefits and challenges. We therefore believe that DECC and Ofgem should adopt a joint plan setting out the aim of the reform and the respective responsibilities of DECC (eg granting new powers to Ofgem through legislation), Ofgem (carrying out a cost-benefit analysis) and, as the case may be, the industry (eg with respect to consequential modifications to industry codes) in delivering the reform.

5.75 Beyond making responsibilities for delivery clear, publishing detailed joint statements should facilitate the engagement of and commentary from stakeholders. Such stakeholders would be given more clarity about the actual implications of the proposed action plan and would therefore be in a better position to contribute their knowledge and expertise on the most legal and technical details. This process would also give more legal certainty to parties about the likely pace and technical implications of a given policy, allowing them to roll out the necessary internal changes (eg IT).

- *How we propose to implement the remedy*

5.76 Our proposed remedy is intended to take the form of recommendations to both DECC and Ofgem.

5.77 First, we propose to recommend to DECC to consult on amending the provisions of the Smart Energy Code that prohibit suppliers from collecting consumption data with greater granularity than daily unless a customer has given explicit consent to do so. This is because access to half-hourly data is necessary if major demand-side response – with associated benefits for consumers – is to be achieved.

5.78 For the reasons set out above in paragraphs 5.52 and 5.53, we support DECC's proposals:

- (a) to introduce the ability for Ofgem to reduce the 56-day period between the notice of a licence modification being published; and
- (b) to give Ofgem powers to modify industry codes time-limited to five years from commencement and scope-limited to the switching and settlement reform programmes (as noted in paragraph 5.52, we consider this proposal to be consistent with our remedies set out in Section 9).

5.79 Second, we propose to recommend to Ofgem that it:

- (a) conduct a full cost-benefit analysis of the move to mandatory half-hourly settlement, including analysis of costs, benefits and distributional implications as well as mitigating measures;
- (b) start the process of gathering evidence for the analysis as soon as practicable;
- (c) consider the cost-effectiveness of alternative design options for half-hourly settlement such as a centralised entity responsible for data collection and aggregation; and

- (d) consider options for reducing the costs of elective half-hourly settlement, including:
 - (i) whether any of these options are likely to delay or accelerate the adoption of mandatory half-hourly settlement; and
 - (ii) any challenges that may arise or benefits that may accrue from the existence of two settlement systems, including in particular the possibility of gaming/cherry-picking behaviour.
- 5.80 Third, we propose to recommend to both DECC and Ofgem that they publish and consult jointly on a plan setting out:
- (a) the aim of the reform for half-hourly settlement;
 - (b) a list of proposed regulatory interventions (including code changes), and the relevant entity in charge of designing and/or approving such interventions, that are necessary in order to implement the half-hourly settlement reform;
 - (c) an estimated timetable for the completion of each necessary intervention; and
 - (d) where appropriate, a list of relevant considerations that will be taken into account in designing each regulatory intervention.

Assessment of effectiveness

- 5.81 In assessing the effectiveness of this proposed remedy, we have considered:
- (a) the extent to which it meets its aim;
 - (b) the extent to which the proposed remedy is capable of effective implementation, monitoring and enforcement; and
 - (c) the timescale over which the remedy is likely to have an effect.
- 5.82 Our provisional view is that the proposed remedy would be effective in achieving its aim of ensuring that, within a reasonable time frame, half-hourly consumption data is used to settle domestic and SME electricity customers falling into profile classes 1 to 4. Accordingly, our provisional view is that the proposed remedy will address, in part, the feature that an absence of a firm plan for moving to half-hourly settlement for domestic and the majority of microbusiness electricity customers and of a provisional cost-effective option of elective half-hourly settlement that gives rise to the Electricity Settlement

AEC through the distortion of suppliers' incentives to encourage their customers to change their consumption profiles (ensuring that suppliers are fully exposed to the costs that they impose on the system).

- 5.83 In particular, the evidence we have obtained does not allow us to determine what would be the most appropriate time frame for the implementation of half-hourly settlement reform. We believe that Ofgem, as sector regulator, is best placed to carry out a cost-benefit analysis that will allow it to reach a view on this matter, and to take overall responsibility for implementing the reform.
- 5.84 We also noted above that DECC has published draft legislation (see paragraphs 5.51 and 5.52) giving Ofgem additional powers to progress electricity settlement reform more quickly, and that Ofgem has published an initial plan to implement half-hourly settlement. In particular, we noted that Ofgem envisages that a final decision on mandatory half-hourly settlement will be taken by the first half of 2018. We welcome these recent developments (including Ofgem's time frame) and consider these consistent with the aims of our proposed remedial action.
- 5.85 While we have noted above concerns relating to the difficulty for Ofgem of implementing such a significant reform (see also Section 11 of our provisional findings report with respect to the regulatory framework and codes governance), we believe that the new powers that are intended to be granted to Ofgem under the draft legislation will greatly facilitate implementation of the reform. In the short term, however, we consider that (a) DECC needs to consult on amending the provisions of the Smart Energy Code to facilitate a move to mandatory half-hourly settlement; (b) Ofgem needs to gather evidence of, and conduct, certain cost-benefit analysis concerning elective and mandatory half-hourly settlement reform; and (c) DECC and Ofgem need to publish a joint document (eg Memorandum of Understanding) setting out their respective roles and responsibility.
- 5.86 In summary, we believe that DECC and Ofgem will act upon our remedy and that our proposed remedy is capable of effective and timely implementation. As a result, we expect Ofgem to deliver the half-hourly settlement reform within an appropriate time frame in a way that maximises the benefits and mitigates the (transitional) costs.
- 5.87 Given that each of the above proposals would need to be taken forward by DECC or Ofgem (or both), we consider that recommendations would be effective in each case. Given both DECC's and Ofgem's recent progress concerning the implementation of half-hourly settlement reform, we are confident that both bodies will implement our proposed recommendations.

We would also expect Ofgem to be able to demonstrate developments concerning our proposed recommendations promptly after our final report is published.

Assessment of proportionality

- 5.88 Our provisional view is that the proposed remedy would be effective in achieving its aim of ensuring that, within a reasonable time frame, half-hourly consumption data is used to settle domestic and SME electricity customers falling into profile classes 1 to 4. Accordingly, our provisional view is that the proposed remedy will address, in part, the feature that an absence of a firm plan for moving to half-hourly settlement for domestic and the majority of microbusiness electricity customers and of a provisional cost-effective option of elective half-hourly settlement that gives rise to the Electricity Settlement AEC through the distortion of suppliers incentives to encourage their customers to change their consumption profiles.
- 5.89 Considering the recent developments set out above, and the general direction of travel of DECC and Ofgem concerning the development of plans for half-hourly settlement reform, we believe that the incremental costs of this proposed remedy will be negligible and, in any event, justified by its aim.

Gas settlement reform

Introduction

- 5.90 We have provisionally found that the current system of gas settlement is a feature of the GB domestic and SME retail gas markets that gives rise to an adverse effect on competition through the inefficient allocation of costs to parties and the scope it creates for gaming, which reduces the efficiency and, therefore, the competitiveness of domestic and microbusiness retail gas supply.
- 5.91 In reaching this view, we have considered in particular parties' submissions, which have suggested that:
- (a) the infrequent updating of the annual quantities³¹³ (AQs) can result in shippers being faced with charges for gas that are inaccurate; this in turn provides inaccurate price signals to suppliers, which distorts the incentives to introduce new products;

³¹³ Each meter has an annual quantity (AQ) assigned to it, which is the expected annual consumption of the meter point. This expectation is based on historical metered volumes and seasonal normal weather conditions.

- (b) the possibility of gaming the AQ system, due to the absence of efficient mechanisms to reconcile estimated consumption with actual consumption, leads to errors in the settlement process that ultimately impact competition and final consumers; and
 - (c) the presence of unidentified gas distorts competition between domestic/ SME and non-domestic suppliers and leads to the inefficient allocation of costs to parties.
- 5.92 As noted in our provisional findings report, Ofgem has approved a modification proposal (known as Project Nexus) designed to address some of these concerns. This included a modification to the Uniform Network Code that would lead to:
- (a) reconciliation at all individual gas meter points;
 - (b) the opportunity for monthly rather than annual updating of the AQ (also referred to as rolling AQ);
 - (c) the possibility for independent gas transporters to use the same systems and processes as other gas transporters; and
 - (d) the potential for automated retrospective adjustment following meter reads where previously submitted data is shown to have been incorrect.
- 5.93 We acknowledged in our provisional findings report that Project Nexus was likely to address most of the current inefficiencies in the gas settlement system set out in paragraph 5.91 above. However, we were concerned that even after implementation of Project Nexus, the gas settlement process would still be characterised by the presence of a (residual) amount of unidentified gas, inefficiencies in the allocation of the cost of this residual unidentified gas, as well as incentives that shippers face to place a higher priority on adjusting AQs down (and delaying adjusting AQs up, so as to game the gas settlement system).
- 5.94 In addition, we noted in the provisional findings report our concerns relating to the implementation of Project Nexus, ie:
- (a) the slow pace of its implementation;
 - (b) the lack of a binding time frame for its implementation (at the time of our provisional findings report, no such time frame had been set); and
 - (c) the fact that some market participants may be adversely affected by these delays.

Update on our analysis of the inefficiencies arising from the gas settlement process

- 5.95 Following the publication of our provisional findings, we have further investigated whether the infrequent updating of AQs, the potential for gaming the gas settlement system and the presence of unidentified gas are likely to lead to inefficiencies in the system even after implementation of Project Nexus.
- 5.96 We consider that the main cause of inefficiency in the gas settlement process arises from the process of allocating unidentified gas between suppliers. A recent report from the Allocation of Unidentified Gas Expert puts the cost of unidentified gas at £119 million in 2015/16 and considers that the majority of this cost is due to undetected theft.³¹⁴ Some shippers believe this figure is an underestimate and suggest that its costs might be nearer £300 million annually.
- 5.97 The cost of unidentified gas is borne disproportionately by the Smaller Supply Point sector, which are typically domestic and microbusinesses customers. A reduction in the amount of unidentified gas and a more evidence-based allocation of its costs between parties will increase the efficiency and therefore the competitiveness of domestic and microbusiness retail gas supply.
- 5.98 In addition to theft, other factors are contributing to unidentified gas. An independent report commissioned by Ofgem identified 40 different issues contributing to unidentified gas. These included shipperless sites, unregistered sites and offtake meter errors.³¹⁵
- 5.99 Whilst Project Nexus will create a framework providing the opportunity for updating AQs on a monthly (rather than annual) basis, and allowing for retrospective adjustments, it will have a limited impact³¹⁶ on the incentives of shippers and suppliers to sufficiently increase the frequency of these updates to a point that would materially reduce unidentified gas.
- 5.100 We have also considered the potential for gaming of the gas settlement system. In our provisional findings report, we noted (paragraph 8.273) the incentives that shippers face to place a higher priority on adjusting AQs

³¹⁴ [2014 Allocation of Unidentified Gas Final Table for 2015/16](#).

³¹⁵ Ofgem's additional submission to the CMA, 18 September 2015.

³¹⁶ While Project Nexus will remove existing system constraints, it will not, for example, change shippers' and suppliers' incentives on how often to submit meter readings for the reasons set out in paragraph 5.100. We also note that shippers and suppliers are currently required to submit a meter read for only 70% of their smaller supply points each year.

down and delaying adjusting AQs up, even after Project Nexus is implemented. This is because parties might still gain financially, in terms of reduced imbalance and settlement costs, from delaying the updates of their customers' AQs, particularly in circumstances where the update of a customer's AQ would lead to an upward revision of an AQ.³¹⁷

- 5.101 In view of the above, it remains the case that we provisionally consider that the current system of gas settlement gives rise to an adverse effect on competition through the inefficient allocation of costs to parties, and in particular of costs arising from unidentified gas (and the scope it creates for gaming). The aim of our proposed remedial action is therefore to ensure that rules designed to address the inefficient allocation of costs, and in particular of costs arising from unidentified gas, are put in place.
- 5.102 In our Remedies Notice, we considered two possible separate remedies:
- (a) a requirement on Xoserve and gas suppliers to ensure that Project Nexus is implemented within a given timeframe in order to address most of the current inefficiencies in the gas settlement system without undue delay; and
 - (b) mandatory submissions of monthly updates to AQs in order to address the scope for gaming.
- 5.103 For the reasons discussed below, we have provisionally decided to proceed with alternative proposed remedies that we consider more effective and proportionate in addressing the Gas Settlement AEC and associated detriment.

Requirement to ensure Project Nexus is implemented in a timely manner

- *Aim of the remedy*

- 5.104 As discussed above, the implementation of Project Nexus would address most of the above-mentioned issues that we identified in our provisional findings report and, in turn, contribute to remedying the Gas Settlement AEC. This proposed remedy would seek to ensure that, in addition to resolving remaining issues, appropriate mechanisms are put in place in order to ensure that Project Nexus is implemented in a timely manner across the industry.

³¹⁷ ie when a particular customer has consumed more gas than expected pursuant to its profile.

5.105 We note that the ultimate aim of any remedy we propose is to address, in part, the detriment arising from the Gas Settlement AEC.

- *Parties' views*

5.106 Many respondents to our provisional findings submitted that a new implementation date for Project Nexus had now been agreed by industry (1 October 2016). The majority of respondents considered that the new implementation date was likely to be achieved and said that Ofgem was the appropriate authority to lead the change. Some parties therefore considered that it was no longer necessary for the CMA to implement a remedy in this area.

5.107 Ofgem submitted that Project Nexus was already being implemented and that it considered the revised date and process to be robust. It also said that it had put in place measures designed to prevent further delays in implementation (see below).³¹⁸

5.108 However, some parties expressed concerns that the implementation date might slip further.³¹⁹ Centrica submitted that the CMA should impose a remedy requiring delivery of Project Nexus by the new date that had been agreed by industry.³²⁰

5.109 E.ON said that Project Nexus should be a priority for the industry and that timescales should not slip further. It argued that the CMA should make a recommendation to Ofgem to implement this remedy. E.ON added that a licence obligation was a sensible route to deliver the remedy but that this obligation should be placed on gas transporters rather than suppliers because Xoserve (the agent of gas transporters) was responsible for the delay.³²¹

5.110 Total Gas & Power agreed that a licence obligation should not be placed on suppliers.³²² Ecotricity felt that pushing through an additional licence modification would waste time and detract from the task at hand.³²³

³¹⁸ Ofgem response to Remedies Notice, paragraph 1.

³¹⁹ Centrica response to Remedies Notice, p98, paragraph 365.

³²⁰ *ibid*, p98, paragraph 365.

³²¹ E.ON response to Remedies Notice, p74.

³²² Total Gas & Power response to Remedies Notice, p10.

³²³ Ecotricity response to Remedies Notice, p9.

- 5.111 Scottish Power³²⁴ and Utility Warehouse³²⁵ proposed the imposition of financial penalties on Xoserve and/or gas transporters who caused Project Nexus to slip further. RWE proposed that Xoserve be held accountable for costs and overruns (but noted that financial penalties would ordinarily be on gas transporters and not Xoserve).³²⁶ In particular, RWE believed that a requirement to deliver Project Nexus by 1 October 2016 should be introduced in gas transporters' standard licence conditions and that there should be penalties for non-compliance which should reflect the impact that the delayed implementation of Project Nexus had on gas shippers and their customers.³²⁷ Similarly, Scottish Power said that relevant standard licence conditions or the Uniform Network Code should be amended with a view to imposing liabilities on gas transporters were Project Nexus to be delivered after 1 October 2016. It considered that this would be proportionate and effective and that the CMA should make a recommendation to Ofgem to make such an amendment.³²⁸
- 5.112 First Utility said that there was still a risk that some smaller shippers – as they had not been able to engage fully with the Project – might not be ready for the new implementation date. First Utility noted that that Project Nexus went live where more than 50% of relevant categories of shippers were ready.³²⁹ It considered that the CMA should recommend to Ofgem that it continue its current role within Project Nexus.³³⁰ Ovo Energy said it had been led to believe that many industry parties considered Xoserve's lack of readiness as the main reason for the delay to Project Nexus and that it was unsure as to whether this remedy would make a material difference.³³¹ Good Energy was concerned that any action to accelerate Project Nexus would place more costs on suppliers.³³² Corona Energy noted that there was little point insisting on timely implementation unless the industry as a whole could be sure that implementation would be effective.³³³

- *Design considerations*

- 5.113 As noted above, a number of developments relating to the implementation of Project Nexus have occurred since the publication of our provisional findings

³²⁴ Scottish Power response to remedies notice, p44.

³²⁵ Utility Warehouse response to Remedies Notice, pp14–15.

³²⁶ RWE response to Remedies Notice, pp117–118.

³²⁷ RWE response to Remedies Notice, pp117–118.

³²⁸ Scottish Power response to Remedies Notice, p44, paragraph 12.3.

³²⁹ First Utility response to provisional findings and Remedies Notice, p48, paragraph 3.128.

³³⁰ *ibid*, paragraph 3.130.

³³¹ Ovo Energy response to Remedies Notice, pp35–36.

³³² Good Energy response to Remedies Notice, p9.

³³³ Corona Energy response to Remedies Notice, p13.

report. In particular, Ofgem has set up a governance structure for its implementation. This includes the appointment of a Project Nexus Implementation Steering Group and of an independent project assurance manager (in this case, the consultancy PwC).

- 5.114 Following an interim report from PwC showing that the original deadline that had been set out for implementation of Project Nexus (1 October 2015) was no longer a viable implementation date,³³⁴ an implementation plan (including a new implementation date, 1 October 2016) was agreed in July 2015 between Ofgem and the Project Nexus Implementation Steering Group.
- 5.115 As a result, National Grid raised modification proposal UNC 548, which was approved by Ofgem on 12 August 2015,³³⁵ making the new implementation date binding for the Uniform Network Code parties. In addition to setting a new implementation date, this modification also introduced into the Uniform Network Code certain mechanisms (also included in the implementation plan) to ensure that Project Nexus is implemented by 1 October 2016 across the industry. In particular, the Uniform Network Code now includes a series of interim milestones centred around the Uniform Network Code parties' readiness for market trials, which are designed to provide greater assurance of progress, and if necessary allow for further mitigating actions to be considered by Ofgem. Moreover, the ability to modify the implementation date (without the need for a further Uniform Network Code modification proposal) has been transferred from the Uniform Network Code Committee (ie the industry) to Ofgem.
- 5.116 The above-mentioned milestones will be monitored by Ofgem and the Project Nexus Implementation Steering Group with a view to avoiding further delays.
- 5.117 We note that a number of actions remain to be taken by various stakeholders in order to ensure an efficient and consistent delivery of Project Nexus, including market trials. Having reviewed parties' submissions, we consider that 1 October 2016 is an appropriate implementation date. Further, given these recent developments, and in particular the establishment of a strong project governance under the supervision of Ofgem, we consider that the risk of Project Nexus not being delivered in a timely manner has significantly decreased.

³³⁴ See Ofgem, 18 May 2015, [Open Letter: Project Nexus implementation](#).

³³⁵ See [Uniform Network Code \(UNC\) 548: Project Nexus – deferral of implementation date \(UNC548\)](#).

- 5.118 In order to achieve implementation by 1 October 2016, we believe that Ofgem must continue monitoring closely the implementation of Project Nexus by the industry, and if appropriate use its powers under section 28 of the GA86 to sanction gas shippers³³⁶ that neglect to take necessary steps (eg failing to set up necessary systems and carry out trials in line with the milestones).
- 5.119 In light of the above, we are proposing to recommend that Ofgem (a) ensure implementation of Project Nexus by 1 October 2016 through monitoring closely the progress made by the industry in meeting intermediate milestones concerning the implementation of Project Nexus; and (b) take (where appropriate) further measures to achieve this objective (for instance if a party fails to meet those milestones).
- 5.120 We have noted the modification proposal raised by a Uniform Network Code party (RWE) to introduce in the Uniform Network Code an incentive payments scheme pursuant to which, if one or more gas transporters are determined to be responsible for a specific failure, leading to a deferral of the implementation date beyond 1 October 2016, payments are to be made to shippers.³³⁷
- 5.121 While we recognise that this modification proposal could, in principle, contribute to ensuring a timely delivery of Project Nexus, we have not investigated the merits of this proposal, nor have we reached any definitive view on this matter. We consider that the industry and Ofgem are better placed than the CMA to determine whether, in practice and taking into consideration the circumstances of Project Nexus, such a mechanism would facilitate a timely implementation, and how it would work.
- *Effectiveness of the proposed remedy*
- 5.122 As noted above, we believe that the governance structure set up by Ofgem will facilitate a timely and effective implementation of Project Nexus. As a result of UNC 548 which has included the milestones and implementation date into the relevant standard licence conditions, we believe that Ofgem has been given appropriate tools to monitor steps taken by the industry to

³³⁶ For instance, we note that under section 28 of the GA86 Ofgem could sanction a gas transporter for breach of its licence conditions, which incorporates the substantive provisions of the Uniform Network Code (including therefore compliance with the milestones for implementation of Project Nexus). Gas shippers' SLC 3(2) provides that a gas shipper shall not knowingly or recklessly pursue any course of conduct which is likely to prejudice, among other things, the due functioning of the arrangements provided for in its network code.

³³⁷ UNC 550: [Project Nexus – Incentivising Central Project Delivery](#).

implement Project Nexus and to take appropriate measures to ensure implementation by 1 October 2016.

- 5.123 However, we have noted that some parties have expressed concerns that the implementation date might slip further. Evidence of these concerns is the modification proposal raised by RWE to introduce incentive payments should the implementation of Project Nexus be further delayed beyond 1 October 2016. This suggests that certain Uniform Network Code parties, which have or may have incentives in postponing the implementation of Project Nexus (and the costs implied by it), may fail to take certain necessary steps and lobby Ofgem to obtain a further delay.
- 5.124 A recommendation to Ofgem to carry forward its ongoing work will provide additional support to Ofgem and a clear steer to stakeholders. We believe that ongoing close monitoring will reduce the risk of any further postponement of the implementation date, unless appropriately justified (which we cannot see at the moment). However, as we believe that Ofgem has the powers and incentives to act upon our recommendation, we do not consider that any direct intervention by the CMA would increase the likelihood of a timely and effective implementation of Project Nexus.
- 5.125 In view of the above, we consider that a recommendation to Ofgem to monitor implementation and, where appropriate, take appropriate measures to ensure implementation by 1 October 2016, would be effective to ensure a timely implementation of Project Nexus. This in turn will contribute significantly to addressing the detriment arising from the Gas Settlement AEC.

- *Proportionality of the proposed remedy*

- 5.126 We also provisionally consider that a recommendation to Ofgem to ensure implementation of Project Nexus by the date agreed with the industry through monitoring closely the progress by the industry and to take (where appropriate) further measures to achieve this objective, would not impose any cost on the industry. While it would require Ofgem to invest sufficient resources to monitor implementation of Project Nexus, we understand Ofgem has already allocated some resources to monitoring Project Nexus. As a result, the incremental costs of this proposed remedy are negligible, in particular, compared with the inefficiencies that are being addressed through the implementation of Project Nexus. For these reasons, we consider that the proposed remedy is no more onerous than necessary and does not produce disadvantages that are disproportionate to its aim.

- 5.127 For the reasons set out above, we believe that a remedy imposed by way of an order by the CMA, as consulted upon in the Remedies Notice, would be more intrusive without being more effective in achieving its aim. Accordingly, we believe our propose remedy is the least intrusive of equally effective alternatives.

Remedies seeking to address inefficient allocation of costs between gas shippers arising from the gas settlement process

- 5.128 As noted above, we have provisionally found that the current system of gas settlement is a feature in the domestic and SME retail gas markets that gives rise to an adverse effect on competition through the inefficient allocation of costs of unidentified gas to parties and the scope it creates for gaming, which reduces the efficiency and, therefore, the competitiveness of domestic and microbusiness retail gas supply.
- 5.129 While we have noted that Project Nexus is likely to address most of the current inefficiencies in the gas settlement system identified, we believe that inefficiencies in the allocation of the costs of unidentified gas and the incentives that shippers face to place a higher priority on adjusting AQs down and delaying adjusting AQs up will still be present after Project Nexus is implemented, leading to inaccurate reporting of customers' consumption and therefore inefficiencies in the allocation of the cost of unidentified gas.
- 5.130 For the reasons set out below, we are proposing to proceed with three proposed remedies, which are complementary to each other, and as a package would increase suppliers' incentives to provide more accurate and frequent updates on individual supply points, reduce the amount of unidentified gas and improve the allocation of its costs between suppliers.

- *Aim of the remedies package*

- 5.131 The purpose of this proposed remedies package is to increase the accuracy of the gas settlement system with a view to reducing, to the extent possible, unidentified gas, and therefore the inefficient allocation of costs between suppliers. It should also reduce the scope for gaming.
- 5.132 Accordingly, the ultimate aim of the proposed remedies package is to address, in part, the detriment arising from the Gas Settlement AEC.

- *Parties' views*

- 5.133 In the Remedies Notice, we proposed imposing an obligation on suppliers to update their customers' AQs on a monthly basis. Most respondents to our

Remedies Notice considered that implementation of this possible remedy would be impractical until the majority of customers had a smart meter. Suppliers would need to visit customers' premises to obtain monthly meter reads and this would be costly. Further, some parties noted that there was no evidence of AQ gaming and proposed some alternative possible remedies.

- 5.134 Centrica considered the remedy to be disproportionate. It considered that a more proportionate response would be the introduction of a performance assurance framework. It also pointed out that there was no evidence of gaming. It said that, if implemented, the remedy would cost Centrica approximately £85 million to collect actual monthly readings.³³⁸
- 5.135 E.ON believed that the benefits of the remedy could be achieved in a more proportionate way through the introduction of a performance assurance framework to ensure meter read frequency was appropriate and any delays in meter read submissions were penalised properly.³³⁹
- 5.136 Scottish Power called for a revised remedy to be implemented. It noted that currently there was no requirement for meter readings received by a supplier to be uploaded to Project Nexus. Its revised remedy would include: (a) to upload monthly meter readings for non-daily metered sites where a smart meter was installed and working; and (b) where there was no smart meter to upload any meter read taken (except where the reading would not be processed because of UK-Link restrictions).³⁴⁰
- 5.137 Also, Scottish Power said that a performance assurance regime under Project Nexus was required. It had raised a modification proposal, UNC Mod 506V,³⁴¹ to introduce such a regime in the Uniform Network Code with a view to reducing unidentified gas, but considered that progress on the development of this modification proposal had been slow. It therefore called for the CMA to make a recommendation to Ofgem to accelerate this process.³⁴²
- 5.138 EDF Energy said that it did not support a remedy requiring monthly updates of all AQs, as it considered this to be both impractical and disproportionate under the current metering regime. EDF Energy noted, however, that a requirement to provide a monthly update of the AQ for which suppliers had a

³³⁸ Centrica response to Remedies Notice, pp98–99.

³³⁹ E.ON response to Remedies Notice, p75.

³⁴⁰ Scottish Power response to Remedies Notice, p45, paragraph 12.10.

³⁴¹ This proposal was subsequently approved by [Ofgem on 17 December 2015](#).

³⁴² Scottish Power response to remedies notice, p46, paragraph 12.13.

meter read would be feasible from an operational perspective but would be enacted as part of the Project Nexus regime of rolling AQ.³⁴³

- 5.139 RWE considered that a new licence condition on gas shippers to make monthly submissions of AQ updates mandatory was a disproportionate response to an issue that was already being addressed through Project Nexus and existing proposals for a Gas Performance Assurance Framework. According to RWE the proposed requirement to order monthly submissions would impose significant costs, be operationally challenging and put additional stress on an industry sector that was already undergoing significant changes.³⁴⁴
- 5.140 Corona Energy similarly deemed the remedy disproportionate and onerous for suppliers who were already trying to deliver Project Nexus.³⁴⁵
- 5.141 SSE considered that this remedy was not needed given the imminent implementation of Project Nexus. It said that, with the implementation of Project Nexus, gas would be reconciled back to actual meter readings and as a result shippers would have an incentive to ensure AQ values were as accurate as possible so as to minimise imbalance charges (which might potentially result in the shipper having to buy extra energy at a higher price).³⁴⁶ ICoSS,³⁴⁷ Ecotricity³⁴⁸ and Gazprom³⁴⁹ concurred with this view.
- 5.142 Further, SSE said that the remedy would be impractical and disproportionate and could not be implemented before implementation of Project Nexus due to technical system limitations and industry governance processes. It suggested that there might still be a theoretical opportunity to game the system post Project Nexus (AQs were used for calculating transportation charges) but considered this risk to be unlikely to occur in practice due to (a) the minimal benefits to be achieved; (b) the complexity of seeking to manipulate the AQs to benefit from transportation charges; (c) the specific system requirements to allow such gaming to take place.³⁵⁰ Ecotricity³⁵¹ agreed that a lot of effort would be required to game the AQ system post Project Nexus. Additionally SSE said that it did not believe that specified targets were required for a performance assurance framework at

³⁴³ EDF Energy response to Remedies Notice, p46.

³⁴⁴ RWE response to Remedies Notice, pp119–120.

³⁴⁵ Corona Energy response to Remedies Notice, p14.

³⁴⁶ SSE response to Remedies Notice, paragraph 3.18.1.

³⁴⁷ ICoSS response to Remedies Notice, p16.

³⁴⁸ Ecotricity response to Remedies Notice, p9.

³⁴⁹ Gazprom response to Remedies Notice, p19.

³⁵⁰ SSE response to Remedies Notice, paragraph 3.18.1.

³⁵¹ Ecotricity response to Remedies Notice, p9.

this stage and was not convinced that the performance assurance framework would find any evidence of inappropriate behaviours connected to settlement.³⁵²

- 5.143 Opus Energy agreed that the potential for gaming AQ updates should be largely removed with the implementation of Project Nexus but supported the introduction of a performance assurance framework as a more proportionate solution than mandating monthly AQs.³⁵³
- 5.144 First Utility did not support mandating monthly meter read submissions because shippers themselves did not receive monthly reads for traditional meters. However, it was in favour of such a remedy if restricted to smart gas meters, since the latter had working communications and a monthly read was available. It considered that a mandatory monthly obligation for smart meter reads would resolve the AQ gaming issues as the smart programme progressed.³⁵⁴
- 5.145 Ofgem submitted that in order for energy costs to be accurately targeted, the accuracy of AQs must improve and that this would depend on greater frequency and accuracy of meter reads being submitted to Xoserve and entered into settlements. This would be facilitated by, and to an extent dependent upon, the roll-out of smart meters and enhanced central systems. However, while an AQ update would be possible each month before implementation of Project Nexus, Ofgem did not consider that this should necessarily be mandated.³⁵⁵
- 5.146 Ofgem thought that meter read performance targets should instead be determined according to an evidence-based performance assurance regime. Such a regime should balance improvements to settlement risk against the costs of achieving such targets. It added that it was currently working with industry parties to develop such a regime, and Uniform Network Code modification proposals were currently under development.³⁵⁶
- 5.147 Co-operative Energy said that it would be in favour of any mechanism which facilitated an increase in the frequency of which AQs could be updated.³⁵⁷ Ecotricity said that it would be more appropriate to focus on meter read performance and require submission of meter reads.³⁵⁸ Both suppliers felt

³⁵² SSE response to Remedies Notice, paragraph 3.18.5.

³⁵³ Opus Energy response to Remedies Notice, p21.

³⁵⁴ First Utility response to provisional findings and Remedies Notice, p48, paragraph 3.132.

³⁵⁵ Ofgem response to Remedies Notice, paragraph 1.1.

³⁵⁶ Ofgem response to Remedies Notice, paragraph 1.2.

³⁵⁷ Co-operative Energy response to Remedies Notice, p22.

³⁵⁸ Ecotricity response to Remedies Notice, p9.

that the shipper should be able to challenge or amend incorrect meter reads and AQs.³⁵⁹

5.148 Total Gas & Power said that after the implementation of Project Nexus there should continue to be monitoring of and action taken against suppliers who were proven to be gaming AQ updates.³⁶⁰

5.149 Ovo Energy³⁶¹ and Good Energy³⁶² were in favour of the remedy. They considered that it would reduce gaming and impose transparency in the gas settlement process. Ovo Energy was confident that the efficiency savings gained from having a fairer market would exceed the increase in operational costs that might occur as a result of shippers having to report their AQs on a more frequent basis.³⁶³

5.150 Citizens Advice said that the performance assurance regime in the electricity sector was much stronger than in the gas sector, and that an equivalent regime in gas might be needed. It said that an audit process or random spot checks could provide a credible deterrent to gaming.³⁶⁴

- *Design considerations*

5.151 Based on the submissions received from parties and our own analysis, we consider that the implementation of the remedy originally consulted upon in the Remedies Notice, ie a mandatory submission of monthly updates to AQs, would be impractical and costly until the majority of customers have a smart/advanced meter installed. This is because, in the absence of smart/advanced meters, for the majority of domestic and microbusiness customers, meter readings can only be obtained through a site visit or directly from the customer. Once smart/advanced meters have been rolled out, meter readings can be obtained remotely.

5.152 Suppliers are already required under the Uniform Network Code to read customers' meters at least once a year for billing purposes. However, the Uniform Network Code only requires that shippers submit meter reads for 70% of all non-daily metered supply points³⁶⁵ annually (ie suppliers may

³⁵⁹ Ecotricity response to Remedies Notice, p9; Co-operative Energy response to Remedies Notice, p22.

³⁶⁰ Total Gas & Power response to Remedies Notice, p11.

³⁶¹ Ovo Energy response to Remedies Notice, pp36–37.

³⁶² Good Energy response to Remedies Notice, p9.

³⁶³ Ovo Energy response to Remedies Notice, pp37–38.

³⁶⁴ Citizens Advice response to Remedies Notice, p56.

³⁶⁵ These are customers whose consumption is not provided to gas transporters on a daily basis. These are divided into: Smaller Supply Points (SSPs), ie meter points that have an annual consumption of not more than 73,200 kWh (typically domestic customers and smaller business premises); and Larger Supply Points (LSPs), ie meter points that have an annual consumption between 73,200 and 58.6 million kWh. LSPs can be further

decide not to submit up to 30% of the meter reads they have collected in a year).³⁶⁶

- 5.153 An Ofgem request for information on AQs, issued in January 2015, found that most suppliers read a high proportion of meters at least once every six months, and that these meter reads were largely being entered into Xoserve's central settlement systems. However, it also suggested that there was substantial scope for improvement.³⁶⁷
- 5.154 While we accept that collecting monthly meter reads for 'dumb' meters would significantly increase costs for shippers and suppliers (and may be burdensome for customers), we believe that the current option of not submitting the meter reads that have been collected (as is currently possible under the Uniform Network Code) is inefficient as it undermines the accuracy of the gas settlement process and gives rise to the scope for gaming. We note in this respect that the process of submitting a meter read to Xoserve has no, or negligible, costs for shippers and suppliers once the meter has been read.
- 5.155 With respect to customers on smart or advanced³⁶⁸ meters, their meters can be read remotely by suppliers and shippers.³⁶⁹ The cost of doing so is thus small (absent malfunction) and therefore collecting and submitting meter readings on a monthly basis would not face the same problems and costs identified in paragraph 5.151.
- 5.156 For the reasons set out below, we are proposing, in lieu of the remedy consulted upon in the Remedies Notice, to implement a proposed remedies package consisting of the following elements:
- (a) With respect to all non-daily metered supply point in Great Britain with a dumb meter,³⁷⁰ we propose to impose an order on gas suppliers (and amend the gas suppliers' standard licence conditions accordingly) to submit to Xoserve meter readings as soon as they become available (eg if provided by the customer or obtained by the shipper/supplier), and at least once per year (ie consistent with the existing obligation under the Uniform Network Code to read customers' meters at least once a year).

subdivided into those with annually read meters (73,200 to 293,000 kWh) and monthly read meters (293,000 to 58.6 million kWh).

³⁶⁶ UNC Section M.

³⁶⁷ Ofgem response to Remedies Notice, p 92

³⁶⁸ ie any gas meter which can be read remotely. These meters can be read remotely by suppliers/shippers and have a number of additional functionalities. See Appendix 5.2, paragraph 10, for further details.

³⁶⁹ Both SMETS 1 and SMETS 2.

³⁷⁰ ie any gas meter which cannot be read remotely.

- (b) With respect to all non-daily metered supply point with a smart or advanced meter, we propose to impose an order on gas suppliers (and amend the gas suppliers' standard licence conditions accordingly) to submit to Xoserve meter readings at least once per month (unless for reasons of malfunction or related issues it was not possible to take such a meter reading).
- (c) We propose to make a recommendation to Ofgem to take appropriate steps to ensure that a performance assurance framework is established within a year of the publication of the CMA's final report (see paragraph 5.181 below).

5.157 The first two elements of this remedies package would be obligations on gas suppliers that are designed to increase the accuracy of the gas settlement process. The third element is designed to facilitate compliance with these two obligations and to put in place additional measures which are aimed at reducing the amount of unidentified gas. Another objective of the performance assurance framework is to contribute to a more efficient allocation of costs arising from the residual unidentified gas between suppliers.

Obligations on gas suppliers to submit meter readings to a particular frequency

- *Assessment of effectiveness*

- 5.158 The two obligations we propose to impose on gas suppliers will ensure that (a) as regards dumb meters, meter readings that are collected by suppliers (eg pursuant to the obligation under the Uniform Network Code to read meters at least once per year) are submitted to Xoserve without undue delay; and (b) as regards smart or advanced meters (representing approximately 1.6 million customers³⁷¹), meter readings are collected by suppliers and submitted to Xoserve at least once per month.
- 5.159 Both obligations will improve the accuracy of AQs and facilitate all metered energy consumption being reconciled on a timely basis (ie using actual rather than estimated consumption in the settlement process). This in turn should lead to a more efficient allocation of costs between shippers and suppliers (due to the use of actual consumption data) and a reduction in unidentified gas (which would also contribute to a more efficient allocation of its costs between shippers and suppliers). In addition, we note that it would

³⁷¹ See DECC, [Smart Meters, Great Britain, Quarterly report to end September 2015](#), p4.

reduce any potential ability for suppliers to delay the reconciliation of any given supply point in order to game the system.

5.160 As regards implementation, we are proposing to impose an order on suppliers concerning the above obligations, together with the introduction of a licence condition. We consider that the simple terms of the proposed order, set out above, would be clear to suppliers, and also to other interested parties such as Xoserve and Ofgem (who would have responsibility, together with the CMA, for monitoring compliance).

5.161 We also consider that the proposed order would be straightforward to implement, given that suppliers are either already obligated to collect the relevant information (as regards the obligation concerning dumb meter readings) or are readily able to collect the relevant information (as regards the obligation concerning smart meters). We also understand that Xoserve's systems are already capable of handling a heavier meter read frequency, and this will improve further once Project Nexus has been implemented.

5.162 We note that, by introducing new licence conditions, Ofgem would be under a duty to maintain compliance. It would also be in a position to require the provision of information from suppliers concerning potential breaches of the licence conditions. Xoserve can readily inform Ofgem as to suppliers' compliance with the licence conditions, and Ofgem will be able directly to enforce against any breach of the licence conditions. This will further reduce the incentives of suppliers to game the system.

5.163 In terms of timescale for implementation, we would expect suppliers to start complying with the obligations, at the latest, on the date of publication of our order.

- *Assessment of proportionality*

5.164 As noted above, we believe that the proposed introduction of these two obligations on gas suppliers will be effective in achieving their aim of increasing the accuracy of the gas settlement process by contributing to the efficient allocation of costs. It will also reduce any residual incentive to game the system. Accordingly, the proposed remedy will address, in part, the detriment arising from the Gas Settlement AEC.

5.165 As noted above, no additional costs would arise from the proposed obligation to submit dumb meter readings as soon as they have been collected and at least once per year, since this will not require suppliers to collect such meter readings any more frequently than they currently do. As regards the proposed obligation to collect and submit smart and advanced

meter readings once per month, given that this can be done remotely by suppliers, we consider that little or no costs will be incurred as a result of the proposed remedy. As also noted, Xoserve will not incur increased costs concerning scaling up its systems, because it is already capable of handling the increased meter read frequency contemplated with this proposed remedy.³⁷² We provisionally consider that such costs would be outweighed by the potential benefits from increasing the accuracy and efficiency of the gas settlement system and reducing the ability for such system to be gamed.

5.166 Given the limited impact, if any, this proposed remedy will have on costs, we consider that it is no more onerous than necessary to achieve its aim and that there is no less onerous remedy that would be as effective.

5.167 We have considered the alternative possible remedy of imposing an obligation on suppliers to collect and submit dumb meter readings once per month, but, in light of parties' submissions and further consideration of the evidence, we consider that while such a possible remedy may be effective, it would be disproportionate given (a) the significant costs that would be likely to be incurred by suppliers in satisfying such an obligation; and (b) the fact that any adverse impact arising from less frequent dumb meter readings would be time-limited, and diminish over time, with the roll-out of smart meters, which is expected to be completed by the end of 2020. Accordingly, we consider that over the short term, the more limited obligations concerning dumb meter readings will be significantly more proportionate and only marginally less effective than mandatory monthly submission of dumb meter readings.

- *Duty to have regard to Ofgem's statutory duties*

5.168 Where the CMA is considering whether to take action for the purpose of modifying one or more of the conditions of a retail gas or electricity supplier's licence, in deciding whether such action would be reasonable and practicable, the CMA must 'have regard' to the relevant statutory functions of Ofgem.

5.169 Ofgem's statutory functions concerning the transmission of electricity are set out in Part 1 of the GA86, as amended by the EA10, and include (among other things) granting transmission licences, promoting efficiency and economy on the part of persons authorised by licences or exemptions to

³⁷² Xoserve has also submitted that it anticipated scaling up its systems in line with projections of shipper demand. This would correspond to increased demand for settlement product 3, ie daily readings submitted in batches available to any supply point.

transmit, distribute or supply gas, and to secure a diverse and viable long-term energy supply.

- 5.170 Ofgem's principal objective in carrying out such functions is to protect the interests of existing and future consumers of gas and electricity supply.³⁷³ The interests of such consumers are taken as a whole, including their interests in (a) the reduction of greenhouse gases, (b) the security of supply, and (c) the fulfilment by Ofgem of the objectives set out in Article 40(a) to (h) of the Gas Directive.³⁷⁴
- 5.171 We do not consider that these proposed remedies will have any (adverse) impact on suppliers' ability to meet all reasonable demands for gas supply, achieving sustainable development, security of supply or environmental concerns. In this regard, the proposed remedies will only impact the 'efficiency' limb of the Trilemma considerations built into Ofgem's statutory duties and functions.
- 5.172 As noted above, we would expect the proposed remedies to increase the accuracy of the gas settlement process, reducing the amount of unidentified gas and leading to a more efficient allocation of costs arising from it between shippers and suppliers. This will be achieved by giving suppliers and shippers appropriate incentives to increase the efficiency of gas settlement. These efficiencies, in turn, should contribute to achieving customer benefits (and in particular for domestic customers since the current system allocates the costs of unidentified gas in a disproportionate manner to such customers³⁷⁵). The proposed remedies therefore directly engage Ofgem's principal objective of protecting the interests of existing and future consumers, wherever appropriate through competition, directly pursuing certain objectives set out in the Gas Directive.³⁷⁶
- 5.173 In light of the above, we consider that the proposed remedies are consistent with Ofgem's principal objective of promoting the interests of existing and future consumers.

³⁷³ See, among others, section 3A and section 6B of the EA89.

³⁷⁴ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in gas and repealing Directive 2003/54/EC, OJ L211/55 (the Electricity Directive).

³⁷⁵ See paragraphs 5.96 & 5.97 above.

³⁷⁶ In particular Article 40 (d), (f) and (g) of the Gas Directive.

- *Assessment of effectiveness*
- 5.174 We believe that Project Nexus and the more frequent submission of meter reads, in accordance with the above proposed remedy, will partially address the concerns we have provisionally identified regarding unidentified gas. However, we do not expect these measures to eliminate it entirely. We believe that a performance assurance framework, in addition, could facilitate a more efficient allocation of the residual amount of unidentified gas between gas shippers and suppliers. In addition, a performance assurance framework could further incentivise compliance with the proposed obligations concerning the frequency of submissions of meter readings (see paragraphs 5.158 and 5.159 above).
- 5.175 In our provisional findings, we noted that Ofgem had approved modification proposal UNC 473,³⁷⁷ which replaced the existing Reconciliation by Difference methodology and reinstated the Allocation of Unidentified Gas Expert arrangements.
- 5.176 More recently Ofgem has approved two further modifications to the Uniform Network Code:
- (a) CP14/268 which puts into effect a theft detection incentive scheme from 26 October 2015;³⁷⁸ and
 - (b) UNC 506V which sets out a process for establishing a performance assurance framework within the context of the Uniform Network Code.³⁷⁹
- 5.177 While we acknowledge and endorse these positive developments, we consider that significant work is still required before the major causes of unidentified gas are identified, understood and addressed, and any residual unidentified gas allocated more efficiently. Although a performance assurance framework can now be established within the context of the Uniform Network Code, as a result of UNC 506V, the role and responsibilities of Ofgem, the code administrator and Uniform Network Code parties for the purpose of establishing and running the performance assurance framework have yet to be defined.

³⁷⁷ Uniform Network Code (UNC) 473 and 473A: Project Nexus - Allocation of Unidentified Gas.

³⁷⁸ Supply Point Administration Agreement CP14/268: Introduction of the gas theft detection incentive scheme.

³⁷⁹ Uniform Network Code (UNC) 506V/506AV: Gas Performance Assurance Framework and Governance Arrangements.

- 5.178 Further, in our provisional findings report, we noted the long lead time and difficulties of implementing major changes through the existing industry code modification process and reported on Project Nexus and other major modification proposals that have been subject to delays or have not proceeded (see Section 11 of our provisional findings report). We consider that without a remedy from the CMA, we cannot be confident that a performance assurance framework, with appropriate roles and scope set out, will be in place within a reasonable timescale and that appropriate incentives to reduce unidentified gas will be agreed by Uniform Network Code parties given the complexity of factors contributing to unidentified gas.
- 5.179 We note, in this regard, that the majority of energy suppliers who responded to our Remedies Notice were in favour of a performance assurance framework, and some were in favour of accelerating the process.
- 5.180 In order to increase incentives to identify, understand and address causes of unidentified gas, we consider that the performance assurance framework should include, but not be limited to, the following key components:
- (a) appropriate targets for unidentified gas to be reduced or, at least, maintained;
 - (b) allocation of the costs of unidentified gas to shippers and suppliers based on accurate and reliable evidence (this will be facilitated by our proposed remedy above in paragraphs 5.156(a) to 5.156(b)) so as to incentivise them to reduce the amount of unidentified gas; and
 - (c) set further appropriate incentives which encourage shippers and suppliers to meet these targets for reducing unidentified gas, including penalties for parties that do not comply with their obligations to submit meter reads as per our proposed remedies package (see paragraphs 5.156(a) and 5.156(b)).
- 5.181 In light of the above, we have provisionally decided to make a recommendation to Ofgem to:
- (a) take responsibility for the development and delivery of a performance assurance framework to increase accuracy of the gas settlement process as soon as reasonably practicable, and at the latest within one year of our final report;
 - (b) establish a project plan and allocate responsibility to Uniform Network Code parties to take actions for its implementation;
 - (c) supervise its implementation; and

(d) take appropriate steps to ensure that failure to meet targets under the performance assurance framework are sanctioned.³⁸⁰

- 5.182 As discussed above, we have identified three key components that should, at a minimum, be covered under a performance assurance framework but would encourage Ofgem to consider whether additional components would contribute to the accuracy of the settlement process and the reduction of unidentified gas and should be added to such a performance assurance framework.
- 5.183 We would expect that such a performance assurance framework will, in combination with our proposed order to increase the frequency of submissions of meter reads, provide the industry with relevant information for addressing the causes of unidentified gas. This in turn should facilitate actions being taken by Xoserve and the industry with a view to facilitating a more efficient allocation of the costs arising from unidentified gas, based on more accurate and reliable evidence, by ensuring that these costs are borne by those parties who are responsible for it. We therefore believe that the proposed performance assurance framework, by setting appropriate incentives (eg financial penalties) to reduce (or at least maintain) the amount of unidentified gas will be effective in reducing significantly the detriment arising from unidentified gas.
- 5.184 We consider that Ofgem, as sector regulator, and with its enhanced role concerning industry codes pursuant to our proposed remedies set out in Section 10, will be best placed to implement this proposed remedy following further consideration, in conjunction with Uniform Network Code parties as appropriate, of whether additional components should be included in a performance assurance framework (in addition to the key components we have identified), and the timing of key milestones in the project plan.
- 5.185 We consider that Ofgem can start to put in place steps concerning the development and delivery of a performance assurance framework immediately after (or even prior to) publication of our final report. We would expect that a project plan could be agreed and published within six months of our final report.
- *Assessment of proportionality*
- 5.186 As noted above, we believe that the proposed recommendation to Ofgem to deliver a performance assurance framework will be effective in achieving its

³⁸⁰ We would recommend that such sanctions be imposed by Ofgem.

aim of increasing the accuracy of the gas settlement process by contributing to the efficient allocation of costs through facilitating understanding of the causes of unidentified gas and incentivising it to be reduced. It will also reduce any residual incentive to game the system, as suppliers would be incentivised to meet the targets set out in the performance assurance framework. Accordingly, the proposed remedy will address, in part, the detriment arising from the Gas Settlement AEC.

- 5.187 We have not estimated the possible costs that may be incurred by Ofgem and/or suppliers from delivery and participation in the performance assurance framework. However, we believe that these would be significantly lower than the estimated cost of unidentified gas (£119 million in 2015/16 – see paragraph 5.96). For the reasons set out above, we believe that these costs arising from unidentified gas will be reduced significantly as a result of our proposed remedy.
- 5.188 Given that the overarching purpose of the performance assurance framework is to facilitate understanding the causes of unidentified gas and incentivising it to be reduced, we believe that the key components we identified in paragraph 5.180 would be the minimum that the performance assurance framework would need to contain in order to be effective. Accordingly, we consider that our proposed remedy is no more onerous than necessary to achieve its aim. We also do not believe that there is an alternative remedy that is less onerous and as effective. As noted above, the current plans to establish a performance assurance framework are not very far advanced, and we do not consider that, absent our proposed remedy, a performance assurance framework would be delivered in a timely fashion.

Remedies to address constraints on competition for prepayment customers

- 5.189 For the reasons set out in our provisional findings report and the Addendum, and as noted in Section 3 above, we believe that there are features of the domestic retail energy markets that give rise to two distinct, but related, adverse effects on competition concerning prepayment customers: one on the demand side (the Domestic Weak Customer Response AEC), and one principally concerning the supply side (the Prepayment AEC).
- 5.190 In practice, these features, and the provisional AECs arising from them, are interlinked and therefore the possible remedies we have considered, and indeed the proposed remedies that we have provisionally decided upon, contribute to addressing aspects of both provisional AECs.
- 5.191 In this section, we consider remedies that seek to address directly certain of the features giving rise to the Prepayment AEC, in particular:

- (a) Three possible remedies seeking to make better use of the available tariff codes, so as to reduce the impact of the dumb prepayment meter technical constraints we identified in the Addendum as a feature that limits the ability of all suppliers, and in particular new entrants, to innovate by offering tariff structures that meet demand from prepayment customers who do not have a smart meter. As noted in Section 3, we have investigated further the nature and causes of these technical constraints and have therefore considered three additional possible remedies to the ones identified in the Second Supplemental Remedies Notice. These possible remedies involve (a) softening SLCs 22B.7(b)³⁸¹ as regards supply to prepayment customers to enable suppliers to make better use of the limited number of tariff codes; (b) redistributing unused gas tariff codes to enhance their availability to suppliers; and (c) managing gas and electricity tariff codes centrally.
- (b) Three possible remedies aimed at increasing all suppliers' incentives, and in particular new entrants', to compete to acquire prepayment customers by enhancing prepayment customers' ability and incentives to engage in the markets and to switch to other suppliers (including by switching to tariffs available on standard meters). These involve reforming the debt assignment protocol and removing barriers that prepayment customers without a debt face when attempting to switch to a credit meter.

5.192 Other proposed remedies which we have provisionally decided upon concern prepayment customers (either as part of the broader domestic retail markets and associated proposed remedies, or specifically as distinct segments) and are considered below in paragraphs 5.360 to 5.445, in Section 6 (engagement remedies) and Section 7 (price cap). We consider the overall effectiveness and proportionality of the package of remedies in Section 8.

5.193 In the Remedies Notice we also set out two potential remedies aimed at accelerating the roll-out of smart meters for prepayment customers:

- (a) a potential remedy according to which domestic retail energy suppliers would be required to stop installing dumb prepayment meters in customers' homes and, from the point of implementation, ensure that all future installed prepayment meters are smart meters; and

³⁸¹ In both gas and electricity suppliers' licence conditions.

- (b) a potential remedy according to which domestic retail energy suppliers would be required to install smart meters in homes that currently have prepayment meters before seeking to install them in homes that currently have traditional meters.

5.194 We have decided not to pursue either of these remedies.

5.195 In relation to the first potential remedy (see paragraph 5.193(a) above), since publishing our provisional findings report and the Remedies Notice, DECC has confirmed that it is planning to implement the New and Replacement Obligation from mid-2018.³⁸² The New and Replacement Obligation will require suppliers 'to take all reasonable steps to install a compliant smart meter where a meter reaches the end of its life or where a meter is installed for the first time (eg in new build properties)'.³⁸³ Since the date of implementation of the New and Replacement Obligation reflects DECC's current assessment of what is technically feasible, we do not consider there is scope for a further remedy in this area.

5.196 In relation to the second potential remedy (see paragraph 5.193(b) above), we received a wide range of responses to this potential remedy, the majority of which were not in favour of implementing it. Parties outlined a range of concerns with this option, including the issues around installing smart meters in tall buildings, that it might reduce the efficiency (and therefore increase the cost) of the smart meter roll-out, that it might jeopardise suppliers' ability to meet the current 2020 deadline for rolling out smart meters (for all customers; not only prepayment customers), that it could have significant negative effects on prepayment customers' experiences, and that prepayment customers are likely to suffer greater detriment than other customers if there are early issues with the DCC (eg as it may prevent top-ups registering on a customer's meter). As a result, we are not proposing to pursue this remedy further.

Making better use of the available tariff codes

5.197 As set out in our provisional findings report,³⁸⁴ we consider that the introduction of smart meters will remove some of the issues currently faced by prepayment customers. The rationale behind the remedies aimed at accelerating the roll-out of smart meters to prepayment customers was that

³⁸² DECC (31 July 2015), [Smart Metering Implementation Programme: Government response to the Smart Metering Rollout Strategy consultation](#).

³⁸³ *ibid.*

³⁸⁴ See [provisional findings report](#), paragraph 127.

doing so would speed up the removal of these constraints. In the Addendum, we set out in more detail our understanding of the technical constraints suppliers face in offering a range of tariffs to prepayment customers as a result of the scarcity of gas and electricity tariff codes.³⁸⁵

- 5.198 Given our decision not to pursue these remedies (for the reasons set out above), and given that some prepayment customers may not receive smart meters until 2020, prepayment customers are likely to remain affected by these constraints for some time. As a result, we have considered whether it would be appropriate to introduce other remedies to mitigate the impact of these technical constraints in the period ahead of wider smart meter roll-out. In this section we set out three possible remedies aimed at reducing the impact of the technical constraints faced by suppliers resulting from the scarcity of gas and electricity tariff pages.
- 5.199 As noted in the Addendum and in Section 3, suppliers need access to gas and electricity tariff codes in order to offer gas and electricity prepayment tariffs to customers with dumb prepayment meters. Both the gas and electricity prepayment systems have a maximum number of tariff codes that can be allocated to suppliers, effectively limiting the number of prepayment tariffs that suppliers are able to offer.
- 5.200 In the gas prepayment system, there is currently a total of 103 gas tariff pages (each containing 11 tariff codes) that are currently allocated to existing suppliers, and no further codes are available. The majority of gas tariff pages (over 80%) are controlled by the Six Large Energy Firms, with only 18 tariff pages currently allocated to independent suppliers. As noted above in Section 3, we consider that this creates a barrier to entry and expansion, in particular, for suppliers other than the Six Large Energy Firms as they have a limited ability to offer a range of prepayment tariffs to customers with dumb meters. In addition, we note that the majority of the tariff codes held by the Six Large Energy Firms are currently not being used to offer tariffs to customers with dumb prepayment meters (see Table 5.1 below).
- 5.201 In the electricity prepayment system each supplier is allocated a 'supplier ID', which is capable of supporting a maximum of 249 tariff codes. In contrast to the gas tariff codes, where there is an unequal distribution of codes between suppliers, in the electricity prepayment system, each supplier receives the same number of tariff codes. There is a total of 99 supplier IDs

³⁸⁵ See the [Addendum](#), Appendix A.

available, of which we understand 57 are currently allocated to existing suppliers.³⁸⁶

- 5.202 In addition, the number of gas tariff codes allocated to each independent supplier is significantly lower than each independent supplier's electricity tariff codes. As noted above, over 80% of gas tariff pages are held by the Six Large Energy Firms, leaving only 18 tariff pages (containing 11 gas tariff codes each) to be shared by independent suppliers (in contrast to electricity, where each supplier receives 249 tariff codes). As a result, the absolute limit and the limited availability of gas tariff codes are the most stringent constraints on independent suppliers' ability to offer a range of prepayment tariffs to customers with dumb meters. Given that many of the prepayment tariffs offered by suppliers are dual fuel, overall, the limited availability of gas tariff codes acts as a key barrier to entry and expansion for independent suppliers in both the gas and electricity prepayment segments. We note that all parties including the Six Large Energy Firms are constrained in their ability to offer to prepayment customers with dumb meters the same range of tariffs that they make available to customers with credit meters.³⁸⁷ It also follows that prepayment meter customers are unlikely to benefit directly from the proposed remedy to remove aspects of the simpler choices component of the RMR rules (see below).
- 5.203 We also noted in the Addendum that these technical constraints do not affect suppliers' ability to offer a wider range of tariffs to prepayment customers with a smart meter (irrespective of whether the 'prepayment' function is enabled or not).
- 5.204 Regarding the number of gas tariff pages currently available, Siemens has stated that it is in the process of trying to add an additional 12 gas tariff pages to the total that can be allocated to suppliers. However, it is currently unclear when (and indeed whether) this development is likely to take place. We note that, if it goes ahead, the additional pages would improve the situation. However, we provisionally consider that the technical constraints would persist, since independent suppliers would, at most, have 30 tariff pages between them (compared with 85 allocated to the Six Large Energy Firms). For instance, if an independent supplier saw its allocation of tariff pages increase from one to two, this would, in practice, still allow the supplier to offer only a very limited number of additional prepayment tariffs to customers on dumb prepayment meters, given the operation of SLC 22B.7(b) (see paragraph 5.218 below). We note, in this regard, that several

³⁸⁶ While we note that certain suppliers may have more than one ID as a result of previous merger and acquisition activity, in practice we understand that the same tariff codes are set on each ID.

³⁸⁷ See the [Addendum](#), Appendix A, paragraph 26.

parties have noted these technical constraints and suggested we consider additional possible remedies targeted at addressing aspects of this feature.

- 5.205 In order to soften these barriers to entry and innovation, we set out below the possible remedies that we have considered and that aim to make more efficient use of the existing tariff codes. Doing so could enable parties, and in particular independent suppliers, to offer a wider range of prepayment tariffs.

Aim of the remedies

- 5.206 The aim of these possible remedies is to ensure that the limited number of gas tariff codes are allocated efficiently, and to enable both gas and electricity tariff codes to be used more efficiently. For the reasons set out in the Addendum and in Section 3 above, the lack of availability of gas tariff pages for suppliers other than the Six Large Energy Firms serves as a potential barrier to entry into and expansion within the prepayment segments, and prevents existing (especially independent) suppliers from offering a range of tariffs to customers with dumb prepayment meters.
- 5.207 In this section, we therefore set out three possible remedies we have considered aimed at mitigating the impact of the gas tariff code constraint:
- (a) softening SLC 22B.7(b);
 - (b) redistributing unused gas tariff codes; and
 - (c) managing gas and electricity tariff codes centrally.
- *Softening SLC 22B.7(b)*
- 5.208 SLC 22B.7(b) requires any difference in charges between payment methods (including costs uplifts) to be applied by a supplier in the same way to all domestic customers with the same payment method (eg across different regions). As the core tariffs offered to direct debit (and standard credit) customers generally differ by region, we understand that the effect of this standard licence condition is that suppliers that wish to offer the same core tariff to their prepayment customers are under an obligation to apply the same regional price variations to these customers. The implication is that, if a supplier decides to offer such a core tariff (ie one that has regional variations) to prepayment customers, it must use different tariff codes for each different regional variation.
- 5.209 Similarly, and as noted in the Addendum, the simpler choices component of the RMR rules restricts suppliers' ability to offer core tariffs specifically targeted at prepayment customers. As a result of the limited number of tariff

codes available to parties, and of these regulatory constraints, the number of core tariffs offered to prepayment customers may be constrained by suppliers' pricing strategy for credit meter customers.

5.210 The aim of this possible remedy is to enable suppliers to make more efficient use of the limited number of tariff codes they have (both gas and electricity) in offering prepayment tariffs to prepayment customers without being constrained by their pricing strategy for customers on credit meters. By having more freedom over whether or not to set different prices by region (or the same price across all, or a limited number of regions), suppliers may be able to offer more prepayment tariffs by making better and more efficient use of the tariff codes that have been allocated.

- *Redistributing unused gas tariff codes*

5.211 While redistributing gas tariff codes would not remove the absolute constraint on the total number of prepayment tariffs that could be offered to customers with dumb prepayment meters, it would be likely to reduce the impact of the constraint on the ability and incentives of new entrants and existing independent suppliers to compete. More specifically, this possible remedy would facilitate redistribution of unused tariff codes to suppliers that wish to offer a wider range of tariffs to customers using dumb prepayment meter infrastructure but that are currently prevented from doing so by a lack of available tariff codes.

- *Managing gas and electricity tariff codes centrally*

5.212 As with the possible remedy seeking to redistribute unused tariff codes, this possible remedy aims to increase the availability of tariff codes to suppliers, although through a more interventionist and comprehensive remedy.

5.213 For the reasons discussed below, we have provisionally decided to soften SLC 22B.7(b) and redistribute unused gas tariff codes. However, we have provisionally decided not to proceed with the possible remedy involving the central management of gas tariff codes.

Parties' views

- 5.214 We note that the three possible remedies considered in this section were suggested by parties in response to our Second Supplemental Remedies Notice.³⁸⁸
- 5.215 Scottish Power noted that having to offer a different version of its prepayment tariffs in each region exacerbated the technical constraints we provisionally identified in the Addendum. Scottish Power noted that certain elements of the RMR simpler choices rules (which we understand to be SLC 22B.7(b)) typically require a supplier to have 14 different tariff codes for its prepayment SVT in order to account for any regional variation that applies to its non-prepayment SVT. It considered that, with the removal of SLC 22B.7(b), as few as three different versions of a tariff (instead of 14) would be required to offer prices that were sufficiently reflective of regional cost differences.
- 5.216 Scottish Power also suggested rationalising the use of tariff codes through reallocating unused codes, potentially by auction. Ovo Energy, Robin Hood Energy and Citizens Advice all also considered that we should intervene to ensure a more equitable mechanism for allocating gas tariff codes between suppliers.
- 5.217 RWE proposed an alternative remedy for resolving the issues around the availability of gas tariff codes. It proposed setting aside a number of gas tariff codes to be managed centrally, for the use of all suppliers.

Design considerations

- *Softening SLC 22B.7(b)*
- 5.218 We identified in the Addendum that if all suppliers offer different prices in each of the 14 distribution regions,³⁸⁹ the total number of gas tariffs that could be offered to customers with dumb prepayment meters, across the entirety of the prepayment segments, is approximately 80 tariffs, due to the constraints of the gas tariff codes system.³⁹⁰ These 80 tariffs could comprise, for example, 30 suppliers each offering just one prepayment SVT and eight suppliers each offering a 12-month fixed tariff that is changed every two

³⁸⁸ See [responses to addendum to provisional findings and second supplemental notice of possible remedies](#)

³⁸⁹ ie the 14 electricity distribution areas (PES regions). While we note that there are only 13 gas distribution zones, we understand that, in practice, suppliers set regional variations within a core tariff based on the 14 PES regions.

³⁹⁰ This limits the total number of gas tariff codes to 1,133.

months (ie a total of 48 tariffs) – considerably fewer than the tariffs available to customers with credit meters.³⁹¹

- 5.219 In contrast, we identified that the 249 electricity tariff codes available to each supplier would allow each supplier to offer one SVT and one 12-month fixed tariff that changes approximately every two months (each with a single rate and Economy 7 variant in each of 14 regions).
- 5.220 However, Scottish Power put to us that, by offering fewer than 14 different regional versions of each tariff (eg by grouping regions with similar costs together and setting a single price for each group), suppliers could use fewer tariff codes (see paragraph 5.215). Adopting this approach would enable suppliers to offer more prepayment tariffs with the finite number of tariff codes currently available.
- 5.221 Scottish Power has estimated that grouping regions into three broader groups for the purpose of setting prices would likely be sufficient to allow suppliers to account adequately for different regional costs.³⁹² If all existing suppliers did this, the total available number of tariffs that could be offered across the segment on the gas prepayment system would be 377 (instead of 80 if prices are set differently in each of the 14 regions). This could allow, for instance, for 30 suppliers to each offer an SVT and a total of 57 12-month fixed tariffs that are changed every two months– considerably more than can be offered at present.³⁹³
- 5.222 For the electricity prepayment system, adopting Scottish Power’s proposal would enable each supplier to offer 41 different tariffs (each with a single rate and Economy 7 variant in each of three broader region groups). This could, for instance, enable each supplier to offer one SVT and up to six different 12-month fixed tariffs, each changing every two months, for example.
- 5.223 Scottish Power has submitted that it currently faces restrictions that prevent it from grouping regions together in this manner. SLC 22B.7(b) requires that any difference in charges between payment methods must be applied by a

³⁹¹ Our analysis of Energylinx data suggests that there were in the region of 40 variable and 40 fixed tariffs (of differing lengths) available to customers on credit meters at the end of Q2 2015.

³⁹² The main regional driver of costs is the difference in transmission and distribution charges across regions. Our analysis of these charges (assuming typical domestic consumption), based on figures from Ofgem (October 2015), [Regional differences in network charges](#), indicates that by grouping each of the 14 regions into one of three groups, and setting a different price for each group, it is possible to set the price of a dual fuel tariff within ±£8 of that which would recover these regional costs fully. This suggests that a supplier opting to group regions in this manner would be able to set prices that are close to those that it may have set if it had set difference prices in each region.

³⁹³ As noted above, our analysis of Energylinx data suggests that there were in the region of 40 variable and 40 fixed tariffs (of differing lengths) available to customers on credit meters at the end of Q2 2015.

supplier in the same way to all domestic customers with the same payment method. This means that if a supplier charges different prices in each region for its direct debit SVT (for example), it would also need to charge different regional prices for its prepayment SVT (with the same payment method cost adjustment for each region). If the supplier took a different approach to this, the price paid by prepayment customers in a given region may not be the cost-adjusted equivalent of the supplier's SVT in that region, and the tariff could therefore breach SLC 22B.7(b).

5.224 We recognise that this condition does not prohibit suppliers from applying the same tariff across all regions (or grouping regions presenting similar costs together for the purpose of setting regional tariff variations) in setting prices to prepayment customers. However, if a supplier chooses not to apply regional variations (or only a few) to a core tariff offered to prepayment customers, it may also have to do so for this core tariff with respect to its direct debit and standard credit customers, in order not to be in breach of SLC 22B.7(b).³⁹⁴

5.225 The intention of this remedy is not to propose that all suppliers remove regional variations for the purposes of setting prices in the prepayment (and other) segments. Rather the aim of this proposed remedy is to eliminate a barrier to suppliers that wish to do so with respect to prepayment customers in order to make more efficient use of their limited tariff codes, without being constrained by their pricing strategy with respect to other payment methods. We note therefore that, following implementation of the proposed remedy, when deciding whether to set different prices in each region (or group of regions) for prepayment customers, suppliers will have to balance the benefits of lessening the impact of the tariff code constraint against the disadvantages of offering prices that do not reflect perfectly the regional differences in cost to serve.

5.226 In view of its aim, we consider that the proposed remedy should be limited in its scope to the prepayment segments. Accordingly, we therefore propose to recommend that Ofgem:

- (a) modify suppliers' standard licence conditions to introduce an exception to SLC 22B.7(b) so as to allow a supplier to set prices to prepayment customers without applying regional cost variations which are applied to other payment methods within the same core tariff; and

³⁹⁴ In practice, most suppliers' decisions around whether to charge regional prices are likely be driven more by the larger direct debit and standard credit segments; they may be unlikely to forego the benefits of charging regional prices in those other segments purely in order to avoid the technical restrictions in the prepayment segments.

(b) deprioritise potential enforcement action pending the modification of SLC 22B.7(b) against any supplier that sets prices to prepayment customers without applying regional cost variations which are applied to other payment methods within the same core tariff.

- *Redistributing unused gas tariff codes*

5.227 As set out above and in the Addendum, the absolute limit on the number of gas tariff codes and the lack of available gas tariff codes are greater constraints on independent suppliers' ability to offer a range of prepayment tariffs to customers with dumb prepayment meters than the absolute limit on the number of electricity tariff codes.

5.228 We consider that once our proposed recommendation in relation to SLC 22B.7(b) (set out above) has been implemented, suppliers will be able to make more efficient use of both their gas and electricity prepayment tariff codes. We have considered below whether other possible remedies could further mitigate the technical issues we have identified. We provisionally consider that a further remedy would be particularly appropriate for gas, where a number of suppliers have faced considerable delays when trying to procure one or more gas tariff codes.³⁹⁵ We are therefore proposing an additional remedy that redistributes some of the unused gas tariff pages currently held by the Six Large Energy Firms, to make them available for existing suppliers and potential future new entrants.

5.229 As noted above, given that almost all suppliers' tariff offerings include a dual fuel option, there is a link between the number of gas tariff codes and electricity tariff codes a supplier uses. For example, if a supplier has only enough electricity tariff codes to offer a given number of electricity tariffs to prepayment customers, it is likely to use only enough gas tariff codes to offer the same number of gas tariffs to prepayment customers. As a result, in this case, the number of electricity tariff codes available to a supplier effectively caps the number of gas tariff codes it is able to use in practice, and vice versa.

5.230 Since each tariff a supplier offers tends to include an Economy 7 and a single-rate electricity tariff, but only a single-rate gas tariff, suppliers require twice the number of electricity tariff codes as they do gas tariff codes for

³⁹⁵ Robin Hood Energy and Ovo Energy have both outlined to the CMA the struggles they faced in having gas tariff codes allocated to them. Robin Hood Energy said that it took several months to be allocated a gas tariff page, having been told by Siemens initially that none were available; Ovo Energy was seeking a second tariff page in order to offer an additional prepayment tariff and faced similar issues.

each tariff they wish to offer.³⁹⁶ This is the case whether suppliers set different prices in each region, or whether they were to group regions as set out above under our proposed remedy softening the application of SLC 22B.7(b) for supply to prepayment customers.³⁹⁷

- 5.231 As noted already, each supplier is issued a supplier ID, which allows them to offer up to 249 electricity prepayment tariffs. Given the relationship set out above, if a supplier uses all of its 249 electricity tariff codes to offer prepayment tariffs (with Economy 7 and single-rate versions of each tariff), it would require no more than 125 gas tariff codes to offer the same range of gas tariffs (with only a single-rate tariff) to prepayment customers.³⁹⁸
- 5.232 This means that given the current constraint suppliers face on the electricity prepayment system, where they are able to offer a maximum of 249 tariffs, we consider that they could conceivably use a maximum of only 125 gas tariff codes, or 12 gas tariff pages.
- 5.233 Under this proposed remedy, therefore, the first element would be to cap the number of gas tariff pages that any supplier can hold at 12, with suppliers then making available to other suppliers any further gas tariff pages that they currently hold. We note that no supplier is currently using more than seven gas tariff pages, from which we conclude that this proposed remedy would not require suppliers to lose any tariff pages that are currently in use.
- 5.234 This element of the proposed remedy would leave all suppliers who would be required to return one or more gas tariff pages (comprising three of the Six Large Energy Firms) with between five and 11 unused tariff pages each.
- 5.235 Table 5.1 sets out the number of gas tariff pages held by each of the Six Large Energy Firms, the number of gas tariff pages they are currently using, the number of tariff pages each supplier would have to return under our

³⁹⁶ In addition, a number of suppliers have set out that they also offer electricity prepayment tariffs for customers with restricted meters. In such cases, suppliers will require more than twice as many electricity tariff codes as they do gas tariff codes. For example, [REDACTED], [REDACTED], [REDACTED].

³⁹⁷ For example, if a supplier sets different prices in each region, it will require 14 gas tariff codes for each tariff, but 28 electricity tariff codes (Economy 7 and single rate in each of 14 regions). Likewise, if a supplier decides to set prices based on three different groups of region (as discussed in paragraph 5.221), it would require three gas tariff codes, but six electricity tariff codes (Economy 7 and single rate in each of three region groups). As noted in footnote 396, some suppliers would require more than this number of electricity tariff codes.

³⁹⁸ As noted above, some suppliers require more than twice the number of electricity tariff codes as gas tariff codes (if they have prepayment customers on restricted meters). As a result, taking this 2:1 ratio gives a conservative (high) estimate of the number of gas tariff codes a supplier could conceivably use, given the constraint it faces in the number of electricity tariffs it is able to offer.

proposal, and the number of unused gas tariff pages each supplier would have after meeting the conditions of this proposed remedy.³⁹⁹

Table 5.1: The number of gas tariff pages held by the Six Large Energy Firms (in order of most gas tariff pages currently held)

<i>Supplier</i>	<i>Pages</i>	<i>Unused pages</i>	<i>Number of pages to return with cap at 12 pages</i>	<i>Remaining unused pages</i>
[X]	29	22 pages unused	17	5
[X]	15	14 pages unused (and uses 4 codes on the one page it uses)	3	11
[X]	14	Currently using 2 slots on 3 of its pages and 1 slot on each of its remaining 11 pages (a total of 17 tariff codes)	2	10
[X]	10	9 pages unused (and uses 2 codes on the one page it uses)	0	9
[X]	10	6 pages currently unused; plans to use a further 4 of these pages (leaving 2 unused)	0	6
[X]	7	16 tariff codes currently unused	0	1.5*
Total			22	

Source: Number of gas pages currently held by suppliers was provided by Siemens; remaining information came from requests for information to the Six Large Energy Firms sent on 25 September 2015.

* Approximately.

5.236 We note that this element of the proposed remedy would increase the number of gas tariff pages allotted or otherwise available for use by independent suppliers from 18 to 40 (or just over 50 if the additional tariff pages being created by Siemens become available).

5.237 Schedule 25 of the Supply Point Administration Agreement provides that gas tariff pages should be allocated equally among the suppliers based on their customer portfolio size. However, we are concerned that this rule may exacerbate the barrier to entry and expansion for independent suppliers, on the basis that compliance with this rule may lead to a broadly similar distribution of unused tariff pages as currently observed. Also, in view of the relevant provisions set out in the Supply Point Administration Agreement,⁴⁰⁰ and parties' submissions,⁴⁰¹ we understand that there are no formal mechanisms in place to monitor the allocation of gas tariff pages and to govern the distribution of tariff pages between suppliers.⁴⁰²

³⁹⁹ Centrica has advised us that it is in the process of returning a number of unused tariff pages to Siemens (Centrica response to addendum to provisional findings and second supplemental notice of possible remedies, p5).

⁴⁰⁰ Specifically paragraph 2.14 of the Supply Point Administration Agreement.

⁴⁰¹ In response to the Addendum

⁴⁰² Siemens put to us that, in the absence of 'spare' tariff pages, a request for a tariff page could only be satisfied when another supplier released one of its tariff pages.

- 5.238 In addition to proposing that three of the Six Large Energy Firms return some of their unused gas tariff pages (so they retain no more than 12 tariff pages in total), we propose to recommend that Ofgem monitor the allocation of gas tariff pages and, if appropriate, intervenes further to ensure a fairer and more efficient allocation of the gas tariff pages (see paragraphs 5.258 to 5.263 below for a discussion of the implementation of this remedy). Given the importance of gas tariff codes in entering and expanding within the prepayment segments as regards supplying to customers on dumb meters and hence their important impact on competition, we consider it essential that an independent third party should control their allocation. As noted above, both Robin Hood Energy and Ovo Energy have set out for us the difficulties they have experienced in attempting to obtain gas tariff pages under the current system, and we consider that Ofgem, as an independent regulator with specific aims of protecting consumers and monitoring and encouraging competition, is the appropriate body to manage the allocation of gas tariff codes.
- 5.239 We have also considered which mechanism Ofgem should employ to allocate tariff codes. Scottish Power suggested that suppliers with excess gas tariff codes should auction them to interested suppliers. However, we do not consider this option to be in the interests of consumers. To the extent that the scarcity of gas tariff codes enables suppliers to set prepayment tariffs above the level that would be observed in a competitive market, it is possible that suppliers wishing to acquire gas tariff codes would bid an amount that reflects the rents they would expect from entering this segment of the market. As a result, an auction may serve only to transfer profits to the suppliers that auction the tariff codes.
- 5.240 We note the limited time period over which we would expect the gas tariff slots restriction to remain a technical constraint concerning the supply of gas and electricity to prepayment customers, given the national programme for the roll-out of smart meters (for which such constraints do not arise), which is expected to be substantially completed in 2020. Accordingly, we do not propose to establish a set of formulaic rules for how Ofgem should allocate these codes to suppliers when implementing this proposed remedy. However, we would expect Ofgem to apply a range of principles, including:
- (a) Suppliers with no gas tariff pages (ie new entrants to the prepayment segments) should be prioritised over suppliers that already have tariff pages.
 - (b) Ofgem should consider whether to keep some gas tariff pages in reserve in case they are requested by a new entrant. Doing so would likely

prevent new entrants being held up while waiting for gas tariff pages to become available.

- (c) If at some point more gas tariff codes are requested than are available through the above mechanism, Ofgem should consider whether further interventions are necessary (eg use-it-or-lose-it conditions on suppliers' gas tariff pages, or an alternative method for redistributing further gas tariff pages).
 - (d) Ofgem should monitor which gas tariff pages are controlled by each supplier, and which are being used at any given time. This would make it quicker and less costly if Ofgem has to reallocate tariff codes further in future.
- 5.241 We note, by way of illustration, that if 18 of the unused tariff pages that would be reallocated by Ofgem pursuant to this proposed remedy were allocated to independent suppliers, this would double such suppliers' current allocation. For instance, a supplier with two gas tariff pages (instead of one, as is typical currently) could offer prepayment customers in three regional groups (pursuant to our proposed remedy softening the application of SLC 22B.7(b)) one prepayment SVT and six fixed prepayment tariffs (eg a new 12-month fixed tariff every two months).
- 5.242 In the first instance, we would seek to implement our proposed remedy by seeking undertakings from the Six Large Energy Firms (as the latter hold over 80% of gas tariff pages). Such undertakings would include the following three components:
- (a) a cap on the number of gas tariff pages that the supplier can hold (at 12);
 - (b) an obligation for the supplier to provide relevant information for Ofgem to monitor the allocation of the gas tariff codes; and
 - (c) a condition that allows Ofgem to mandate the transfer of one or more gas tariff pages to another supplier.
- 5.243 Absent such undertakings, we would recommend that Ofgem introduce a new licence condition in suppliers' standard licence conditions to include the three components set out above.
- 5.244 We have also noted how the parameters of gas tariff pages 13 and 14 are currently set by the Supply Point Administration Agreement. These tariff pages are available for anyone to use (eg suppliers without tariff pages of their own), so that all suppliers are able to offer prepayment tariffs. Given

that the apparent purpose of tariff pages 13 and 14 is to facilitate entry, we believe that an independent sector regulator should set the level of standing charge and unit rate rather than this being done by industry participants. Accordingly, we would encourage Ofgem to take responsibility for setting the parameters of tariff pages 13 and 14.

- *Remedy we are not minded to pursue: managing gas and electricity tariff codes centrally*

- 5.245 In addition to the two proposed remedies set out above, we also considered whether there was a case for pursuing a version of a possible remedy submitted by RWE in its response to the Second Supplemental Remedies Notice.
- 5.246 Each tariff code sets out both a standing charge and a unit rate, which together tell the prepayment meter the rate at which to decrement the customer's credit. Under RWE's proposal, a number of gas (and potentially electricity) prepayment tariff codes would be set aside to be managed centrally in such a way that they are available for all suppliers to use. The body in charge of managing the tariff codes would set a standing charge and unit rate for each tariff code, with suppliers then free to choose the tariff code (ie the combination of standing charge and unit rate) that best matches the tariff they would like to offer.
- 5.247 Under this proposed remedy, the standing charges and unit rates for each prepayment tariff code would be set centrally, meaning that no supplier could change the associated prices linked to a tariff code unilaterally.⁴⁰³ As a result, there would be greater scope for multiple suppliers to use the same set of tariff codes, thereby mitigating the constraint on the total number of tariffs that suppliers can offer. The objective of this possible remedy, therefore, would be to reduce significantly the absolute constraint on the number of prepayment tariffs that could be offered across the market, if applied to both electricity and gas.
- 5.248 Table 5.2 below sets out a stylised version of how this possible remedy might work for a gas prepayment tariff. For example, tariff code 23 would allow a gas tariff with a standing charge of 18p/day and a unit rate of

⁴⁰³ Under the current gas prepayment system, in theory a supplier can use any gas prepayment tariff code, even if it is controlled by another supplier. However, in practice firms are reluctant to use a tariff code that is not under their direct control, given the possibility that the other supplier could change the standing charge and/or unit rate applying to that tariff code unilaterally. This means that in practice, each firm uses only the gas tariff codes under its own control.

4p/kWh. Suppliers would be able to pick the combination of standing charge and unit rate that best matches the tariff they would like to offer.

Table 5.2: Stylised example of central management of gas tariff codes

Standing charge (p/day)	Unit rate (p/kwh)				
	1	2	3	4	5
10	Code 1	Code 7	Code 13	Code 19	Code 25
12	Code 2	Code 8	Code 14	Code 20	Code 26
14	Code 3	Code 9	Code 15	Code 21	Code 27
16	Code 4	Code 10	Code 16	Code 22	Code 28
18	Code 5	Code 11	Code 17	Code 23	Code 29
20	Code 6	Code 12	Code 18	Code 24	Code 30

- 5.249 It is important to note that the table above is for illustration purposes only. In practice, considerably more tariff codes would be required to give the level of detail needed by firms in setting their prices (since the increments of standing charge and unit rates would have to be considerably smaller than in Table 5.2). That is, such a remedy would be effective only if it is not overly limiting on the range of tariffs that suppliers are able to offer using the centrally managed tariff codes.
- 5.250 In deciding how many tariff codes would be needed to make such a system effective, there is a trade-off between the number of codes used and the granularity with which suppliers can set their prices. That is, since each tariff code has a standing charge and unit rate allocated to it by a central body, the supplier has to pick the code that best matches the tariff it would like to offer. As a result, it is possible that the standing charge and unit rate might not match perfectly the tariff the supplier would ideally like to offer. While this would place some limitations on the tariffs that suppliers can set, we do not consider that it makes this an unworkable solution.
- 5.251 We consider that in order to make such a system effective, it would likely require all the available gas tariff codes to be set centrally. If, for example, only some of the currently unused gas tariff codes were allocated to the central body to set (as was RWE's suggestion), we consider that suppliers may be unable to choose from a sufficiently granular set of standing charge/unit rate combinations to enable effective competition in the prepayment segments.
- 5.252 In the case of electricity tariff codes, we understand that there is a considerable number of 'supplier IDs' (each coding for up to 249 electricity tariffs) that have not yet been allocated to suppliers. As a result, we consider that for electricity, there are likely to be sufficient unallocated tariff codes to implement this possible remedy. However, it is not clear whether such a remedy would be possible without considerable upheaval in the electricity

prepayment segment. As a result, it is not clear whether it would be feasible to introduce this possible remedy for electricity in a timely manner.

- 5.253 It would be important for the central body to monitor closely how the standing charges and unit rates allocated to the tariff codes map to the actual tariffs available in the market. By doing so, it may be better able to recognise which tariff codes have fallen out of use and can therefore be allocated new standing charges and unit rates, thereby making suppliers better able to set tariffs that match those they would like to set ideally.
- 5.254 RWE's proposal suggested that the Gas Prepayment Expert Group Forum should be responsible for setting the standing charge and unit rate assigned to each tariff code. However, we consider that if we were to implement this possible remedy, it would be more appropriate for Ofgem to set and monitor the rates, for the reasons set out above.
- 5.255 In addition, suppliers wanting to offer tariffs lower than those available on the centrally managed tariff codes (eg when cutting prices in response to a reduction in wholesale prices) would have to request an adjustment to the centrally set tariff codes to include options with a lower standing charge and/or unit rate. We do not consider that it would be in the interests of competition for a supplier to have to seek approval from an industry body such as the Gas Prepayment Expert Forum (or an equivalent body for electricity) to offer lower prices than those currently available on the market.
- 5.256 We consider that this possible remedy would be of particular value if it was possible to implement it for both gas and electricity. Implementing such a remedy only for gas would remove the constraint on the total number of gas tariffs that could be offered. However, the constraints faced in the electricity prepayment system would remain, meaning that it would not remove the overall cap on the total number of prepayment tariffs that could be offered.
- 5.257 Notwithstanding the positive aspects of this possible remedy and its potential effectiveness at addressing the underlying feature of technical constraints, we consider that it would be complex, time-consuming and costly to implement and, given the limited timescale over which this feature is expected to persist, and the timescale within which our other proposed remedies can be implemented concerning the technical constraints, our provisional view is that this possible remedy would not be effective and proportionate. Accordingly, we have provisionally decided not to consider this possible remedy further. Further details of our reasoning is set out below.

How these remedies should be implemented

- 5.258 In order to make better use of the available tariff codes, and mitigate the impact of the technical constraints on competition, we have provisionally decided to recommend that Ofgem:
- (a) modify suppliers' standard licence conditions to introduce an exception to SLC 22B.7(b) so as to allow a supplier to set prices to prepayment customers without applying regional cost variations which are applied to other payment methods within the same core tariff;
 - (b) deprioritise potential enforcement action pending the modification of SLC 22B.7(b) against any supplier that sets prices to prepayment customers without applying regional cost variations which are applied to other payment methods within the same core tariff; and
 - (c) take responsibility for the efficient allocation of gas tariff pages.
- 5.259 In addition, we are proposing a recommendation to Ofgem to monitor the allocation of tariff pages so as to ensure that no supplier holds more than 12 gas tariff pages, and if necessary to take appropriate steps to allocate gas tariff pages fairly and more efficiently between suppliers. Within this context, Ofgem should consider whether it is necessary to take steps aimed at facilitating new entry in the markets (for instance by prioritising allocation of unused tariff pages to new entrants and keeping some tariff pages in reserve for this purpose).
- 5.260 In the first instance, we would seek to implement this proposed remedy by seeking undertakings from the Six Large Energy Firms. Such undertakings would include the following three components:
- (a) the cap on the number of gas tariff pages that any supplier can hold (at 12);
 - (b) an obligation for suppliers to provide relevant information for Ofgem to monitor the allocation of the gas tariff codes; and
 - (c) a condition that allows Ofgem to mandate the transfer of one or more gas tariff pages to another supplier.
- 5.261 Absent such undertakings, we would recommend that Ofgem introduce a new licence condition in suppliers' standard licence conditions to include the three components set out above.
- 5.262 We would also expect any necessary changes to be made to the Supply Point Administration Agreement.

- 5.263 Moreover, Ofgem should publish a statement setting out the principles (reflecting the aim of this proposed remedy) and process that it intends to follow prior to issuing a formal direction requesting a supplier to transfer unused gas tariff codes to another supplier.

Assessment of effectiveness

- 5.264 In assessing the effectiveness of these proposed remedies, we have considered:

- (a) the extent to which they would be expected to address the technical constraints we have identified;
- (b) the extent to which they are capable of effective implementation, monitoring and enforcement; and
- (c) the timescale over which they are likely to have an effect.

- *Addressing the technical constraints*

- 5.265 We consider that these proposed remedies, which include a recommendation to soften SLC 22B.7(b) and a recommendation that Ofgem take responsibility for the allocation of tariff pages will be effective in reducing the impact of the technical issues we have identified, which contribute to the Prepayment AEC.
- 5.266 We consider that the softening of SLC 22B.7(b) should enable suppliers to use both the available gas and electricity tariff codes in a more efficient manner, potentially increasing the total number of gas and electricity tariffs that suppliers are able to offer to prepayment customers with dumb meters using their limited tariff code allocations. We believe, however, that on its own, this remedy would only have a limited impact on suppliers' ability to offer a wider range of tariffs.
- 5.267 We also consider that a recommendation to Ofgem to take responsibility for the reallocation of tariff pages would be effective in further mitigating the impact of the technical constraints affecting independent suppliers. Reallocating 22 currently unused gas tariff pages will more than double (from 18) the number of gas tariff pages available to independent suppliers. We consider that this should significantly reduce the problems independent suppliers face in acquiring gas tariff codes, thereby reducing the barriers to entry faced by new suppliers and barriers to expansion faced by existing suppliers.

5.268 We note that two new entrants in the prepayment segments are Robin Hood Energy and Economy Energy, each of which has a single gas tariff page. While this proposed remedy may not enable suppliers to offer the same range of fixed and variable tariffs they offer to customers with credit meters, these two suppliers have demonstrated that it is possible to operate in this segment with a limited number of tariff pages. Making more tariff pages available to similar suppliers, and enabling them to use them more efficiently would likely increase the level of competition in the prepayment segments.

5.269 We consider that this proposed remedy should result in more suppliers being able to offer a wider range of tariffs to prepayment customers with dumb meters. The precise outcomes will depend on how Ofgem decides to reallocate the tariff codes.

5.270 However, this proposed remedy would not remove the absolute constraint on the number of tariffs that suppliers can offer to customers with dumb prepayment meters. As a result, suppliers will still face constraints around the range of prepayment tariffs they are able to offer; it does not solve the technical issues entirely.

- *Implementation, monitoring compliance and enforcement*

5.271 In determining whether a proposed remedy is effective, we have had regard to the need for the proposed remedy to be clear to the persons to whom it is directed, such as suppliers; and also to other interested persons, such as Ofgem (which would have responsibility for implementation, monitoring and compliance).

5.272 As regards implementation of the proposed remedies, we have set out in paragraphs 5.258 to 5.263 above the relevant undertakings or licence condition modifications that would need to be made, and the various different levels of responsibility that Ofgem should take as regards allocating gas tariff pages. In certain respects for these proposed remedies, we are leaving it open to Ofgem to determine the detailed implementation, such as to whom it reallocates gas tariff pages, and when and how. In this regard, Ofgem's information-gathering powers will enable it to procure information pertinent to reallocating tariff pages. For these reasons, we provisionally consider that Ofgem will be best placed to implement all aspects of these proposed remedies, and therefore provisionally consider that a recommendation (with or without undertakings) will be effective.

5.273 As regards monitoring compliance and enforcement, we also note that Ofgem will have a duty to monitor compliance with the new licence conditions and, as sector regulator, will be best placed to gather information

concerning compliance with the licence conditions, and any directions made concerning the allocation of gas tariff codes. As regards new licence conditions, Ofgem would also have the power to enforce against any breaches.

- *Timescale*

- 5.274 In evaluating the effectiveness of the proposed remedies, we have considered the timescale over which the Prepayment AEC would be expected to endure, and the timescale over which the proposed remedies would be likely to take effect. As regards the Prepayment AEC, our provisional view is that, absent the proposed remedies, the feature and associated AEC and detriment would persist until the national roll-out of smart meters has been substantially completed. We would expect therefore that the need for these proposed remedies would fall away at that point.
- 5.275 As regards the timescale for implementation, we consider that the proposed remedy could be implemented by suppliers within reasonable timescales, and therefore Ofgem should revise and introduce the relevant licence conditions as soon as reasonably practicable. In the meantime, we also recommend that Ofgem deprioritise potential enforcement action concerning SLC 22B.7(b) against any supplier that sets prices to prepayment customers without applying regional cost variations which are applied to other payment methods within the same core tariff.
- 5.276 We have also considered whether our proposed remedies are compliant with applicable legislation and regulations. In this regard, we note that EU law requires differences in charges between payment methods to be cost-reflective. By contrast, the provision set out in SLC 22B.7(b), which was introduced as part of Ofgem's RMR rules (with a view to simplifying the tariff choice journey), does not implement an EU provision.

Assessment of proportionality

- 5.277 In considering whether the proposed remedies would be proportionate, we have considered whether they:
- (a) are effective in achieving their legitimate aim;
 - (b) are no more onerous than needed to achieve their aim;
 - (c) are the least onerous if there is a choice between several effective measures; and

(d) do not produce disadvantages which are disproportionate to their aim.⁴⁰⁴

- 5.278 As set out above, we consider that these proposed remedies are likely to be effective in ensuring the gas tariff codes are used and allocated efficiently, so that, in part, they address the technical constraints in the prepayment segments we have provisionally found (among other features) give rise to the Prepayment AEC and associated detriment.
- 5.279 We have also considered the option of centralising the management of gas and electricity tariff pages, as an alternative to one or both of the proposed remedies. While we feel that this possible remedy could be effective in mitigating the impact of the technical constraints, we consider that it would be complex, time-consuming and costly to implement, and therefore that, given the nature of the technical constraints feature and how long we expect it to persist, we consider that this possible remedy would not be proportionate (and, possibly, also not effective on a timely basis). We consider that this possible remedy would require a more thorough overhaul of the prepayment segments, which would not be proportionate given the short period over which consumers can be expected to benefit, given the technical constraints will be entirely removed by the roll-out of smart meters, which should be substantially completed by 2020.
- 5.280 As a result, we believe that, even if this alternative possible remedy were effective, the combination of remedies we are proposing is the least onerous of the options we have considered. We also noted in paragraph 5.239 above the possibility of suppliers auctioning the unused tariff pages. However, for the reasons given above, we do not consider that this remedy would be effective, since it would be likely to lead to high prepayment meter prices being maintained.
- 5.281 We have also considered whether the proposed remedies go further than necessary to achieve their aim. However, given that the individual aspects of the proposed remedies all work together to ensure that the most efficient use and allocation is made of the existing gas tariff pages, we believe that each component part is necessary to achieve the overall aim. Moreover, each component of the proposed remedies goes no further than necessary, in particular, given that Ofgem will have some flexibility concerning the mechanisms of implementation.

⁴⁰⁴ CC3, paragraph 344, citing the principles established in the *Fedesa* case, Case C-331/88, *the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others*, (1990) ECR I-4023, paragraph 13.

- 5.282 We have also considered the implementation costs that will be incurred by Ofgem, which we would expect to be small, and would relate mainly to the modification of the licence conditions and administering the reallocation of the gas tariff pages, which will be largely outweighed by the benefits of increased competition as a result of more tariffs being made available to prepayment customers with a dumb meter.
- 5.283 We consider that the costs to suppliers of complying with these proposed remedies are minimal. As regards the softening of SLC 22B.7(b), this would not involve any cost to suppliers. Ofgem told us that this provision was implemented as part of Ofgem's RMR Simpler policy for similar reasons to the simpler choices component of the RMR rules, ie to simplify the tariff choice journey. We believe that our proposed remedy would not have any material impact on a customer's tariff journey. It is also consistent with our proposed remedy to remove aspects of the simpler choices component of the RMR rules (see below). While we acknowledge that this proposed remedy may lead to distributional impacts between customers of different regions as a result of the removal of regional variations within a core tariff, we believe that these impacts will be limited⁴⁰⁵ and justified by the greater availability of tariffs that will be allowed by this remedy.
- 5.284 We have also assessed the costs to suppliers of reallocating the unused gas tariff pages. We acknowledge the current constraints on suppliers resulting from the availability of electricity tariff codes, and do not consider that holding more than 12 gas tariff pages would deliver any significant value to a supplier. Redistributing three of the Six Large Energy Firms' excess tariff codes is therefore unlikely to affect the range of tariffs they are able to offer.
- 5.285 We recognise that holding unused gas tariff pages may have some current option value for a supplier (for example, if electricity tariff codes become less scarce in future, suppliers with spare gas tariff codes would be able to offer more dual fuel tariffs). However, we consider it unlikely that there will be significant further availability of electricity tariff codes in the period before the smart meter roll-out is complete. As a result, for the remaining period for which suppliers need to use the dumb prepayment meter infrastructure, we consider it unlikely that our proposed remedy limiting suppliers' gas tariff

⁴⁰⁵ This is because suppliers would be in any event constrained by SLC 27, which requires that pricing differences between payment methods do not exceed the costs-to-serve differential. Moreover, suppliers should be able to group regions into a small number of broader groups with similar costs, and therefore limited distributional impacts between customers in different regions, and between customers and suppliers within a core tariff. As noted above, Scottish Power suggested that three broader groups should be sufficient for this purpose. This should be effective in significantly reducing the number of tariff codes required to offer a core tariff to prepayment customers, while reducing to a minimum any such distributional impact.

page holdings to 12 would have a detrimental effect on the ability of any of the Six Large Energy Firms to offer prepayment tariffs.

- 5.286 Furthermore, we consider that the value of facilitating entry or expansion by independent suppliers that would result from redistributing gas tariff pages is likely to exceed any option value to the three of the Six Large Energy Firms holding unused gas tariff pages that would be reallocated pursuant to our proposed remedies.
- 5.287 For these reasons, we do not believe that these proposed remedies, individually or in combination, will produce any disadvantage to these suppliers or consumers that is disproportionate to its aim.
- 5.288 We noted in paragraph 5.240(c) above that should more gas tariff codes be requested than are available through the above mechanism, Ofgem should consider whether further interventions are necessary (eg use-it-or-lose-it conditions on suppliers' gas tariff pages, or an alternative method for redistributing further gas tariff pages). In doing so, Ofgem should consider the proportionality of any further interventions.

Duty to have regard to Ofgem's statutory duties

- 5.289 As stated above, where the CMA is considering whether to take action for the purpose of modifying one or more of the conditions of a retail gas or electricity supplier's licence, in deciding whether such action would be reasonable and practicable, the CMA must 'have regard' to the relevant statutory functions of Ofgem.
- 5.290 In reaching our provisional decision to recommend a modification to SLC 22B.7(b), and possible new standard licence conditions concerning gas and electricity supply that sets the maximum number of gas tariff pages a supplier can hold, requires information provision and allows Ofgem to mandate the reallocation of gas tariff pages, we have, as part of our own application of the legal framework requiring us to decide upon proposed remedies that are effective and proportionate,⁴⁰⁶ explicitly taken into account many of the factors to which Ofgem must have regard when carrying out its functions. We have therefore concentrated below on those considerations not explicitly taken into account elsewhere in this section of the provisional decision on remedies.
- 5.291 In particular, we do not consider that these proposed remedies will have an adverse impact on suppliers' ability to meet all reasonable demands for gas

⁴⁰⁶ CC3, paragraphs 334–347.

and electricity supply, achieving sustainable development, security of supply or environmental concerns. In this regard, the proposed remedies will only have a bearing on the affordability considerations built into Ofgem's statutory duties and functions.

- 5.292 As noted above, we would expect the proposed remedies to reduce the technical barriers that restrict suppliers' ability (in particular new entrants) to offer a wide variety of tariffs to prepayment customers with dumb prepayment meters. This in turn should increase competition between suppliers, and customer engagement, as customers would be more likely to find attractively priced tariffs and/or tariffs fitting their need. The proposed remedies therefore directly engage Ofgem's principal objective of protecting the interests of existing and future consumers, wherever appropriate through competition.
- 5.293 In addition, we note that while not the key driver for the proposed remedies, they will also have the side effect of providing some protection to vulnerable customers, since a higher proportion of low income customers use prepayment meter.⁴⁰⁷ The proposed remedies therefore indirectly engage Ofgem's duty to have regard to the interests of, among others, individuals with low incomes.
- 5.294 In light of the above, we consider that the proposed remedies are consistent with Ofgem's principal objective of promoting the interests of existing and future consumers.

Reforming the protocol for the assignment of debt on prepayment meters

- 5.295 One of the features of the Prepayment AEC that we have identified is the softened incentives for all suppliers, and in particular new entrants, to compete to acquire prepayment customers. This is due to, among other things, a low prospect for these suppliers of successfully completing the switch of indebted customers, who represent about 15% of prepayment customers.
- 5.296 In the Second Supplemental Remedies Notice, we consulted on reform of the current Debt Assignment Protocol with a view to facilitating switching for indebted prepayment customers.
- 5.297 Our specific proposed remedy was to recommend that Ofgem amend the relevant licence conditions and industry code provisions, respectively, in

⁴⁰⁷ See Section 3.

order to address the following areas of the Debt Assignment Protocol that Ofgem had identified required further actions by itself and the industry:

- (a) The 'objection letter' sent by an incumbent supplier should not confuse customers as to their right to switch, making clear that the switch will continue; further 'objection letters' should only be sent to customers for whom it is established that they are not eligible to switch.
- (b) The 'complex debt' aspect of the Debt Assignment Protocol should be revisited in order to diminish the instances in which the switch is disallowed.
- (c) Issues relating to multiple registrations should be addressed in order to avoid multiple objection letters being sent to customers with such metering arrangements, causing unnecessary confusion for them and adding cost.

Aim of the remedy

- 5.298 The proposed remedy seeks to improve the Debt Assignment Protocol process with a view to removing barriers to switching for indebted prepayment customers. This should increase the number of indebted customers that initiate and complete a switch to a competing supplier, therefore increasing the competitive constraints in the prepayment segments.

Parties' views

- 5.299 Ofgem said it welcomed the CMA's recognition of the Debt Assignment Protocol as an issue. It said it had been working with the industry on improvements to the Debt Assignment Protocol and further reform might best be achieved by the industry formulating an action plan with solutions to the issues identified, along with a timetable for implementation in 2016.⁴⁰⁸
- 5.300 The Six Large Energy Firms, apart from SSE⁴⁰⁹, expressed support for a remedy that improved the Debt Assignment Protocol by building on the industry's existing work in this area, including its development of the Point of Acquisition (PoA) model. Several wanted a remedy that made the Debt Assignment Protocol process and adoption of the Point of Acquisition model

⁴⁰⁸ Ofgem response to second supplemental notice of possible remedies, p13.

⁴⁰⁹ SSE also said that it was fully supportive of proportionate and effective changes to ensure the DAP works more effectively for prepayment customers.

mandatory for all suppliers.^{410,411,412,413} Some said the CMA recommending Ofgem to address the issues would be sufficient⁴¹⁴ and the benefits of the CMA using its order-making power to support Ofgem's ongoing work was unclear.⁴¹⁵

5.301 SSE said the proposed remedy was unnecessary and ineffective because it would be superseded by existing and imminent market developments, with the procedure for suppliers universally adopting the Point of Acquisition model already underway.⁴¹⁶

5.302 Other parties had mixed views on the remedy:

(a) Some independent suppliers and Energy UK suggested the remedy was unnecessary because of existing industry work on the Debt Assignment Protocol.⁴¹⁷

(b) Some independent suppliers expressed some support for the remedy.⁴¹⁸

(c) Some parties suggested more action than the proposed remedy was necessary to improve the Debt Assignment Protocol.⁴¹⁹

5.303 Citizens Advice said the current Debt Assignment Protocol process was highly flawed. It said it was not confident that the remedy would deliver change promptly enough because the industry had consistently shown a lack of urgency in addressing issues with the Debt Assignment Protocol. It said that if the remedy was implemented, the CMA should use its order-making powers to support Ofgem's work.

Design considerations

5.304 In designing this proposed remedy, we have considered:

(a) our key concerns set out in the Addendum about the complexity of the switching process for indebted prepayment customers;

⁴¹⁰ Centrica's response to second supplemental notice of possible remedies, p14.

⁴¹¹ RWE npower's response to second supplemental notice of possible remedies, p13.

⁴¹² EDF Energy's response to second supplemental notice of possible remedies, p10.

⁴¹³ E.ON's response to second supplemental notice of possible remedies, pp14–15.

⁴¹⁴ Scottish Power's response to second supplemental notice of possible remedies, pp12–13.

⁴¹⁵ E.ON's response to second supplemental notice of possible remedies, pp14–15.

⁴¹⁶ SSE's response to second supplemental notice of possible remedies, p26

⁴¹⁷ First Utility, Good Energy and Energy UK responses to second supplemental notice of possible remedies.

⁴¹⁸ Ovo Energy and Robin Hood Energy responses to second supplemental notice of possible remedies.

⁴¹⁹ BGL Group, Ecotricity and Our Power Community Benefit Society responses to second supplemental notice of possible remedies.

- (b) the ongoing work by Ofgem and industry to change the Debt Assignment Protocol so as to improve the switching process for these customers; and
 - (c) the need to ensure the delivery of further improvements to the switching process for indebted prepayment customers.
- 5.305 There is in our view further scope for improving the switching process for indebted prepayment customers, in particular by simplifying it. We acknowledge that Ofgem and the industry are currently working on further changes that would seek to achieve this aim. However, as noted by Citizens Advice, such changes might be at risk of not being delivered quickly if the responsibility of driving this process forward were left to the industry alone. In particular, and in the light of our provisional findings with respect to industry codes governance, we are concerned that the necessary modification to the relevant codes may be unnecessarily delayed.
- 5.306 In its response to our Second Supplemental Remedies Notice, Ofgem indicated that further reform to the Debt Assignment Protocol may best be achieved by industry formulating an action plan with solutions to the technical issues they have identified, along with a timetable for implementation in 2016. While Ofgem noted that this approach would allow changes to be introduced more quickly than would be the case if reforms were made via modifications to the licence conditions, it recognised that modifying the supply licence per the CMA's proposal represented another route to bringing about improvements with the Debt Assignment Protocol, should industry-led action prove ineffective.
- 5.307 We accept that industry-led change may be a quicker route to achieve the aim of this proposed remedy compared with a licence modification led by Ofgem or the CMA under its order-making powers. Suppliers' incentives, however, may not align with those of indebted prepayment customers, such that suppliers may not necessarily take swift action to further improve the Debt Assignment Protocol process to the benefit of these customers. Therefore, in view of our provisional findings in relation to the Codes AEC, and consistent with our proposed remedies in that area, we expect Ofgem to continue monitoring and supporting the development of changes to the Debt Assignment Protocol.
- 5.308 We believe that Ofgem should ensure that clear objectives and a timetable with appropriate milestones are set out as soon as possible. It should also monitor that appropriate steps are taken by the industry in line with these milestones and signal its willingness to take action if it appears that the industry is not in a position to deliver a satisfactory solution by the end of

2016 (including by initiating a licence modification process). Absent such interventions by Ofgem, implementation by the industry of the expected improvements to the Debt Assignment Protocol may be unnecessarily delayed, or insufficiently focused on the interest of consumers. We are concerned that, while Ofgem has been involved in developing these improvements to the Debt Assignment Protocol, it is not playing a sufficiently active role to ensure that these improvements (which would involve some code modifications) are delivered in a timely and effective manner (see also on similar issues our provisional findings report and remedies relating to the Governance AEC and the Codes AEC).

- 5.309 For these reasons, we are proposing to recommend to Ofgem to take appropriate steps to ensure that changes to the Debt Assignment Protocol, and in particular in areas relating to objection letters, complex debt and issues relating to multiple registrations, as detailed above (see paragraph 5.297), are implemented by the end of 2016. For this purpose, we have also provisionally decided to recommend Ofgem to ensure that clear objectives and a timetable with appropriate milestones are set out, to supervise this process against such objectives and milestones, and to take all steps, if and when necessary, to ensure delivery of these changes.

Assessment of effectiveness

- 5.310 In assessing the effectiveness of this proposed remedy, we have considered:
- (a) the extent to which it meets our aim;
 - (b) the extent to which the proposed remedy is capable of effective implementation, monitoring and enforcement; and
 - (c) the timescale over which the proposed remedy is likely to have an effect.
- 5.311 We believe that, in light of our provisional findings concerning the Codes AEC, our proposed remedy will be effective in prompting Ofgem to ensure that certain meritorious changes to the Debt Assignment Protocol are made on a timely basis, through effective project management. An improved Debt Assignment Protocol will facilitate indebted prepayment customers to switch, which we would expect to address, in part, suppliers' softened incentives to compete to acquire prepayment customers.
- 5.312 We believe that Ofgem, working together with the industry, is best placed to design and implement the necessary changes to the Debt Assignment Protocol that would ensure improvements to the switching process, and in turn facilitate switching for indebted prepayment customers.

- 5.313 Ofgem has in our view the appropriate incentives and resources to ensure that the proposed changes to the Debt Assignment Protocol are in customer's interests and are implemented by suppliers in a timely and effective manner, by the end of 2016.
- 5.314 We want to ensure the changes to the Debt Assignment Protocol are implemented at the earliest opportunity to address the impediments to switching by indebted prepayment customers. In view of parties' responses, we believe it is possible for the necessary changes to the Debt Assignment Protocol to be implemented by the end of 2016.

Assessment of proportionality

- 5.315 In considering whether the proposed remedy would be a proportionate remedy to achieve its aim, we have considered whether the remedy:
- (a) is effective in achieving its legitimate aim;
 - (b) is no more onerous than needed to achieve its aim;
 - (c) is the least onerous if there is a choice between several effective measures; and
 - (d) does not produce disadvantages which are disproportionate to the aim.⁴²⁰
- 5.316 For the reasons noted above in paragraphs 5.310 to 5.314, we believe that the proposed remedy will be effective in achieving its aim.
- 5.317 We do not consider that the proposed remedy will produce any disadvantages which are disproportionate to the aim. It simply supports Ofgem in making changes to the Debt Assignment Protocol which have already been identified by Ofgem and the industry in order to ensure these changes happen. Similarly, we think the costs of implementing the remedy will be minimal because it essentially supports ongoing work by Ofgem and the industry.
- 5.318 Accordingly, we consider that the proposed remedy is no more onerous than needed to achieve its aim of facilitating switching by indebted prepayment customers. Given the ongoing work by Ofgem in this area, we believe it would be disproportionate to impose an order on suppliers to make the

⁴²⁰ CC3, paragraph 344, citing the principles established in the *Fedesa* case, Case C-331/88, *the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others*, (1990) ECR I-4023, paragraph 13.

relevant changes. Accordingly, we therefore provisionally consider our remedy is the least onerous of effective alternatives.

Remedy we are not minded to pursue: prohibition on the charging of a security deposit

- 5.319 In the Addendum and in Section 3, we noted that prepayment customers face actual or perceived impediments to switching to tariffs available on credit meters (over and above those identified in the domestic retail energy markets as a whole). These impediments limit the opportunity for customers to engage in the markets which contribute to one of the features identified in our Prepayment AEC, ie the softened incentives for all suppliers, and in particular new entrants, to compete to acquire prepayment customers. One of the impediments we have identified is the requirement (by some but not all suppliers) for customers that wish to switch to a credit meter to pay for a security deposit.
- 5.320 In our Second Supplemental Remedies Notice, we consulted on a possible remedy consisting in the prohibition of suppliers charging security deposits in specific circumstances.
- 5.321 The possible remedy attempted to address the lack of clarity about when it is unreasonable to charge a security deposit by setting out specific, achievable criteria for prepayment customers to meet. These criteria were:
- (a) the customer is not in debt;
 - (b) the customer has not incurred any fines, charges or interest for late payment in the last six months.

Aim of the remedy

- 5.322 The possible remedy sought to address the actual or perceived impediment to switching that prepayment customers face as a result of the potential need to pay a security deposit when switching away from a prepayment meter.

Parties' views

- 5.323 Ofgem welcomed the CMA's recognition of the potential impact of security deposits on customers' ability to switch. However, it said it was important to note that this issue only applied to a small number of customers because only five suppliers currently requested security deposits. It also suggested that a number of factors should be considered if the CMA decided to

proceed with the remedy including the risk that if prescriptive about when security deposits could be applied suppliers could adopt a ‘tick box’ approach rather than engage with customers individually.⁴²¹

5.324 All of the Six Large Energy Firms, apart from E.ON, raised concerns about the remedy. Several were concerned about the impact on suppliers’ ability to manage risk.^{422,423} In addition:

- (a) Centrica said it was not right to prohibit the charging of a security deposit in the circumstances described because a customer satisfying these criteria may still be at a high risk of becoming indebted were credit to be provided. Centrica also said that an unintended consequence of the remedy could be more requests for a meter exchange being refused.⁴²⁴
- (b) SSE said the remedy was disproportionate, unlikely to be effective and could result in adverse unintended effects. It said the remedy would require suppliers to make significant changes to their billing processes and business models and would affect only a very small number of prepayment customers. It also said it could create a barrier to entry and expansion, increase tariff prices and undermine effective competition.⁴²⁵
- (c) Scottish Power said it did not think the CMA’s criteria for the application of security deposits would work in practice because customers on prepayment meters could not, in general, make late payments and because most suppliers did not levy fines, charges or interest for late payment.⁴²⁶

5.325 E.ON said that it supported the remedy on the assumption that a supplier still had the right to refuse a request from an existing prepayment customer to have a credit meter installed where that refusal was objectively justified, for example following an unsatisfactory credit check result.⁴²⁷

5.326 Some other suppliers also expressed concerns about the possible remedy on the basis that if security deposits were restricted it could result in more

⁴²¹ Ofgem response to second supplemental notice of possible remedies, pp8–9.

⁴²² EDF Energy’s response to second supplemental notice of possible remedies, p7

⁴²³ RWE npower’s response to second supplemental notice of possible remedies, pp9–10.

⁴²⁴ Centrica’s response to second supplemental notice of possible remedies, p11.

⁴²⁵ SSE’s response to second supplemental notice of possible remedies, p21.

⁴²⁶ Scottish Power’s response to second supplemental notice of possible remedies, p10.

⁴²⁷ E.ON’s response to second supplemental notice of possible remedies, p9.

customers facing renewed financial difficulty and debt management issues⁴²⁸ and stop suppliers assessing each customer individually.⁴²⁹

- 5.327 Other parties expressed some support for the possible remedy^{430,431,432,433} These included Citizens Advice although it noted that given the small number of suppliers charging security deposits, the remedy might have only a marginal impact on the number of customers switching away from prepayment meters.⁴³⁴

Assessment of effectiveness and proportionality

- 5.328 In light of parties' responses, we do not consider that this possible remedy would be effective and proportionate in meeting our aim to lower barriers to switching for prepayment customers.
- 5.329 In view of parties' responses, we consider that it is the lack of customer awareness and understanding of their options (over and above the actual cost of the security deposit) that contribute to the perception of barriers to switching. Customers can already choose from a range of tariff options offered by suppliers that do not require a security deposit. We also note that SLC 27.3 prohibits 'unreasonable' security deposits being charged by suppliers.
- 5.330 We believe that such a lack of awareness and understanding of available options can be effectively addressed through an informational remedy, whereby suppliers provide clear and relevant information to their customers with respect to security deposits. We suggest that Ofgem consider this issue in the context of our proposal for a programme to identify, test and implement measures to provide customers with different or additional information to prompt them to engage in the energy market (see Section 6).
- 5.331 We also note that there may be potential for adverse consequences from the remedy. While security deposits hamper customers' ability and incentives to switch (as noted above), these can be an efficient tool for suppliers to mitigate the risk (and costs) of bad debt. It is, however, difficult to identify precise rules that strike an efficient balance between these two considerations. We believe that suppliers should be free to decide the level of risk they find appropriate. We are also concerned that precise rules may

⁴²⁸ First Utility's response to second supplemental notice of possible remedies, p7.

⁴²⁹ Good Energy's response to second supplemental notice of possible remedies, p3.

⁴³⁰ Robin Hood Energy's response to second supplemental notice of possible remedies, p6.

⁴³¹ Ovo Energy's response to second supplemental notice of possible remedies, p4.

⁴³² Ecotricity's response to second supplemental notice of possible remedies, p3.

⁴³³ BGL Group's response to second supplemental notice of possible remedies, p6.

⁴³⁴ Citizens Advice's response to second supplemental notice of possible remedies, p7.

become, as noted by Ofgem, a ‘tick-the-box’ exercise which would undermine suppliers’ incentives to engage with customers to find an appropriate solution.

Remedy we are not minded to pursue: prohibition on suppliers from charging customers upfront for the cost of a new meter

5.332 In the Addendum, we noted that prepayment customers face actual or perceived impediments to switching (over and above those identified in the domestic retail energy markets as a whole). These impediments limit the opportunity for customers to engage in the markets, therefore contributing to one of the features identified in our Prepayment AEC, ie the softened incentives for all suppliers, and in particular new entrants, to compete to acquire prepayment customers.

5.333 In our Second Supplemental Remedies Notice, we consulted on suppliers being prohibited from charging customers upfront for the cost of a new meter when switching away from prepayment meters. In line with SLC 27.2A suppliers would be able to recover the costs of the meter from the customer, provided this is spread over a period of time.

Aim of the remedy

5.334 The possible remedy sought to lower the barriers to switching by addressing the actual or perceived impediment to switching that prepayment customers may face as a result of the cost of meter installation when switching away from a prepayment meter. In particular, it sought to reduce the burden of the upfront costs which may discourage certain customers to complete the switch.

Parties’ views

5.335 Ofgem welcomed the CMA’s recognition of the issue of the upfront charges. It highlighted the existing widespread removal of such charges by the industry and said the issue was time sensitive because the roll-out of smart meters should mean suppliers could switch payment modes remotely and not have to charge.⁴³⁵

⁴³⁵ Ofgem response to second supplemental notice of possible remedies, p10.

- 5.336 Four of the Six Large Energy Firms expressed support for the remedy^{436,437,438,439}
- 5.337 Centrica and SSE opposed the remedy:
- (a) Centrica said the remedy was not proportionate because the charges were not a major barrier to meter exchanges and the smart meter roll-out would ultimately resolve the issue.⁴⁴⁰
 - (b) SSE said the remedy was disproportionate, unlikely to be effective and could result in unintended adverse effects. It said that for the uncertain benefit of a minimal number of customers, the remedy imposed significant constraints on how suppliers managed bad debt and financial risk.⁴⁴¹
- 5.338 Some other suppliers also said the remedy was disproportionate,^{442,443} and the issue would shortly be resolved by the roll-out of smart metering.⁴⁴⁴
- 5.339 Other parties expressed some support for the remedy^{445,446} These included Citizens Advice, although it noted that the vast majority of suppliers did not charge for meter installation or removal so the remedy would have only a marginal impact in improving the number of customers switching away from prepayment meters.⁴⁴⁷

Assessment of effectiveness and proportionality

- 5.340 In light of parties' responses, we do not consider that the remedy will be effective in meeting our aim to lower barriers to switching for prepayment customers.
- 5.341 We note that suppliers must roll out smart meters in the next four years at no cost to customers. The issue of upfront charges is therefore only a temporary concern which affects only a small number of customers.

⁴³⁶ RWE npower's response to second supplemental notice of possible remedies, p11.

⁴³⁷ EDF Energy's response to second supplemental notice of possible remedies, p8.

⁴³⁸ E.ON's response to second supplemental notice of possible remedies, p11.

⁴³⁹ Scottish Power's response to second supplemental notice of possible remedies, p11.

⁴⁴⁰ Centrica's response to second supplemental notice of possible remedies, p12.

⁴⁴¹ SSE's response to second supplemental notice of possible remedies, p25.

⁴⁴² First Utility's response to second supplemental notice of possible remedies, pp7–8.

⁴⁴³ Robin Hood Energy's response to second supplemental notice of possible remedies, p7.

⁴⁴⁴ Good Energy's response to second supplemental notice of possible remedies, p4.

⁴⁴⁵ Ovo Energy's response to second supplemental notice of possible remedies, p4.

⁴⁴⁶ Ecotricity's response to second supplemental notice of possible remedies, p3.

⁴⁴⁷ Citizens Advice's response to second supplemental notice of possible remedies, p9.

- 5.342 Having reviewed parties' responses, we consider that it is the lack of customer awareness and understanding of their options (but not the actual cost of the meter replacement) that contribute to the perception of barriers to switching. Customers can already choose from a range of tariff options offered by suppliers that do not charge the costs of replacing the meter upfront (if at all).
- 5.343 We believe that such a lack of awareness and understanding of available options is more effectively addressed through an informational remedy, by ordering suppliers to provide clear and relevant information to their customers with respect to meter replacement costs (see Section 6). We also suggest that Ofgem consider this in the context of our proposal for a programme to identify, test and implement measures to provide customers with different or additional information to prompt them to engage in the energy market (see Section 6). In our view a remedy such as the one envisaged in the Second Supplemental Remedies Notice would not have any significant additional impact on switching rates, over and above the informational remedy.

Issues arising from competition in metering

- 5.344 Metering is an essential part of creating well-functioning, competitive energy markets. Because gas and electricity are consumed in real time, while billing and payment take place at periodic intervals, reliable and accurate meters play a vital role in determining exactly how much energy customers have consumed – and therefore how much they must pay suppliers.
- 5.345 Metering in energy is by its nature technical, and we have found that the meter a customer has in place imposes technical constraints that can have a significant impact on the nature and extent of competition. Section 3 above highlights the problems we have identified in relation to customers on prepayment and restricted meters.
- 5.346 Metering in Great Britain is a liberalised activity – in contrast to the situation in most EU member states where it is provided as a regulated activity by distribution network operators^{448,449} – and in the provisional findings report we identified two potential competition problems arising from the regulatory regime governing liberalised metering activity:

⁴⁴⁸ See Aoife Brophy Haney, Tooraj Jamasb and Michael G Pollitt, 'Smart Metering and Electricity Demand: Technology, Economics and International Experience', Cambridge Working Paper in Economics 0905.

⁴⁴⁹ See European Commission staff working document, [Cost-benefit analyses & state of play of smart metering deployment in the EU-27](#), p21 and Table 11.

- (a) the Centrica exemption from gas and electricity meter inspections for health and safety purposes; and
- (b) the regime governing the certification of electricity meters to ensure their accuracy.

5.347 In this section we address both of these issues.

The Centrica exemption

- 5.348 Domestic gas and electricity meters must be inspected for health and safety reasons every two years by the supplier.⁴⁵⁰ Centrica, the company with the largest number of domestic gas and electricity customers, was able to assure Ofgem and Health and Safety Executive (HSE) that its processes of inspection were sufficiently robust for it to be allowed an exemption from this requirement. Instead, it would have to inspect meters only every five years.
- 5.349 One party, First Utility, pointed out to us that this created a disincentive for competitors to win Centrica customers: it became disproportionately likely that a switcher from Centrica would have a meter that had not been inspected in the last two years, and therefore that the obligation would fall immediately on the new supplier to inspect the meter. Increasing the cost of acquiring Centrica customers thus reduced competition for them.
- 5.350 We accepted the logic of this argument in our provisional findings report and invited views in relation to such concerns. Ofgem has now put in place a generalised exemption that is due to come into force on 1 April 2016.⁴⁵¹ We therefore consider that there is no further need to consider these concerns.

Meter certification

- 5.351 Electricity meters must be certified as being accurate on a regular basis in a process that is overseen by The National Measurements and Regulation Office (NMRO). The NMRO collects data on certification rates from the 12 largest suppliers⁴⁵² on an annual basis.
- 5.352 Meters of a given design tend to lose accuracy at a similar rate, and therefore it is economic to test only a sample of meters of each design.

⁴⁵⁰ The requirement for suppliers to have up-to-date certificates ensuring the accuracy of all electricity meters is set out in Schedule 7 to the Electricity Act 1987.

⁴⁵¹ Ofgem (November 2015), [Reforming suppliers' meter inspection obligations – final proposals](#).

⁴⁵² The Six Large Energy Firms and six largest smaller suppliers.

Suppliers have had the obligation to ensure that 100% of each meter class has been certified as being accurate.

- 5.353 However, since it would be costly and impractical to maintain a 100% certification rate⁴⁵³ (there are currently 27 million electricity meters), the NMRO has not historically taken further action if a supplier's certification rates are in the high 90%s. As of December 2014 all of the Six Large Energy Firms had certification rates above 95%, and the average figure for the smaller suppliers monitored by the NMRO was 93%.
- 5.354 One party, First Utility, has pointed out to us that this mechanism for ensuring meter accuracy suffers two problems: it is wasteful and it creates an economy of scale for larger suppliers. The waste comes from the fact that an obligation is placed on each supplier, which in statistical terms could lead to too much testing or to action that avoids the testing – like replacing meters that still function well.⁴⁵⁴ The economy of scale is that for rare meter types, a large supplier might have a sufficient number to be able to satisfy the testing requirement at a relatively low cost. However, a small supplier, with very few such meters, finds that each addition of an unusual meter type puts it in breach of its certification requirement. It therefore finds that the only economic way to comply is to install a new meter as the default choice when it wins over a customer with an unusual meter.
- 5.355 Having considered First Utility's submission, we agree that the certification regime treats large and small suppliers differentially and that it runs the risk of imposing unnecessary costs through the replacement of meters that still function well. We understand that DECC has also recognised the problem and has developed, in collaboration with industry (the Smart Metering Governance Group), a plan which seeks to address both of these issues.⁴⁵⁵ In particular, the plan proposes prioritising sample testing of the meter types that are the most common in Great Britain's meter population. This policy should maximise, subject to the samples passing the tests, the proportion of the meters that will have their certification life extended.
- 5.356 The Six Large Energy Firms and one independent supplier have chosen to participate and will be sharing the costs of these tests.
- 5.357 The proposed cost-sharing arrangement should address most of the externality arising from the current regime, since the Six Large Energy Firms have the largest absolute number of electricity meters, and are expected to

⁴⁵³ This is also to avoid traditional-for-traditional meter exchanges prior to smart meter roll-out.

⁴⁵⁴ Further during the period of smart meters roll-out, the current system might also lead to high volumes of traditional to traditional meter replacements and result in additional costs.

⁴⁵⁵ DECC submission to the CMA, 15 February 2016.

benefit most from the certification extension. However, since the smaller suppliers, except one, are not part of this agreement, they will be able to free-ride, as the extensions will also apply to their meters of the same types.

- 5.358 We note that the policy might not address the problem of uncertified meters of less popular types. The incentives for suppliers to apply for extension of these meter types may not be sufficient, and these meters will remain uncertified, or will have to be exchanged. This will lead to costs to suppliers who have or who are gaining such customers. The scale of this problem will depend on the distribution of meter types.
- 5.359 Nevertheless, we believe that the impact on competition is likely to be small and that the current plan constitutes a substantial improvement to the regime. We have therefore decided not pursue this issue any further.

Withdrawing the simpler choices component of the RMR rules

- 5.360 In our provisional findings we found that the simpler choices component of Ofgem's retail market review (RMR) rules (including the ban on complex tariffs, the maximum limit on the number of tariffs that suppliers will be able to offer at any point in time, the simplification of cash discounts, and the ban on bundling) is a feature of the markets in the domestic retail supply of electricity and gas that gives rise to an AEC by reducing retail suppliers' ability and incentives to compete and innovate in designing tariff structures, and by softening competition between PCWs (the RMR AEC).⁴⁵⁶
- 5.361 To address our provisional concerns in this area, in the Remedies Notice we proposed removing the following aspects of the simpler choices component of the RMR rules:
- (a) the ban on complex tariffs;⁴⁵⁷
 - (b) a maximum limit on the number of tariffs that suppliers can offer at any point in time⁴⁵⁸ (the 'four-tariff rule'); and
 - (c) the simplification of cash discounts.⁴⁵⁹
- 5.362 Following parties' submissions on this proposed remedy, our provisional view is that the scope of the remedy should include additional aspects of the simpler choices component of the RMR rules. The specific provisions that

⁴⁵⁶ See [provisional findings report](#), Section 12.

⁴⁵⁷ SLCs 22A.3(a) and (b).

⁴⁵⁸ SLC 22B.2(b).

⁴⁵⁹ SLCs 22B.3–22B.4A.

we are proposing to remove and those we are proposing to retain are set out in paragraphs 5.380 to 5.399 below and Appendix 5.4.

- 5.363 The RMR rules were designed as an integrated package of rules aimed at addressing certain barriers to effective customer engagement arising, in particular, from complex tariff options, the information provided to domestic customers, and low levels of trust in energy suppliers. The RMR rules had three components ('simpler choices'; 'clearer information'; and 'fairer treatment') and were implemented through modifications to the standard licence conditions for the retail supply of gas and electricity.
- 5.364 The simpler choices component was designed to make it easier for customers to understand and compare the energy tariffs offered by suppliers and falls within the scope of this proposed remedy.
- 5.365 The 'clearer information' component was designed to help domestic customers understand the information they receive from suppliers and is considered as part of our assessment of remedies to help customers engage. However, we have also considered the impact that the removal of the simpler choices component of the RMR rules would have on the information tools⁴⁶⁰ introduced by the RMR rules in the proportionality assessment of this proposed remedy (in terms of potential unintended consequences).
- 5.366 The 'fairer treatment' component of the RMR rules was designed to ensure that domestic customers are treated fairly in all interactions they have with energy suppliers. The Standards of Conduct rules (SLC 25C), introduced as part of the 'fairer treatment' component of the RMR rules, are considered in Section 6 on the use of principles-based regulation. In particular, we consider the extent to which the Standards of Conduct might mitigate any potential unintended consequences of the proposal to remove aspects of the simpler choices component of the RMR rules.

Aim of the remedy

- 5.367 The aim of the proposed remedy is:
- (a) to promote competition and innovation between retail energy suppliers in the retention and acquisition of domestic customers by allowing them to offer a wider range of tariffs than permitted by the simpler choices

⁴⁶⁰ The tariff comparison rate, personal projection, cheapest tariff messaging and tariff information label.

component of the RMR rules, including tariffs designed to appeal to certain customer groups; and

(b) to facilitate competition between PCWs by addressing the constraints which the simpler choices component of the RMR rules place on the number of tariffs offered by suppliers and, accordingly, allowing PCWs to negotiate exclusive tariffs with domestic energy suppliers and to offer discounts funded by the commissions they receive from suppliers.

5.368 Accordingly, the aim of the proposed remedy is to address the RMR AEC and to partly address the Domestic Weak Customer Response AEC. We also note that it addresses, in part, the Prepayment AEC.⁴⁶¹

5.369 In the provisional findings we set out evidence on the impact the RMR rules have had on the ability and incentives for suppliers to compete on the range of tariffs and discounts that suppliers can offer domestic customers. We also consider that the RMR rules (in particular the four-tariff rule) limit the scope for competition between PCWs for customers switching energy suppliers to exert downward pressure on energy prices. In particular, we consider that, absent the four-tariff rule, PCWs would be in a good position to negotiate favourably priced exclusive tariffs with retail energy suppliers (see paragraph 5.409).

5.370 The ‘four-tariff rule’ is not the only barrier to PCWs negotiating favourable exclusive deals with suppliers. The recent requirement for PCWs to display the whole market also has the potential to undermine the incentives on the part of suppliers to negotiate such deals. We consider this matter further in Section 6.

5.371 We recognise that the simpler choices rules were introduced in an attempt to address concerns that suppliers may have an incentive to mislead customers, by marketing complex tariffs that look attractive but do not in reality provide good value for money. We set out our overall approach to addressing such concerns in Section 4, which explains our proposed remedies to help customers engage. To mitigate any unintended consequences arising from a potentially significant increase in the number of tariffs on offer, we propose a remedy to strengthen the role of principle-based Standards of Conduct (see Section 6).

⁴⁶¹ See Section 8.

Parties' views on the proposed remedy

- 5.372 We received responses from parties including the Six Large Energy Firms, the Mid-tier Suppliers, PCWs⁴⁶² and consumer groups.⁴⁶³
- 5.373 The Six Large Energy Firms and the Mid-tier Suppliers (with the exception of First Utility), were supportive of our proposed remedy.⁴⁶⁴ In particular, parties said the following in relation to whether this remedy would be effective in increasing competition between domestic retail energy suppliers and/or between PCWs:
- (a) Suppliers generally agreed that the simpler choices component of the RMR rules had constrained suppliers' ability to innovate.^{465,466,467,468}
 - (b) Some suppliers^{469,470,471} said that the remedy would enable suppliers to negotiate exclusive offers with PCWs. SSE said that removing tariff restrictions would facilitate more effective competition between PCWs, either through cashback offers or offering exclusive tariffs. However, Ofgem⁴⁷² and uSwitch⁴⁷³ said that such offers (ie discounted tariffs offered exclusively via TPIs) were not offered pre-RMR when it was possible, so there might be other barriers preventing this.

⁴⁶² In particular, Gocompare.com, MoneySuperMarket, MoneySavingExpert and uSwitch.

⁴⁶³ Which? Age UK and Citizens Advice.

⁴⁶⁴ Centrica response to provisional findings and Remedies Notice, p51. EDF Energy response to Remedies Notice, p4, paragraph 0.11; E.ON response to provisional findings, p3, paragraph 13; RWE response to provisional findings, p2, paragraphs 50–54. Scottish Power response to Remedies Notice, p6, paragraph 3.1; SSE response to Remedies Notice, p8. Co-operative Energy response to Remedies Notice, p4; Ovo Energy response to Remedies Notice, p16; Utility Warehouse response to Remedies Notice, p4.

⁴⁶⁵ Centrica response to provisional findings and Remedies Notice, p52; EDF Energy response to RN, pp14–15, paragraphs 3.1 & 3.11; E.ON response to provisional findings, p20, paragraphs 91 & 92; RWE response to Remedies Notice, p3, paragraph 17; Scottish Power response to Remedies Notice, p8, paragraph 3.4. SSE response to Remedies Notice, p22.

⁴⁶⁶ Co-operative Energy response to Remedies Notice, p4.

⁴⁶⁷ Ovo Energy response to Remedies Notice, p16.

⁴⁶⁸ Utility Warehouse response to Remedies Notice, p4.

⁴⁶⁹ Centrica response to provisional findings and Remedies Notice, p52. Centrica said the remedy would enable suppliers to negotiate exclusive offers with PCWs if it was implemented in conjunction with the removal of the obligation to provide the Cheapest Tariff Mechanism and changes to the Confidence Code for PCWs.

⁴⁷⁰ E.ON response to provisional findings, p20, paragraph 92.

⁴⁷¹ RWE response to Remedies Notice, p34, paragraph 2.2. RWE said this would result in further benefits to consumers from increased competition between PCWs, provided that it was combined with the removal of the requirement for PCWs to show the whole of market view.

⁴⁷² Ofgem response to Remedies Notice, p2.

⁴⁷³ uSwitch response to Remedies Notice, pp8–10.

- (c) Some suppliers^{474,475} said that to be fully effective the remedy should remove from domestic retail energy suppliers' licences all aspects of the simpler choices component of the RMR rules.
- 5.374 First Utility said it would be more proportionate to focus a remedy on the derogation process available to suppliers wishing to depart from the simpler choices component of the RMR rules. It said the remedy would not be effective in increasing competition as it did not, of itself, address the issue of sticky customers.⁴⁷⁶ First Utility also said that it did not think that the four-tariff rule restricted innovation.
- 5.375 Some parties identified as a potential risk that increased complexity of suppliers' offers could adversely impact on customer engagement.^{477,478,479}
- 5.376 Ofgem said that it did not want to return to the 'confusopoly' that existed prior to the RMR rules⁴⁸⁰ and that multi-tier tariffs, tariffs with multiple components and loyalty discounts might make tariff comparisons more difficult.⁴⁸¹ Ofgem said, however, that it did not consider an increase in the number of tariffs to be a risk to customer engagement as growth in the number of suppliers in recent years meant there were already a large number of tariffs on offer. Moreover, PCWs could significantly reduce the search costs of comparing a large number of tariffs.
- 5.377 E.ON⁴⁸² said that PCWs handled most complexity on behalf of customers and SSE⁴⁸³ that the best way for customers to compare tariffs was to use the personal projection. Gocompare.com⁴⁸⁴ said that unrestricted choice might discourage searching, but PCWs helped make searching easy. Gocompare.com⁴⁸⁵ and Money Supermarket⁴⁸⁶ said that the absolute number of tariffs was not of major importance.

⁴⁷⁴ Scottish Power said this meant SLC 1, SLC 22A, SLC 22B, SLC 22C.7, SLC 22C.9, SLC 22CA, SLC 22CB, SLC 22D, SLC 22E, SLC 22F, SLC 31A, SLC 31C and SLC 31D.

⁴⁷⁵ SSE said this encompassed: (1) unit rate and standing charge requirements, (2) the tariff cap, (3) discount restrictions and (4) bundling restrictions – (SLCs 22A and 22B).

⁴⁷⁶ First Utility response to Remedies Notice, p23.

⁴⁷⁷ EDF Energy response to provisional findings, paragraph 4.5, p17; EDF Energy response to Remedies Notice, paragraph 3.3, p13; EDF Energy response to provisional findings, paragraph 4.5, p17.

⁴⁷⁸ First Utility response to Remedies Notice, p23.

⁴⁷⁹ Gocompare.com response to Remedies Notice, p3.

⁴⁸⁰ Ofgem response to Remedies Notice, p1.

⁴⁸¹ Ofgem (18 November 2015), Paper 1: Impact of remedy 3 on consumer engagement, working paper.

⁴⁸² E.ON response to provisional findings, p22, paragraph 98.

⁴⁸³ SSE response to Remedies Notice, p23.

⁴⁸⁴ Gocompare.com response to Remedies Notice, p3.

⁴⁸⁵ Gocompare.com response to Remedies Notice, p3.

⁴⁸⁶ Money Supermarket response to Remedies Notice, p4.

Design considerations

5.378 We considered the following elements in the design of this proposed remedy:

- (a) which standard licence conditions concerning the simpler choices component of the RMR rules should be removed;
- (b) which standard licence conditions concerning the simpler choices component of the RMR rules should be retained; and
- (c) how to implement this proposed remedy.

Which standard licence conditions concerning the ‘simpler choices’ component of the RMR rules should be removed

5.379 In our provisional findings, we found that the simpler choices component of the RMR rules (including the ban on complex tariffs, the four-tariff rule and the simplification of cash discounts) reduced suppliers’ ability to innovate and softened competition between PCWs. In addition to these restrictions, we have considered whether the rules concerning the offer of bundled products and reward points should also be removed under this proposed remedy with a view to addressing more fully the RMR AEC.

5.380 We propose to remove the standard licence conditions concerning the following:⁴⁸⁷

- (a) the ban on complex tariffs (SLC 22A.3 (a) and (b));
- (b) the four-tariff rule (SLC 22B.2 (a) and (b));
- (c) the ban on certain discounts (SLCs 22B.3–6 and 22B.24–28);
- (d) the ban on certain bundled products (SLCs 22B.9–16 and 22B.24–28);
- (e) the ban on certain reward points (SLCs 22B.17–23 and 22B.24–28); and
- (f) the prohibition against tariffs exclusive to new/existing customers (SLC 22B.30 and 22B.31).

⁴⁸⁷ The specific wording of these standard licence conditions is set out in Appendix 5.4.

- *Ban on complex tariffs*

5.381 We propose to remove the requirement that all tariffs must have a single standing charge (which may be zero) and either a single unit rate or time-of-use rates (which cannot vary according to the level of consumption).⁴⁸⁸ We consider that these restrictions on the structure of tariffs restrict innovation and competition between suppliers as they are prevented from offering new products or tariffs that are beneficial to certain segments of customer population, particularly in relation to energy usage (eg two-tier ‘no standing charge’ tariffs launched by suppliers to meet the needs of low usage customers, which existed prior to the RMR rules).

5.382 We also considered replacing SLC 22A.3(a) and (b) with a requirement on domestic energy suppliers to structure all tariffs as a single unit rate in pence per kWh. This, unlike SLC 22A.3, would in principle enable customers to compare tariffs without recourse to a PCW or the need to carry out an involved calculation. However, any limit on tariff structures has the potential to stifle innovation and restrict competition. In addition, restricting the structure of all tariffs to a single unit rate would limit suppliers’ ability to respond to smart meter roll-out. While time-of-use tariffs are permitted by the simpler choices component of the RMR rules, no more than one unit rate can apply to any given time period and unit rates cannot vary by the level of consumption. Further, a single unit rate would be of limited benefit in terms of transparency in the presence of discounting.

- *Four-tariff rule*

5.383 We propose to remove the four-tariff rule,⁴⁸⁹ which prohibits suppliers from offering more than four core tariffs per fuel per metering arrangement in any region. We consider that, in addition to the ban on complex tariffs, the four-tariff rule also restricts suppliers’ ability to compete and innovate as they are prevented from offering new tariffs or products to attract customers and respond effectively to tariffs introduced by their competitors. The four-tariff rule is particularly restrictive in relation to the ability of suppliers to offer tariffs that are designed to attract specific groups of customers rather than being targeted at the mass market (eg tariffs aimed at low consumption users, tariffs aimed at certain social groups and tariffs with particular characteristics such as ‘green tariffs’ and tracker tariffs).

⁴⁸⁸ SLC 22A.3 (a) and (b).

⁴⁸⁹ SLC 22B.2 (a) and (b).

5.384 We also consider that with the removal of the four-tariff rule competition between PCWs has the potential to exert downward pressure on commissions and tariffs as they will be able to negotiate exclusive tariffs with energy suppliers. For similar reasons, we considered, but have provisionally decided not to proceed with replacing SLC 22B.2(a) and (b) with a restriction containing a higher number of permitted tariff structures.

- *Ban on discounts*

5.385 We propose to remove the restrictions prohibiting suppliers from offering discounts that fall outside of three permitted types of cash discount, ie dual fuel, online account management, and dividend payments.⁴⁹⁰ We consider that, in addition to the ban on complex tariffs and the four-tariff rule, such restrictions also restrict competition among suppliers. The removal of these restrictions will allow suppliers to offer other types of discounts which might incentivise customers to switch (eg cashback) and reward them for behaviour that reduces suppliers' costs (prompt payment discounts). In addition, the removal of such restrictions will also give more flexibility to suppliers in respect of the manner in which such discounts are offered to domestic customers (for instance, suppliers will be allowed to offer one-off discounts and discounts applying to new or existing customers only).

- *Ban on bundled products*

5.386 We propose to remove the rules concerning the offering of bundled products which include rules on how products may be bundled with tariffs and the form they take.⁴⁹¹ We consider that these rules restrict competition among suppliers and restrict innovation.⁴⁹² In particular, the current bundling restrictions are designed to be applied in tandem with the four-tariff rule with the aim of simplifying suppliers' tariff offerings. The removal of these restrictions will allow suppliers to offer packages of tariffs with other services and allow flexibility in respect of the manner in which such discounts are offered to customers.

- *Ban on reward points*

5.387 We propose to remove the rules concerning the offering of reward points discounts.⁴⁹³ We consider that these rules also restrict innovation and

⁴⁹⁰ SLCs 22B.3–6 and 22B.24–28.

⁴⁹¹ SLCs 22B.9–16 and 22B.24–28.

⁴⁹² Bundling is a common business practice for which there are many pro-competitive and efficiency reasons. Bundling may breach competition laws if a dominant firm uses it abusively (eg to exclude rivals).

⁴⁹³ SLCs 22B.17–28.

competition among suppliers. The removal of these restrictions will allow suppliers to decide on how reward points are offered with tariffs and the form they take. For instance, they will be able to have a refer-a-friend initiative where existing customers and the individual referred receive a reward (instead of having to make the reward available to all customers).

- *New and existing customers*

5.388 We propose to remove the requirement that suppliers must ensure that all its tariffs are available to new and existing customers subject to some exceptions⁴⁹⁴ as we consider that this restriction has the potential to dampen competition between suppliers. We also consider that removing this restriction would be effective in allowing suppliers to innovate more.

5.389 We recognise that removing this restriction may risk the unintended consequence of resulting in harm to inactive customers by removing a constraint which active customers impose on suppliers' pricing.⁴⁹⁵ However, we consider that this risk would be mitigated by the increase in competition that suppliers would face for the retention of their existing customers. In particular, if suppliers were to restrict the availability of their most competitive tariffs to new customers, this could result in the loss of more active customers to rival suppliers who would be expected to respond using similar tactics. Those lost customers would be costly to replace.⁴⁹⁶ In addition, we were told by suppliers that they made all tariffs available to new and existing customers prior to the introduction of the RMR rules (see the provisional findings report, Appendix 7.3).

5.390 We also recognise that removing this provision could make the Cheapest Tariff Messaging provisions (which require suppliers to provide their customers with information about their cheapest available tariffs) redundant. In particular, if suppliers are not required to make all their tariffs available to new and existing customers, these provisions could have the effect of encouraging suppliers to restrict the availability of their most competitive tariffs to new customers so as to avoid showing their current customers their best rates. Recent experience with white label and collective selling arrangements demonstrates the risks of suppliers gaming current RMR rules to avoid showing their current customers their best rates.⁴⁹⁷ However, as discussed in Section 6 (see 'Ofgem-led programme'), we propose to

⁴⁹⁴ SLC 22B.30 and 22B.31.

⁴⁹⁵ This is analogous to the argument that marginal customers protect infra-marginal customers.

⁴⁹⁶ The Six Large Energy Firms have typically paid commissions to PCWs in the range of £15–£35 per fuel (see [Appendix 8.3](#) to the provisional findings, paragraph 7).

⁴⁹⁷ Ofgem recently clarified that Cheapest Tariff Messaging should include all the tariffs offered by a supplier including white label and collective switching tariffs.

recommend to Ofgem that it trials Cheapest Tariff Messaging that covers all tariffs available in a market. Cheapest Tariff Messaging that covers all the market could mitigate risks associated with such provisions by reducing the opportunities for any supplier to manage messaging to their existing customers by segmenting the market.

5.391 Generally we consider that the interests of consumers are better served by promoting innovation and competition rather than imposing restrictions that might adversely impact on the incentives and ability of suppliers to respond to competition.

5.392 We also propose as part of the proposed remedy, to recommend to Ofgem that it makes any consequential standard licence condition amendments. In particular, the standard licence condition concerning the information tools introduced as part of the 'clearer information' component of the RMR rules.

Which standard licence conditions concerning the 'simpler choices' component of the RMR rules should be retained

5.393 We propose to retain the standard licence conditions concerning the following:⁴⁹⁸

- (a) the recovery of charges (SLC 22A.2);
- (b) the tariff name (SLC 22B.2 (c));
- (c) charges for different payment methods (SLCs 22B.7(a) and 27.2A);
- (d) fixed-term tariffs (SLC 22C); and
- (e) dead tariffs (SLC 22D).

- *Recovery of charges*

5.394 We propose to keep the requirement on suppliers to include all charges for supply activities in the unit rate (or time-of-use rates) and/or the standing charge.⁴⁹⁹ We consider that this requirement helps consumers better understand tariffs and prevent 'drip pricing'.⁵⁰⁰ In contrast to the use of discounts and bundles, while the removal of this restriction might be effective in allowing suppliers to innovate more, we consider that it may risk the

⁴⁹⁸ The specific wording of these standard licence conditions is set out in Appendix 5.4.

⁴⁹⁹ SLC 22A.2.

⁵⁰⁰ Drip pricing is where an advertised headline price does not include additional fees and charges that are later disclosed incrementally in the sales process.

unintended consequence of harming customers on the basis that there is limited pro-competitive benefit arising from drip pricing and a considerable risk that it may be used to mislead customers by exploiting common behavioural biases.⁵⁰¹

- *Tariff name*

5.395 We propose to keep the requirement that suppliers must not use (in any region) more than one tariff name for each core tariff at any time.⁵⁰² We consider that this requirement does not materially impact suppliers' ability to innovate.

- *Charges for different payment methods*

5.396 We propose to keep the requirements concerning the charges for different payment methods⁵⁰³ (subject to our proposed remedy concerning the Prepayment AEC and softening the application of the standard licence condition as regards supply to prepayment customers), ie suppliers must ensure that any differences in charges between payment methods must be cost reflective. The requirement that differences in charges between payment methods must be cost reflective is set out in EU law.⁵⁰⁴

- *Dead tariffs*

5.397 We propose to keep the requirements concerning fixed-term tariffs (eg suppliers cannot roll over fixed-term contracts if, at the end of a fixed contract, customers have not chosen another tariff or supplier, and suppliers cannot increase the price of a fixed-term supply contract, or unilaterally vary any terms and conditions in any way which makes the customer worse off).⁵⁰⁵ We note that the restriction in fixed-term contracts on suppliers unilaterally varying the price or other terms and conditions in any way which makes the customer worse off reflects requirements set out in consumer law, ie that terms in contracts between businesses and consumers must be

⁵⁰¹ See, for example, Office of Fair Trading (2010), Advertising of prices.

⁵⁰² SLC 22B.2 (c).

⁵⁰³ SLC 22B.7 (a) and SLC 27.2A.

⁵⁰⁴ European Parliament and Council Directive 2009/73/EC ('the Gas Directive') of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (2009) OJ L 211/94, Annex I 1(d); and European Parliament and Council Directive 2009/72/EC ('the Electricity Directive') of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (2009) OJ L 211/55, (Annex I 1(d)).

⁵⁰⁵ SLC 22C.

fair and transparent.⁵⁰⁶ We also consider that these restrictions make fixed-term tariffs easier to understand and less risky for consumers by aligning offers with their expectations and mitigating concerns about auto-rollovers.

- 5.398 We propose to keep the requirements concerning dead tariffs as we see no obvious pro-innovation reasons for allowing suppliers to keep those tariffs.⁵⁰⁷ Under the existing rules, suppliers must not have evergreen tariffs that are not available to new customers (ie dead tariffs) subject to two exceptions: (a) in order to permit suppliers to transfer their customers off dead tariffs; and (b) to permit customers to continue on dead tariffs which are cheaper than the cheapest equivalent evergreen tariff which is available to new customers. We consider that these restrictions address concerns that dead tariffs allow suppliers to segment the market and their removal may undermine our remedies concerning the Domestic Weak Customer Response AEC (see Section 6) by contributing to customer confusion as they may find it difficult to find details of their dead tariffs for comparison.

How to implement this remedy

- 5.399 We propose to implement this remedy through a recommendation to Ofgem (a) to modify the gas and electricity standard licence conditions to remove the following conditions: the ban on complex tariffs, the four-tariff rule, the ban on certain discounts, the ban on certain bundled products, the ban on certain reward points, and the prohibition against tariffs exclusive to new/existing customers; and (b) to make any necessary minor consequential amendments. Pending making the necessary amendments to suppliers' licences, we also propose to recommend that Ofgem deprioritise potential enforcement action concerning the licence conditions noted above against any supplier that operates in breach of such conditions.

Assessment of effectiveness

- 5.400 In our provisional view, the proposed remedy would be effective in achieving its aim of promoting competition and innovation between retail energy suppliers in the retention and acquisition of domestic customers, and facilitating competition between PCWs in the supply of services to domestic

⁵⁰⁶ Part 2 of the Consumer Rights Act 2015 which implements Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts (and replaces the Unfair Terms in Consumer Contracts Regulations 1999 with effect from 1st October 2015). For the application of the fairness test to terms in consumer contracts permitting the business to unilaterally vary price or other contract terms, see in particular the following judgments of the Court of Justice of the European Union: Cases C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* and C-92/11 *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen e.V.* EU:C:2013:180. The CMA's view on the application of Part 2 of the CRA to such terms is set out in its Unfair Contract Terms Guidance (CMA37) at paragraphs 5.21.1–5.23.7.

⁵⁰⁷ SLC 22D.

customers (see paragraphs 5.368). Accordingly, the proposed remedy would be effective in addressing the RMR AEC and the resulting consumer detriment.

- 5.401 In assessing the effectiveness of the proposed remedy, we have, in particular, considered the following factors:
- (a) whether our proposed remedy would be expected to promote competition (and innovation) between suppliers and between PCWs;
 - (b) the extent to which the proposed remedy is capable of effective implementation, monitoring and enforcement;
 - (c) the timescale over which the proposed remedy is likely to have an effect. and
 - (d) compliance with existing or expected laws and regulations.

Competition and innovation between retail energy suppliers

- 5.402 We consider that evidence on the potential effectiveness of the removal of the simpler choices component of the RMR rules to promote competition between suppliers is provided by:
- (a) suppliers' submissions, and our own analysis, of how they behaved prior to the RMR rules, and how they responded to the introduction of those rules; and
 - (b) suppliers' submissions on how they would respond to the removal of these rules and the derogations to the relevant standard licence conditions that have been sought, granted and rejected since implementation of these rules.
- 5.403 In the provisional findings report we noted that the introduction of the RMR rules, and specifically the four-tariff rule, resulted in the Six Large Energy Firms withdrawing a number of tariffs and discounts, and changing tariff structures that may have been beneficial to customers and competition (provisional findings report, paragraph 8.243).
- 5.404 All of the Six Large Energy Firms said that if the simpler choices rules were to be removed they would offer (or would consider offering) new tariffs and products to their domestic customers (see Appendix 5.5 for further details). In particular:

- (a) Centrica said that it would look to market [REDACTED].⁵⁰⁸
- (b) EDF Energy said that it would expect to see the re-emergence of some of the types of tariff that were available before the RMR rules, such as [REDACTED].⁵⁰⁹
- (c) E.ON said that it might continue with some of the ideas that it was working on prior to the RMR rules, [REDACTED]. E.ON also said that the introduction of smart meters was likely to maximise the effectiveness of this remedy.⁵¹⁰
- (d) RWE said that it would be an opportunity for suppliers to create differentiated and bespoke tariffs positioned to appeal to different customer groups (such as social and green tariffs, tariffs for landlords, tariffs designed in partnership with charities and tariffs for those with electric vehicles) and to offer discounts to target different lower price offers at low and high consumption customers. RWE also said that it might incentivise engagement by, for example, offering lifestyle bundles, and loyalty and reward schemes.
- (e) Scottish Power said that based on previous experience, energy suppliers might consider returning to offering discounted tariffs (where the tariff is priced for a fixed-term at a fixed discount to the SVT), tariffs with no standing charge, cashbacks, and capped and 'tracker' products, as well as experimenting with time-of-use tariffs when a critical mass of smart meters had been rolled out.⁵¹¹

5.405 The Six Large Energy Firms said that there were technical constraints on the number of tariffs that they could offer prepayment customers (see paragraphs 5.189 to 5.318 above for discussion of prepayment related remedies), but that the proposed remedy should facilitate greater choice for prepayment customers by enabling suppliers to offer a greater variety of discounts, in particular, for prepayment customers with a smart meter.^{512,513}

5.406 In Appendix 5.5 we provide detailed information on the derogations sought, granted and rejected concerning issues such as the four-tariff rule, the ban

⁵⁰⁸ Centrica response to Remedies Notice, p55.

⁵⁰⁹ EDF Energy response to Remedies Notice, p15, paragraph 3.14.

⁵¹⁰ E.ON response to provisional findings and Remedies Notice, p20, paragraph 93.

⁵¹¹ Scottish Power response to Remedies Notice, p9, paragraph 3.6.

⁵¹² RWE response to provisional findings, p44, paragraph 215. RWE said that there were technical constraints on the number of tariffs that they could offer prepayment customers due to the limited number of available tariff slots across the industry but that, notwithstanding the technical constraints, the proposed remedy should facilitate greater choice for prepayment customers by enabling suppliers to offer a greater variety of discounts such as cashback and other non-cash incentives.

⁵¹³ Scottish Power response to Remedies Notice, Table 1.

on certain discounts, and the prohibition against tariffs exclusive to new/existing customers. Our view is that the number and nature of the derogations sought is further evidence that the simpler choices rules have been a constraint on the tariffs and discounts offered by retail energy suppliers to their domestic customers, but that the number of derogations sought and granted will understate the extent of the constraint imposed by the relevant rules. This is because Ofgem will grant derogations only where an applicant can demonstrate that compliance with one or more relevant standard licence conditions would have substantial unintended or unanticipated negative consequences for consumers.⁵¹⁴ In addition, we consider that the need for suppliers to go through a process of seeking derogations in which the onus is on them to demonstrate that these conditions for granting a derogation are met creates delays and uncertainty that could deter suppliers from making applications. Such a process also has the potential to distort competition if some suppliers are in a better position than others to navigate the process.

Competition between price comparison websites

- 5.407 We consider that the removal of the simpler choices component of the RMR rules together with the removal of the ‘whole of the market’ requirement from the Confidence Code (see paragraph 5.414 below) should promote competition between PCWs by allowing them to negotiate exclusive tariffs with retail energy suppliers putting downward pressure on tariff prices and commissions they receive from suppliers. In addition to addressing the RMR AEC, this proposed remedy also therefore addresses part of the Domestic Weak Customer Response AEC.
- 5.408 We have been told that the simpler choices rules are a constraint on PCWs negotiating exclusive tariffs as these tariffs would count towards suppliers’ four permitted tariffs, under the four-tariff rule.
- 5.409 We consider that, absent the four-tariff rule, PCWs would be in a good position to negotiate favourably priced tariffs with retail energy suppliers. In particular, in our provisional findings we found that PCWs are becoming an increasingly important sales channel for energy suppliers.⁵¹⁵ In addition, we consider that PCWs could have an incentive to offer suppliers lower commission rates in exchange for exclusive rights to cheaper deals. For both

⁵¹⁴ Ofgem’s Guidance for Derogation Requests says that on an enduring basis it is envisaged that the minimum duration for a derogation will be about six weeks, however the process could take up to six months. See Ofgem (25 September 2013), Guidance for derogation requests from domestic Retail Market Review (RMR) licence conditions.

⁵¹⁵ See Appendix 8.3: Price comparison websites and collective switches.

suppliers and PCWs, the attraction of such deals would be achieving a high volume of sales with favourably priced tariffs that might be promoted in joint advertising campaigns.

- 5.410 We consider that the willingness, absent the four-tariff rule, of retail energy suppliers and PCWs to participate in such negotiations is demonstrated by the recent collective switching schemes. In particular, the collective switch schemes have had an exemption from the four-tariff rule (see Section 6) and have offered exclusive tariffs negotiated by the scheme organiser (which in some cases was a PCW) with an energy supplier. First Utility said that PCWs had used the collective switching rules as a way to create exclusive tariffs.
- 5.411 In recent years Centrica, E.ON, RWE and Scottish Power have all participated in schemes which have typically offered customers a discount to their SVT. Commissions have been part of the negotiation. In 2015 E.ON agreed collective tariffs with three organisers (iChoosr, EnergyHelpline and uSwitch) which offered discounts of more than 20% on its SVT and accounted for around [X]% of acquisitions from January to July 2015.
- 5.412 As explained above (see paragraph 5.409), the proposed remedy may be expected to exert downward pressure on the levels of commission charged by PCWs. In Section 3 we give estimates of the detriment to domestic energy customers arising from the prices of the Six Large Energy Firms exceeding competitive levels. These estimates do not, however, allow for lower levels of commission charged by PCWs. We therefore consider it plausible that there are incremental benefits to customers attributable to this proposed remedy.
- 5.413 In 2014 the Six Large Energy Firms paid a total of £24 million in commissions to PCW for acquisition of domestic customers. Typical commission rates, per fuel, charged by PCWs and those for collective switching schemes have been between £[X] and £[X] per fuel⁵¹⁶ and £[X] and £[X]⁵¹⁷ respectively. The wide range in the level of commission rates demonstrates that there is scope for competition to put downward pressure on commission rates. If the average commission rate were to fall by just

⁵¹⁶ Specifically for the Six Large Energy Firms:

- (a) Centrica's commission payment ranges [X];
- (b) EDF Energy's commission payment ranges from [X] to [X] per fuel;
- (c) E.ON's commission payment ranges from [X] to [X] per fuel;
- (d) RWE's commission payment ranges from [X] to [X] per fuel;
- (e) Scottish Power's commission payment ranges from [X] to [X] per fuel; and
- (f) [X] per fuel. [X]

⁵¹⁷ For the collective switches the Six Large Energy Firms have previously won: (a) Centrica paid commission of [X], (b) E.ON paid commission [X] (c) RWE paid commission of [X] and (d) Scottish Power paid commission of £[X] per service.

10%, based on the volume of switches through PCWs in 2014 we estimate a reduction in commission payments paid by the Six Large Energy Firms of about £2.4 million. The potential benefits may be higher if the number of switches through PCWs increases.

- 5.414 For reasons set out in Section 6, we consider that the effectiveness of removing the four-tariff rule, in terms of allowing for PCWs to negotiate exclusive deals, would be significantly undermined by the requirement in the Confidence Code to display the whole of the market. Accordingly, we are proposing, as part of a package of remedies aimed at promoting the role of PCWs, to remove this requirement (see Section 6).

Implementation, monitoring compliance and enforcement

- 5.415 In determining whether a proposed remedy is effective, we have had regard to the need for the proposed remedy to be clear to the persons to whom it is directed, such as suppliers; and also to other interested persons, such as Ofgem (which would have responsibility for implementation, monitoring and compliance).
- 5.416 As regards the implementation of the proposed remedy, we have set out a number of detailed specifications (see paragraphs 5.380 and 5.393 above). In this regard, we have sought to take a detailed approach by describing the terms of the proposed remedy (and the associated licence conditions that would be affected) so that it would not only be clear to Ofgem (as the addressee of our recommendation) to understand, but also be straightforward for it to introduce.
- 5.417 We have also considered whether to implement this proposed remedy by way of an order on suppliers. However, we do not consider that it would be appropriate to impose an order on suppliers given that they do not ultimately control what conditions are included in their licences. Ofgem, as sector regulator, is responsible for maintaining suppliers' licences, and their terms and conditions.
- 5.418 We have also considered whether it may be appropriate to order Ofgem to remove the relevant licence conditions. However, we believe such a measure would be unnecessary on the basis that we are proposing not only to recommend that Ofgem remove the relevant licence conditions, but also that Ofgem deprioritises potential enforcement action concerning such licence conditions.
- 5.419 As regards monitoring compliance, Ofgem would be under a duty to monitor compliance with the licence conditions and, as noted above, well placed to

deprioritise action concerning potential breaches of the licence conditions that we propose to recommend are removed.

Timescale

- 5.420 In evaluating the effectiveness of the proposed remedy, we have considered the timescale over which the RMR AEC would be expected to endure, and the timescale over which the proposed remedy would be likely to take effect. As regards the RMR AEC, our provisional view is that, absent the proposed remedy, the detriment would persist, and would likely become exacerbated by the national programme for the roll-out of smart meters and the implementation of our other proposed remedies concerning the Domestic Weak Customer Response AEC and the Prepayment AEC.
- 5.421 As regards timescales for implementation, we consider that the proposed remedy could be implemented by all suppliers within reasonable timescales following removal from their licences. We expect this proposed remedy to have effect within a relatively short time period given:
- (a) the evidence that suppliers previously offered tariffs which they may look to reintroduce (see paragraph 5.5);
 - (b) the number of derogation requests; and
 - (c) that the time to design and launch a new tariff is relatively short. For example, uSwitch said it could take several weeks to create and launch a new tariff.⁵¹⁸
- 5.422 We expect that Ofgem's consultation on the removal of the relevant standard licence conditions would conclude by the end of 2016. Ofgem could then implement and enforce the revised standard licence conditions from the beginning of 2017 with suppliers permitted to provide a wide range of tariffs. However, in order for our proposed remedy to take effect as soon as possible, we are also proposing to recommend that Ofgem deprioritise potential enforcement action against any supplier that operates in breach of the licence conditions being removed.
- 5.423 We also expect that this proposed remedy will become more effective with the roll-out of smart meters. While time-of-use tariffs are permitted by the RMR simpler choices rules, no more than one unit rate can apply to any given time period and unit rates cannot vary by the level of consumption.

⁵¹⁸ uSwitch response to Remedies Notice, p8.

Compliance with existing or expected laws and regulations

- 5.424 Ofgem has submitted that the RMR rules were designed as an integrated package and hence removing one component would have knock-on implications for other aspects. In particular, if the standard licence conditions restricting the number of tariffs (SLC 22B.2 (a) and (b)), tariff structure (SLC 22A.3(a) and (b)) and cash discounts (SLCs 22B.4-6) were removed, Ofgem said the methodologies for calculating the ‘Tariff Comparison Rates’, ‘Personal Projections’ and ‘Cheapest Tariff Messaging’ would need to be revisited to ensure that the tools continue to serve their policy intent. Ofgem has submitted that these tools were not designed to accommodate multi-tier tariffs and a wide variety of discounts and bundles. Ofgem has also submitted that a tariff with multiple unit rates would require multiple lines in the ‘Tariff Information Labels’ which might be confusing.⁵¹⁹
- 5.425 Three of the Six Large Energy Firms said that the ‘Cheapest Tariff Messaging’ requirements would not be compatible with an increase in the number, complexity and range of tariffs.^{520,521,522}
- 5.426 We are currently minded to maintain the information tools introduced as part of the RMR rules, and propose to make a recommendation that Ofgem makes the necessary methodological amendments that may be required (see paragraph 5.392). Ofgem said that it is well placed to update the tools.⁵²³

⁵¹⁹ Ofgem said that at present all discounts (cash and non-cash) were included in the TCR and PP. However, the licence distinguishes between contingent and non-contingent discounts. The latter are always included but the former are not, except for cash discounts for dual fuel and online account management. If suppliers are able to offer more types of contingent cash discounts, Ofgem will need to consider whether these should also be included in the TCR and PP, and if dual fuel and online discounts should continue to be included. Ofgem may also consider whether suppliers should inform their customers which contingent discounts are included/excluded from the TCR and PP.

⁵²⁰ Centrica said that the Cheapest Tariff Messaging was incompatible with a more varied, tailored product range because as non-price elements became more important, a recommendation based on the energy unit cost was likely to be inaccurate and misleading. See Centrica response to provisional findings and Remedies Notice, p21, paragraph 84.

⁵²¹ EDF Energy said that the implementation of this remedy would require the regulation around Cheapest Tariff Messaging to be removed as it would no longer be practical or helpful to customers due to the increased number and complexity of tariffs and likely frequency of changes. See EDF Energy response to Remedies Notice, p15, paragraph 3.17.

⁵²² SSE said that changes may be required to other RMR rules to ensure this remedy could most effectively meet its objectives. For example, the Cheapest Tariff Messaging to ensure information overload did not curtail engagement as more innovative products are introduced. See SSE response to Remedies Notice, p21.

⁵²³ Ofgem (18 November 2015), Paper 1: Impact of remedy 3 on consumer engagement, working paper.

Assessment of proportionality

5.427 In this section we set out our assessment of whether our proposed remedy would be proportionate to achieve its aim. We do this by considering whether the proposed remedy:⁵²⁴

- (a) would be effective in achieving its legitimate aim;
- (b) would not be more onerous than needed to achieve its aim;
- (c) would be the least onerous if there were a choice between several effective measures; and
- (d) would not produce disadvantages which are disproportionate to the aim.

Would be effective in achieving its legitimate aim

5.428 For the reasons set out in paragraphs 5.400 to 5.426 above, we consider that the proposed remedy would be effective in achieving its aim of promoting competition and innovation between retail energy suppliers in the retention and acquisition of domestic customers, and facilitating competition between PCWs in the supply of services to domestic customers. Accordingly, it would be effective in addressing the RMR AEC and the resulting consumer detriment.

No more onerous than needed to achieve its aim

5.429 We also consider that this proposed remedy would be no more onerous than needed to achieve its aim. We have considered each of the individual parts of the simpler choices component of the RMR rules, and reached a provisional decision on whether each part should be removed or retained. In doing so, we propose only to remove those parts that have a clear detrimental effect on innovation and competition, and where any unintended adverse consequences of their removal can be addressed through other remedies we are proposing (see paragraph 5.367).

Least onerous if there were a choice between several effective measures

5.430 As noted above, we have considered several variations concerning the proposed remedy, and whether there may be alternative remedies that achieve the same aim. However, we provisionally consider that the proposed

⁵²⁴ CC3, paragraph 344, citing the principles established in the *Fedesa* case, Case C-331/88, *the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others*, (1990) ECR I-4023, paragraph 13.

remedy is the only form of remedy that would be effective to address fully the RMR AEC and, for each part of the simpler choices component of the RMR rules that we propose to remove, we have reached the provisional conclusion that only its removal would be effective (rather than a potentially less onerous alternative of replacing the condition with a less restrictive version, such as an 'eight-tariff' rule or allowing certain complex tariffs or discounts to continue to be prohibited). We therefore do not consider that there is a less onerous remedy that would be equally as effective.

Would not produce disadvantages disproportionate to the aim

- 5.431 We have provisionally concluded that the proposed remedy would not produce adverse effects that would be disproportionate to its aim. In particular, we consider that implementation of this remedy should result in minimal cost for suppliers and PCWs as this simply requires amendments to the supplier licence conditions. The cost to suppliers of understanding the implications of the remedy for their business should also be minimal given that the simpler choices component of the RMR rules was only recently introduced. In the context of this assessment, we have considered any unintended consequences resulting from the proposed remedy.
- 5.432 The removal of the simpler choices component of the RMR rules may result in more tariffs and a wider range of products on the market. However, our view is that there are a range of tools which may help customers navigate the tariffs on offer in the market and make decisions and, accordingly, address any such unintended consequences arising from this proposed remedy. These tools are the following:
- (a) PCWs have an increasingly important role in the market. For example, PCWs are being increasingly used by customers for searching and switching;⁵²⁵ PCWs are an important source of domestic customer acquisitions for suppliers; and for energy-focused PCWs, energy accounts for a large part of their revenue.⁵²⁶ We expect PCWs to be able to handle an increase in the number and range of tariffs. PCWs have the incentive to innovate in response to the emergence of innovative offerings to help customers compare offers and make informed decisions. uSwitch told us that pre-RMR it did not face such problems and uSwitch said it employed capable mathematicians who could design tools to cut through tariff complexity in order to provide a comparison. In addition, given the importance of PCWs to suppliers, we think that it

⁵²⁵ See Appendix 8.3: Price comparison websites and collective switches.

⁵²⁶ See Appendix 8.3: Price comparison websites and collective switches.

would not be in suppliers' interests to design tariffs that are too complicated to be displayed on PCWs. Finally, we are also proposing remedies that we would expect to promote the use of PCWs (see Section 6).

- (b) QR (Quick Response) codes⁵²⁷ and Midata⁵²⁸ can assist customers who have access to and are confident in using the relevant technologies in making comparisons.
- (c) Citizens Advice's price comparison service (which operates as a white label solution with source data provided by Energylinx) should also help customers make comparisons. This may be particularly helpful to customers who do not trust or use commercial PCWs and those without internet access.

5.433 In addition, some of the Six Large Energy Firms told us that there were operational, practical and reputational constraints on the number of tariffs they offered. For example, Scottish Power said that each new tariff had to be built on the billing system at significant cost and the Cheapest Tariff Messaging calculation had a significant impact on the processing time for a billing run, and the time taken would increase with the number of tariffs that needed to be compared. In our provisional findings report we found that before the introduction of the simpler choices component of the RMR rules suppliers had reduced the number of tariffs they offered.⁵²⁹ Centrica said that the market was self-correcting before RMR.

5.434 We have also considered the extent to which the Standards of Conduct rules in the 'fairer treatment' component of the RMR rules should mitigate the risks associated with our proposed remedy (see Section 6).

Duty to have regard to Ofgem's statutory duties

5.435 Pursuant to Schedule 9 of the 2002 Act the CMA has powers under the EA89 and GA86 to provide for the modification of standard licence conditions to such an extent as may appear to be requisite or expedient for the purpose of giving effect to any provision made by an order under section 160 or 161 of the 2002 Act. Section 168 of the 2002 Act requires the CMA, when it is considering whether to modify licence conditions in a regulated

⁵²⁷ QR codes are machine-readable codes used for storing website addresses or other information and are read using the camera on a smartphone. They are present on energy bills, helping customers compare tariffs across the market.

⁵²⁸ Midata is a voluntary programme the government is undertaking with industry, which over time will give consumers increasing access to their personal data in a portable, electronic format.

⁵²⁹ See Appendix 8.2: Impact of the Retail Market Review, paragraph 11.

sector by way of an order, to ‘have regard to the relevant statutory functions of the sectoral regulator concerned’. As we are minded to remove some of the simpler choices SLCs introduced by Ofgem pursuant to its RMR, we have had regard to Ofgem’s statutory duties and objectives when reviewing the simpler choices SLCs.

- 5.436 Ofgem’s statutory duties and functions, set out in the EA89 and the GA86, as amended by the EA10,⁵³⁰ have set competition as a secondary objective, with the principal objective being the interests of existing and future consumers taken as a whole, including decarbonisation, security of supply and the fulfilment by Ofgem of the objectives set out in Article 40(a) to (h) of the Gas Directive⁵³¹ and Article 36(a) to (h) of the Electricity Directive.⁵³²
- 5.437 Ofgem is generally required to carry out its functions in the manner it considers best calculated to further the principal objective. Before deciding to carry out its functions in a particular manner with a view to promoting competition, Ofgem must consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests,⁵³³ having regard (among other things) to (i) the need to secure that, so far as economical to meet them, all reasonable demands for gas and electricity supply are met and can be financed, (ii) achieving sustainable development, and (iii) the interests of ‘vulnerable’ consumers.⁵³⁴
- 5.438 As stated above, we propose to remove the simpler choices standard licence conditions concerning:
- (a) the structure of tariffs (SLC 22A.3 (a) and (b));
 - (b) the number of tariffs that suppliers can offer to domestic customers (the ‘four-tariff rule’ (SLC 22B.2 (a) and (b));
 - (c) the offer of discounts (SLCs 22B.4–6 and 22B.24–28);
 - (d) the offer of bundled products (SLCs 22B.9-16 and 22B.24–28);

⁵³⁰ Sections 4AA(1)(1A), 34, 35, 36, 36A of the GA86; Sections 3A(1)(1B), 43, 47, 48, 49 of the EA89.

⁵³¹ European Parliament and Council Directive 2009/73/EC of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (2009) OJ L 211/94.

⁵³² European Parliament and Council Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (2009) OJ L 211/55.

⁵³³ Section 4AA(1)(1C) of the GA86; Section 3A(1)(1C) of the EA89.

⁵³⁴ [Powers and duties of GEMA](#).

- (e) the offer of reward points (SLCs 22B.17–23 and 22B.24–28); and
 - (f) making all tariffs that are available to new customers also available to existing customers (subject to some exceptions)(SLCs 22B.30 and 22B.31).
- 5.439 In reaching our provisional decision to remove each of the aforementioned simpler choices standard licence conditions we have, as part of our own application of the legal framework requiring us to decide upon proposed remedies that are effective and proportionate,⁵³⁵ taken into account Ofgem’s statutory duties and objectives below.
- 5.440 In particular, we do not consider that any aspect of this proposed remedy will have an adverse impact on suppliers’ ability to meet all reasonable demands for gas and electricity supply, achieving sustainable development, security of supply or environmental concerns. In this regard, the proposed remedy will only impact the ‘efficiency’ limb of the Trilemma considerations built into Ofgem’s statutory duties and functions, insofar as we would expect each restriction being removed under the proposed remedy to result in an enhanced ability for suppliers to innovate when offering tariffs to domestic customers. In turn, we would expect this to translate to greater choice for consumers.
- 5.441 In addition to generally allowing suppliers to innovate and compete more intensively for domestic customers, we note that the removal of the following restrictions will lead to additional efficiency benefits:
- (a) Structure of tariffs. The removal of the restriction on tariff structure would in particular benefit certain segments of the consumer population that are aware of and interested in their energy usage patterns. We believe such tariffs will become increasingly popular, as the continuing roll-out of smart meters and the industry move towards half-hourly settlement will make it easier and more accurate for customers to monitor their energy usage, and easier for suppliers to tailor tariffs to particular customer groups.
 - (b) The ‘four-tariff rule’. The removal of the four-tariff rule would incentivise PCWs to compete more intensively by negotiating individual deals with suppliers for particular tariffs or packages of tariffs.
 - (c) Discounting and reward points. The removal of the restrictions on certain discounts and reward points would allow suppliers the potential to lower

⁵³⁵ See [CC3](#).

their operating costs as regards domestic customers (as they would have more information on their usage or habits), which could increase the supplier's efficiency. In turn, we would expect this to translate to lower prices.

(d) Bundling. The removal of the restriction on bundling would allow suppliers to offer packages of tariffs with other services that are ancillary to energy supply or concern other utilities sectors. Energy consumers would therefore benefit from a wider choice of products and services across markets.

5.442 In having regard to Ofgem's principal objective, we have also considered the potential impact that each aspect of the proposed remedy may have on protecting the interests of existing and future consumers, including vulnerable consumers. In this context, we have noted in paragraphs 5.432 to 5.433 above a possible unintended consequence of the proposed remedy (were it to be implemented by itself), concerning a potential proliferation of tariffs⁵³⁶ and the potential for such proliferation to lead to harm to consumers, in particular vulnerable consumers or consumers with limited internet access, who may become (or feel) confused.

5.443 However, we note that the proposed remedy would be introduced in conjunction with additional proposed remedies concerning the ability and incentive of PCWs to engage energy consumers (see Section 6), and a proposed new standard of conduct concerning the fair treatment of customers (see Section 6). We are of the view that the former would reduce the search costs of consumers with internet access and that the latter could be appropriately monitored and enforced by Ofgem so as to protect other consumers from unfair treatment. Accordingly, we believe that these additional proposed remedies will protect consumers and guard against this potential adverse outcome.

5.444 Taken together with these other proposed remedies, our provisional view is that the overall proposed remedies package satisfies Ofgem's principal objective of protecting the interests of existing and future consumers wherever possible by promoting effective competition.

⁵³⁶ In Ofgem's response to our Remedies Notice, it indicated that it did not consider an increase in the number of tariffs to be a risk to customer engagement as growth in the number of suppliers in recent years had meant that there were already a large number of tariffs on offer.

Provisional conclusion

- 5.445 We provisionally conclude that our proposed remedy to recommend Ofgem to remove certain aspects of the simpler choices component of the RMR rules (ie restrictions concerning the structure of tariffs, the number of tariffs, and the offer of discounts, bundled products and reward points), combined with a recommendation to Ofgem to remove the ‘whole of market’ requirement in PCWs’ Confidence Code and the addition of a new component to the Standards of Conduct (see Section 6), will be an effective and proportionate remedies package.

Interaction with other remedies

- 5.446 We set out in Section 4 our high-level assessment of how we expect these proposed remedies to interact with the other components of our remedies package, notably proposed measures to help customers engage to exploit the benefits of competition and proposed measures to protect customers who are less able to engage to exploit the benefits of competition. In Section 8, we present an assessment of the effectiveness and proportionality of the remedies package for domestic customers as a whole.

6. Domestic retail: helping customers engage to exploit the benefits of competition

- 6.1 In the provisional findings report we provisionally found that a combination of features in the markets for the domestic retail supply of gas and electricity give rise to an AEC though an overarching feature of weak customer response (the Domestic Weak Customer Response AEC), which, in turn, gives suppliers a position of unilateral market power concerning their inactive customer base which they are able to exploit through their pricing policies or otherwise.⁵³⁷
- 6.2 The features we identified included: customers' limited awareness of and interest in their ability to switch energy supplier; actual and perceived barriers to accessing and assessing information; and actual and perceived barriers to switching.
- 6.3 As noted earlier in this report (see paragraphs 3.12 to 3.22), the most recent evidence we have gathered on the gains available to customers from switching has strengthened our view that substantial numbers of domestic customers on standard meters and Economy 7 meters exhibit weak customer response. Indeed the evidence shows that the gains available to – but not exploited by – customers on the standard variable tariff (who still make up the substantial majority of the customers of the Six Large Energy Firms) have increased considerably over the last two years.
- 6.4 We also noted that the overall weight of evidence supports a provisional finding that disengagement and weak customer response is a more significant problem among customers on prepayment meters compared with domestic customers on direct debit (see paragraphs 3.79 to 3.102). We note a number of factors that may explain this:
- (a) Prepayment customers face particular restrictions on accessing and assessing information about switching (including relatively low access to the internet and confidence in using PCWs).
 - (b) Prepayment customers include higher proportions of individuals with low levels of income; with low levels of education; living in social rented housing; and having a disability – demographic characteristics that we have found to be associated with low levels of engagement in retail energy markets.

⁵³⁷ [Provisional findings report](#), paragraph 12.4.

- (c) While the need to top up prepayment cards regularly is likely to increase awareness of retail energy markets among prepayment customers, low levels of engagement may have in part been influenced by the outcomes we have observed arising from the Prepayment AEC – notably the lower gains from switching and the confusion surrounding rights to switch when the customer has outstanding debt.
- 6.5 Finally, on the basis of our further analysis of the retail supply of electricity to domestic customers on restricted meters (see paragraphs 3.114):
- (a) We consider that Ofgem’s research concerning customers on restricted DTS meters demonstrates that customers on restricted meters have particularly limited awareness of, and interest in, their ability to switch energy supplier.
 - (b) We have provisionally found that customers on restricted meters face higher barriers to accessing and assessing information arising, in particular, from a general lack of price transparency concerning the tariffs that are available to them, which results from restricted meter tariffs not being supported by PCWs or suppliers’ online search tools and also from low incentives on suppliers to invest in marketing to customers on restricted meters.
 - (c) We have also provisionally found that customers on restricted meters face higher actual and/or perceived barriers to switching arising, in particular, from the following aspects of the domestic retail electricity market concerning customers on restricted meters:
 - (i) a requirement imposed by suppliers on some customers on restricted meters to replace their existing meter with an unrestricted, Economy 7 or Economy 10 meter at a cost to the customer;
 - (ii) the fact that changing meter might also involve some rewiring in the home; and
 - (iii) the uncertainty customers face in determining whether switching supplier is a good thing given the difficulties they face in both comparing the options available to them and taking into account the possible irreversible loss of the functionality of their meter.
- 6.6 In this section we set out our proposed package of remedies designed to help domestic energy customers engage to exploit the benefits of competition by addressing certain aspects of the features contributing to the Domestic Weak Customer Response AEC.

6.7 Our proposed remedies package consists of five broad categories of remedy, which focus on the role of different participants in the retail markets – namely, Ofgem, the customer’s own supplier, PCWs, and rival suppliers – in strengthening domestic customer engagement. In particular, the proposed remedies provide for:

- (a) the establishment by Ofgem of a programme to provide customers – directly or through their own suppliers – with information to prompt them to engage;
- (b) Ofgem making greater use of principles rather than prescriptive rules in addressing potential adverse supplier behaviour concerning the comparability of tariffs;
- (c) enhancing the ability and incentives of TPIs to promote customer engagement in the retail energy markets;
- (d) creating an Ofgem-controlled database of ‘disengaged customers’ on default tariffs, to allow rival suppliers to prompt these customers to engage in the retail energy markets; and
- (e) requiring all suppliers to make all their single-rate tariffs available to domestic customers on any type of restricted meter, without making switching conditional on a restricted meter being replaced, and to provide additional information to customers on restricted meters.

6.8 In the rest of this section we provide a detailed assessment of each of these proposed remedies. In terms of the interaction between these remedies and our remedies for domestic customers:

- (a) We set out in Section 4 our high-level assessment of how we expect each of these proposed remedies to interact with the other components of our remedies package, notably proposed measures to help create a framework for effective competition and proposed measures to protect customers who are less able to engage to exploit the benefits of competition.
- (b) In Section 8, we present a more detailed assessment of the effectiveness and proportionality of the remedies package for domestic customers concerning, in particular, the Prepayment AEC, the RMR AEC and the Domestic Weak Customer Response AEC.

Ofgem programme to promote customer engagement

- 6.9 In our provisional findings report,⁵³⁸ we identified several features giving rise to the Domestic Weak Customer Response AEC, one of which was that certain customers face actual and perceived barriers in accessing and assessing information. One of the aspects of the energy markets contributing to this feature was the complex information provided in bills. Our provisional view was that this aspect of the domestic retail energy markets inhibits value-for-money assessments of the available options, particularly on the part of those customers who lack the capability to search and consider options fully.
- 6.10 Ofgem has also recognised the importance of clear information in facilitating customer engagement and introduced the ‘clearer information’ component of the RMR rules in an attempt to ensure that suppliers’ routine communications to customers were clear, easy to understand and personalised to them. The key provisions included the Cheapest Tariff Messaging, tariff summary box and tariff comparison rate.⁵³⁹
- 6.11 However, our concern with these provisions is that they were not subject to adequate testing prior to (or after) their introduction. There are many potentially plausible but divergent arguments about the way in which information should be provided to domestic customers to facilitate understanding and engagement.⁵⁴⁰ Without adequate testing it is not possible to know which approach will work best in practice. Further, even if testing is conducted ex ante, changes in technology and cultural practices are likely to mean that what works changes over time.⁵⁴¹
- 6.12 Accordingly, our proposed remedy is a recommendation to Ofgem that it establish an ongoing programme to identify, test (through randomised controlled trials (RCTs), where appropriate) and implement (for example, through appropriate changes to standard licence conditions) measures to provide domestic customers with different or additional information with the aim of promoting engagement in the domestic retail energy markets. The proposed remedy invites suppliers to offer undertakings to participate in this Ofgem-led programme. If this does not prove to be successful, we propose that suppliers be required to participate in the programme.

⁵³⁸ See [provisional findings report](#), Section 12.

⁵³⁹ Ofgem’s current requirements for information on bills as circulated for its effective billing workshop on 25 November 2015.

⁵⁴⁰ For example, how frequently customers are provided with information, whether information is likely to have more impact if provided in a bill or separately from the bill, how much detail to provide, and whether people understand the graphical presentation of information and/or metrics such as the tariff comparison rate.

⁵⁴¹ [The Behavioural Insights Team response to Remedies Notice](#), p9.

- 6.13 We also propose to recommend to Ofgem that it conduct RCTs concerning the following shortlist of measures:
- (a) Changes to the information in domestic bills and how this is presented, including a market-wide cheapest tariff message.
 - (b) Changes to the specific messaging that domestic customers receive in bills once they move, or are moved, on to an SVT and/or other default tariffs.
 - (c) Changes to the name of the default tariffs.
- 6.14 We note that, in contrast to our proposed remedy concerning the ‘simpler choices’ component of the RMR rules, we are not proposing that specific provisions of the ‘clearer information’ component of the RMR rules be repealed now. Rather, we recommend that they be subject to a systematic regime of testing through a programme that is led by Ofgem, a potential outcome of which may be the repeal and/or amendment over time of such provisions.
- 6.15 We have also considered other areas which Ofgem may wish to consider for testing within the context of this programme. These include:
- (a) the form of information that could be presented to prepayment customers to address their lack of awareness and understanding of available options would be information with respect to security deposits; and
 - (b) the form and frequency of marketing communications by rival suppliers in the context of the Database remedy.
- 6.16 The proposed application of a similar remedy to the microbusiness segments is covered in Section 9.

Aim of the proposed remedy

- 6.17 The aim of this proposed remedy is to identify the most appropriate form of information included in routine communications from suppliers (eg bills), reducing or minimising the complexity of those communications, and providing domestic customers with different or additional information or messaging that would prompt them to switch tariff or supplier. Accordingly, the ultimate aim of this proposed remedy is to address (in whole or in part) the feature that certain customers face actual and perceived barriers to accessing and assessing information, and to help address the Domestic Weak Customer Response AEC. The proposed remedy will also address, in

part, the feature that domestic customers have limited awareness of, and interest in, their ability to switch.

- 6.18 The measures to be identified and tested by Ofgem would relate to what, how and when information is presented to domestic customers in routine communications with suppliers (including bills, annual statements, price increase notices, and fixed term notices). This proposed remedy would ensure that the approach for identifying such measures is responsive to changing market conditions, and would encourage the testing and development of particular measures related to customer information that have been identified by us during the investigation.

Parties' views

- 6.19 We invited views on whether energy suppliers should be providing their customers with more, less or different information in order to best encourage customer engagement.
- 6.20 Ofgem said the route and format for delivering customer information were important to consider, including the role of consumer awareness campaigns.⁵⁴²
- 6.21 The Six Large Energy Firms were generally supportive of measures to facilitate customers accessing and assessing information,⁵⁴³ although SSE said the CMA had not established the AEC and therefore no remedy was necessary.⁵⁴⁴ In particular:
- (a) Centrica said it would like to use consumer research to make customer information more engaging, but could not because Ofgem had prescribed the format and content of its communications with customers as part of the 'clearer information' component of the RMR rules.⁵⁴⁵
 - (b) EDF Energy and RWE also said that they would like to make improvements to the information provided to customers but could not because Ofgem had prescribed the format and content of its communications.⁵⁴⁶

⁵⁴² [Ofgem response to Remedies Notice](#), p56.

⁵⁴³ [Centrica response to Remedies Notice](#), p73; [EDF Energy response to Remedies Notice](#), p32, paragraphs 9.1–9.4; [E.ON response to Remedies Notice](#), p37; [Scottish Power response to Remedies Notice](#), paragraph 10.1, p29 (p60 of PDF) and [RWE npower response to Remedies Notice](#) p70 (p166 of PDF). RWE said it was generally supportive of measures to facilitate customers accessing and assessing information in the most effective way with a view to improving engagement levels.

⁵⁴⁴ [SSE response to provisional findings and Remedies Notice](#), p62.

⁵⁴⁵ [Centrica response to Remedies Notice](#), p73; [EDF Energy response to Remedies Notice](#), p32; and [RWE npower response to Remedies Notice](#), p70.

⁵⁴⁶ [EDF Energy response to Remedies Notice](#), p32 and [RWE npower response to Remedies Notice](#), p70.

RWE also noted that while customers found some of the information useful, for some customers it impacted engagement due to the volume of information.

- (c) SSE said that it did not support the provision of additional information to customers because the current prescriptive information requirements resulted in bills that were already too complex. SSE suggested that there were more effective alternatives to the proposed remedy such as removing the prescriptive requirements and enabling suppliers to trial new designs and find the optimal solution for their customers.⁵⁴⁷
- (d) Scottish Power said the remedy was not sufficiently well-defined for it to comment on its effectiveness or proportionality but agreed that it was worth considering measures to provide domestic and microbusiness customers with different or additional information to reduce actual or perceived barriers to accessing and assessing information.⁵⁴⁸

6.22 We invited views on the current format and content of energy bills and whether the current bills facilitated engagement by customers.

- (a) Some parties said that specific pieces of information on bills such as the Tariff Comparison Rate,⁵⁴⁹ Quick Response codes,⁵⁵⁰ Tariff Information Label⁵⁵¹ and the supplier Cheapest Tariff Message⁵⁵² should be removed or made more useful for customers. The Six Large Energy Firms and the Mid-tier Suppliers said that the 'clearer information'

⁵⁴⁷ [SSE response to provisional findings and Remedies Notice](#), p62.

⁵⁴⁸ [Scottish Power response to Remedies Notice](#), paragraphs 9.5 & 9.9, pp27–28.

⁵⁴⁹ [Centrica response to Remedies Notice](#), p20 (Centrica said the tariff comparison rate should be removed as it was often inaccurate and unengaging); [EDF Energy response to Remedies Notice](#), p33 (EDF Energy said that specific pieces of information on bills such as the tariff comparison rate and Personal Projections did not appear to be providing the intended assurance that they were meant to. Its Bill Design research highlighted that very few people were aware of the tariff comparison rate and what it showed as explanations varied in length and accuracy, and could also differ by provider. Cash and cheque payers had particular difficulty with Personal Projections with varying quarterly bills and were not always clear what action to take); [First Utility response to Remedies Notice](#), p37; [Good Energy response to Remedies Notice](#), p8 (Good Energy said that the tariff comparison rate could be misleading) and [Energy Action Scotland response to Remedies Notice](#), p10.

⁵⁵⁰ [E.ON response to Remedies Notice](#) p39, [SSE response to provisional findings and Remedies Notice](#) p 64 (p144 of PDF) (SSE said that specific pieces of information on bills such as QR codes were unlikely to add value to the majority of customers. The Tariff Information Label, while a useful tool, could be made more useful for customers), [Utility Warehouse response to Remedies Notice](#), p11.

⁵⁵¹ [First Utility response to Remedies Notice](#), p37.

⁵⁵² [uSwitch response to Remedies Notice](#) p17.

component of the RMR rules was too prescriptive and required too much information to be included in bills.^{553,554}

- (b) Citizens Advice⁵⁵⁵ and Which?⁵⁵⁶ said there should be more research and testing to identify what information would be most effective in increasing customer engagement.
- (c) The Behavioural Insights Team said it was important to test any changes in bill content, and that suppliers should be required to work with Ofgem to test different information on bills.⁵⁵⁷
- (d) uSwitch⁵⁵⁸ and MoneySavingExpert⁵⁵⁹ said it was important to consider how information was displayed in bills.
- (e) Ofgem said there was scope to improve the clarity of bills. It said its own customer research showed a positive early impact for the Cheaper Tariff Messaging but there was less awareness, or use, of the Tariff Comparison Rate. Ofgem also said that there were significantly more billing requirements in the domestic markets than in the microbusiness segments, and that these resulted from Ofgem and government policy, the EU third energy package and the Energy UK billing code of practice. All requirements have been reflected in the standard licence conditions.⁵⁶⁰

6.23 We invited views on whether or not customers reaching the end of a contract period should subsequently receive bills that highlighted that they had been moved onto the SVT and/or other default tariff.

⁵⁵³ [Centrica response to Remedies Notice](#) p73 (Centrica said that the 'clearer information' rules were too prescriptive and prevented competitive differentiation by dictating the content, format and layout of bills by requiring too much information to be included); [EDF Energy response to Remedies Notice](#), p33, [E.ON response to Remedies Notice](#) p37–40 (E.ON said that regulatory requirements and specific pieces of information on bills such as QR codes had made the bill increasingly congested, making it more difficult for the customer to understand the information and discern what they needed from the bill. E.ON said that the 'clearer information' rules were too prescriptive and had resulted in bills and annual statements including confusing or unnecessary information which could be simplified. It recommended an industry-led review to ensure that all the information was pertinent to the customers and was clear, simple and engaging), [RWE npower response to Remedies Notice](#), p70; [Scottish Power response to Remedies Notice](#), p26; and [SSE response to provisional findings and Remedies Notice](#) p11 (SSE said that the 'clearer information' rules were too prescriptive and required too much information to be included in bills, hindering consumer engagement and contributing to a negative perception of suppliers).

⁵⁵⁴ [Co-operative Energy response to Remedies Notice](#), p15; [First Utility response to Remedies Notice](#), p36, [Ovo Energy response to Remedies Notice](#), p18 and [Utility Warehouse response to Remedies Notice](#), p10.

⁵⁵⁵ [Citizens Advice/Citizens Advice Scotland response to Remedies Notice](#), p42.

⁵⁵⁶ [Which? response to Remedies Notice](#) p6.

⁵⁵⁷ [The Behavioural Insights Team response to Remedies Notice](#), pp8–9.

⁵⁵⁸ [uSwitch response to Remedies Notice](#), pp16–18.

⁵⁵⁹ [Moneysavingexpert.com response to Remedies Notice](#), p8.

⁵⁶⁰ [Ofgem response to Remedies Notice](#), p56.

- (a) Four of the Six Large Energy Firms⁵⁶¹ agreed, with some saying this already happened. The other two expressed different views.⁵⁶²
- (b) Co-operative Energy said there were currently licence obligations in place for suppliers to inform customers of their options when approaching the end of their fixed-term period and to prompt the customer to take action.⁵⁶³
- (c) Citizens Advice,⁵⁶⁴ The Behavioural Insights Team,⁵⁶⁵ uSwitch⁵⁶⁶ and MoneySavingExpert⁵⁶⁷ said there should be better use of existing prompts or additional prompts for domestic customers when they reached the end of their contract period.

6.24 In the Remedies Notice, we also invited views on the wording that should be used for customers who have failed to engage once they have rolled onto an SVT or default tariff. In our Supplemental Remedies Notice, we also sought views on what the default tariff should be called, including if it should be called 'emergency tariff'.

- (a) All the Six Large Energy Firms said that further research with customers was necessary to determine the most appropriate name for the default tariff.⁵⁶⁸ Some said that it was important to strike a balance between a name that implied safety (which would make customers engage less or stop engaging), and a name that caused customers concern about

⁵⁶¹ [Centrica response to Remedies Notice](#), p74; [EDF Energy response to Remedies Notice](#), p34; [E.ON response to Remedies Notice](#), p41 (E.ON said this was already covered by the CYPL messaging on every bill) and [SSE response to provisional findings and Remedies Notice](#) p66 (p146 of the PDF). (SSE said that while current communications already covered this to a certain extent, the content of the information provided could be improved, by allowing suppliers to tailor these communications to their customers' needs).

⁵⁶² [RWE npower response to Remedies Notice](#), p72 (p168 of the PDF) (RWE said that while this may help to encourage some customers to switch tariff, it may be more appropriate to send a separate communication depending on the customer's billing cycle and time elapsed between the tariff end and the customer's bill, rather than risk this information getting lost within the customer bill information already provided); [Scottish Power response to Remedies Notice](#), paragraph 9.15, p29 (p62 of the PDF) (Scottish Power said this was unnecessary because this messaging was included in other communications).

⁵⁶³ [Co-operative Energy response to Remedies Notice](#), p17. (It also said that it believed these requirements sufficiently engaged its customers who had taken the steps to switch to it. There was no evidence that any subsequent messaging would improve the engagement level of customers who had previously engaged in the market by choosing a fixed tariff. Moreover the issue identified by the CMA was the engagement of customers who had never, or very rarely, switched, nor taken advantage of lower priced tariffs.)

⁵⁶⁴ [Citizens Advice/Citizens Advice Scotland response to Remedies Notice](#), p43 (Citizens Advice said there should be better use of existing prompts, for example amending the Cheapest Tariff Messaging).

⁵⁶⁵ [The Behavioural Insights Team response to Remedies Notice](#), p10.

⁵⁶⁶ [uSwitch response to Remedies Notice](#), p19.

⁵⁶⁷ [MoneySavingExpert response to Remedies Notice](#), p8.

⁵⁶⁸ [Centrica response to Supplementary Remedies Notice](#), p10, [E.ON response to Supplementary Remedies Notice](#), p12, [Scottish Power response to Supplementary Remedies Notice](#), p11, [EDF response to Supplementary Remedies Notice](#), p9, [RWE npower response to Supplementary Remedies Notice](#), p14 and [SSE response to Supplementary Remedies Notice](#), p17 (SSE said names such as 'emergency', 'temporary', 'transitional' and 'default' should be avoided as the negative connotations might confuse customers. Further research with customers was necessary to determine the most appropriate name for the tariff).

having their energy supply disconnected (which would cause unnecessary concern).⁵⁶⁹

(b) Citizens Advice,⁵⁷⁰ The Behavioural Insights Team⁵⁷¹ and uSwitch⁵⁷² also said there should be testing with customers to identify the most suitable name for the default tariff.

(c) First Utility,⁵⁷³ Utility Warehouse⁵⁷⁴ and Good Energy⁵⁷⁵ commented on specific names for the default tariff.

6.25 We also invited views on a possible remedy requiring suppliers to inform domestic customers about the cheapest tariff on the markets across all suppliers. We indicated that we were not minded to consider this possible remedy further for two main reasons:

(a) We were concerned that by forcing energy suppliers to share detailed pricing information, this possible remedy could weaken competition and encourage or facilitate some form of (tacit) coordination between suppliers; and

(b) We considered that requiring suppliers to advertise competitors' tariffs would not provide customers with the correct incentives to engage effectively in the markets in the longer term, as they could rely on their supplier to conduct a search on their behalf and provide them with the results. This could encourage customers to remain relatively disengaged in the future, undermining our other possible remedies to facilitate widespread customer engagement.

6.26 Parties provided the following comments on this possible remedy.

⁵⁶⁹ Centrica response to Supplementary Remedies Notice, p10; Scottish Power response to Supplementary Remedies Notice, p11; EDF response to Supplementary Remedies Notice, p9 (EDF Energy said that further research with customers was necessary to determine the most appropriate name for the default tariff in order for it to invoke the desired reaction from consumers while accurately reflecting the key features of the default tariff. EDF Energy stated that if the wording in notifications and prompts was clear and simple then there should be minimal risk that customers would be concerned about having their energy supply disconnected).

⁵⁷⁰ Citizens Advice response to Supplementary Remedies Notice, pp8–9.

⁵⁷¹ The Behavioural Insights Team response to Supplementary Remedies Notice, pp4–5.

⁵⁷² uSwitch response to Supplementary Remedies Notice, p8.

⁵⁷³ First Utility response to Supplementary Remedies Notice, p8.

⁵⁷⁴ Utility Warehouse response to Supplementary Remedies Notice, p6.

⁵⁷⁵ Good Energy response to Supplementary Remedies Notice, p6.

- (a) E.ON,⁵⁷⁶ SSE,⁵⁷⁷ RWE npower,⁵⁷⁸ and Scottish Power⁵⁷⁹ agreed that this remedy should not be considered further.
- (b) First Utility said the remedy should be considered because if customers could see the savings to be made by switching supplier it would increase engagement. First Utility said that concerns about suppliers having to advertise their competitors' tariffs could be addressed by showing a level of total savings.⁵⁸⁰ First Utility also said that Ofgem could have a role in determining the market-wide cheapest tariff and sharing it with suppliers.⁵⁸¹
- (c) EDF Energy said it had found relatively few customers switching to another supplier as a result of its 'Blue+ Price Promise' whereby it notified its customers about competitors' tariffs if they could save more than £1 per week by switching.⁵⁸²

Design considerations

6.27 We have considered the following elements in the design of this proposed remedy:

- (a) what approach should be taken to identifying and testing the measures concerning the information provided to domestic customers;
- (b) whether the identification and testing of the measures concerning the information provided to domestic customers should be Ofgem- or supplier-led;
- (c) whether we should identify a shortlist of proposed measures for testing;
- (d) what further powers, if any, Ofgem would need for the effective implementation of the proposed programme; and
- (e) how the proposed remedy should be implemented.

⁵⁷⁶ [E.ON response to Remedies Notice](#), p92.

⁵⁷⁷ [SSE response to provisional findings and Remedies Notice](#), p111.

⁵⁷⁸ [RWE npower response to Remedies Notice](#), p146. RWE said it did not consider this would be an effective remedy.

⁵⁷⁹ [Scottish Power response to Remedies Notice](#), paragraph 19.3, p60 (p94 of PDF).

⁵⁸⁰ [First Utility response to Remedies Notice](#), p37.

⁵⁸¹ [First Utility response hearing summary on 2 October 2015](#), p5.

⁵⁸² [Summary of response hearing with EDF Energy on 28 July 2015](#), p5.

What approach should be taken

- 6.28 Our view is that there is scope to develop Ofgem's approach to testing and evaluating the impact of the 'clearer information' component of the RMR rules.
- 6.29 Ofgem did undertake qualitative research on aspects of the RMR rules prior to implementation, but we consider that this research was insufficiently rigorous taking into account the scale of the intervention and the potential cost for customers of getting it wrong. In particular:
- (a) Ofgem used focus groups involving only small samples of domestic customers;
 - (b) Ofgem used its Consumer First Panel which consists of 80 domestic customers from across Great Britain. Panel members are unlikely to be representative of customers more widely because in meeting regularly they will become more knowledgeable about energy topics; and
 - (c) Ofgem did not test the changes in 'real life' situations. What customers say they may do in response to certain information may not reflect what they actually do in practice.
- 6.30 Ofgem is evaluating the impact of the RMR rules, but the approach that it has adopted – primarily conducting a large-scale consumer survey annually for four years – is problematic.⁵⁸³ In particular:
- (a) Establishing a baseline is difficult as the RMR rules were developed over a long period of consultation. In the provisional findings we found that the Six Large Energy Firms were responding to Ofgem's concerns prior to the implementation of these rules (see provisional findings, Appendix 7.3). This means that an assessment on the impact of the rules based on a comparison of supplier behaviour after-implementation and before-implementation could understate the impact of the rules.
 - (b) Changes in customer behaviour since implementation of the RMR rules cannot necessarily be attributed to the RMR rules given the potential for other unrelated factors to have influenced consumer engagement. In addition, attributing change to individual components of the RMR rules presents yet further complexities, as the RMR rules were designed to work as a package.

⁵⁸³ Ofgem outlined its approach to evaluation and the potential challenges in its letter [Domestic Retail Market Review Evaluation – a proposed way forward](#), 31 January 2014.

- 6.31 Submissions from consumer groups indicate that they share our concerns. Specifically:
- (a) Which? said that, given the past work by Ofgem and others to improve communications to customers, it was now necessary to learn lessons from this work and devote significantly more time to testing any new engagement mechanisms.⁵⁸⁴
 - (b) Citizens Advice said there should be a research-led review of the regulated content on energy bills to explore what content could be safely removed.⁵⁸⁵
- 6.32 The Behavioural Insights Team told us that rigorous testing was the best way to ensure that any future changes in supplier communications had their intended effect on customers. The Behavioural Insights Team said that RCTs should be used to test different messages on bills and other communications such as annual statements and product end notifications.⁵⁸⁶
- 6.33 The Behavioural Insights Team also told us that RCTs had been effective in testing interventions in other sectors.⁵⁸⁷ For example, trials of different tax letters had resulted in the development of letters that encouraged more people to pay their taxes and trials of different forms at job centres had resulted in the development of forms that encouraged more jobseekers to get back into work.⁵⁸⁸
- 6.34 Conducting a RCT would typically involve the following steps:
- (a) identifying two or more interventions to compare (eg old versus new; different variations of the intervention) and qualitative testing with some customers ahead of any full-scale trial;
 - (b) determining the outcome that the intervention is intended to influence and how it will be measured in the trial;
 - (c) deciding on the randomisation design, including the number of customers in the control and treatment group(s);

⁵⁸⁴ Which? response to Remedies Notice, p6.

⁵⁸⁵ Citizens Advice/Citizens Advice Scotland response to Remedies Notice, p42.

⁵⁸⁶ The Behavioural Insights Team response to Remedies Notice, p9.

⁵⁸⁷ The Behavioural Insights Team response to Remedies Notice, p9.

⁵⁸⁸ See The Behavioural Insights Team's [Update report 2013-15](#) for more details of the impact of different messages on consumers tested through RCTs.

- (d) writing a trial protocol specifying the conduct of the trial, including processes to ensure that the trial is implemented correctly by participants;
 - (e) running the trial in conjunction with participants according to the protocol;
 - (f) measuring the results and determining the impact of the interventions;
 - (g) conducting follow-up research with trial customers (typically those in the treatment group(s)) to gain a full understanding of the behavioural response to the intervention; and
 - (h) deciding whether and how to implement the intervention. This may be in the precise form in which the intervention was trialled, or it may be modified to take account of new information (arising, for example, from the follow-up research to the trial). If these modifications are not trivial it may be appropriate to conduct a further trial.
- 6.35 We agree that RCTs can provide the clearest evidence on the potential impact of an intervention.⁵⁸⁹ In particular, the introduction of a randomly assigned control group provides a basis for isolating the impact of an intervention. Conducting the trial in ‘real time’ tests how customers actually respond to an intervention rather than how they say they would respond.⁵⁹⁰
- 6.36 We consider that RCTs would be appropriate where:
- (a) the treatment can be applied to a sample of customers independently of a control group;
 - (b) the desired outcome can be measured;
 - (c) the expected impact of an intervention is sufficiently large for there to be a reasonable expectation of being able to detect it;
 - (d) the costs of a trial are proportionate to the potential benefits; and
 - (e) the intervention is immediately reversible if found to be ineffective or to have unintended consequences.

⁵⁸⁹ HM Treasury (April 2011), *The Magenta Book: Guidance for evaluation*, p27.

⁵⁹⁰ Cabinet Office Behavioural Insights Team (June 2012), *Test, Learn Adapt: Developing Public Policy with Randomised Controlled Trials*, p4.

- 6.37 Our provisional view is that the overall approach of the Ofgem-led programme should provide for:
- (a) the specification of potential forms of information that domestic customers (on any meter type) may receive from suppliers in routine communications (eg bills, annual statements, price increase notices and fixed term notices) and messaging aimed at prompting customers to engage (referred to below as ‘the measures’);
 - (b) rigorous testing (through RCTs in the case of the ‘shortlist’ of proposed measures as set out in paragraph 6.13) of the impact of the measures identified prior to market-wide implementation;
 - (c) the implementation of the measures considered most appropriate following testing (for example, through appropriate changes to the standard licence conditions);
 - (d) ongoing monitoring of the impact of the implemented measures; and
 - (e) adjustments as appropriate where measures may no longer be having the desired effect.

Whether the programme should be led by Ofgem or suppliers

- 6.38 All of the Six Large Energy Firms⁵⁹¹ said they have previously conducted or were already conducting their own research with customers on communications.
- 6.39 However, our provisional view is that Ofgem is better placed than suppliers to take the lead in a programme to identify and test measures aimed at promoting consumer engagement. This is because Ofgem has a market-wide perspective and can therefore ensure that best practice is implemented consistently across the markets. In addition, Ofgem’s interests will be better aligned with those of customers than suppliers’ interests, since Ofgem’s principal statutory objective is to protect the interests of current and future consumers of gas and electricity.⁵⁹²
- 6.40 We recognise that Ofgem would need the resources, expertise and budget to establish and run a robust and credible programme which includes RCTs where appropriate. Ofgem would also need the necessary expertise to

⁵⁹¹ Centrica response to Remedies Notice, p73; EDF Energy response to Remedies Notice, p32; E.ON response to Remedies Notice, p38; Scottish Power response to Remedies Notice, p27 (p61 of PDF); and RWE npower response to Remedies Notice p4 (p100 of PDF); SSE response to provisional findings and Remedies Notice, p63 (p143 of PDF).

⁵⁹² Sections 4AA(1)(1A), 34, 35, 36, 36A of the GA86; sections 3A(1)(1B), 43, 47, 48, 49 of the EA89.

oversee the design and implementation of the programme. Ofgem would not necessarily need to have these resources available to it in-house as it could also make use of external resources and expertise, where appropriate.

- 6.41 We have discussed these requirements with Ofgem. Ofgem told us that it was already proposing further consumer research and testing in the area of effective billing, and indicated that it would like to run RCTs and build in-house capability to conduct such work.
- 6.42 We also think that Ofgem would need cooperation from suppliers, at least as regards providing certain information and data, in order to conduct a robust RCT. For example, Ofgem, or a third party appointed by Ofgem, might need, at the very least, the contact details of domestic customers, and information required to assess the effectiveness of the measures that are being tested in the ‘treatment’ and ‘control’ groups. The Behavioural Insights Team told us that RCTs were most effective when stakeholders cooperated, citing the example of HMRC regarding RCTs relating to tax forms and DWP and Jobcentre Plus regarding RCTs relating to information for jobseekers. [✂]

Whether we should identify a shortlist of proposed measures for testing

- 6.43 In light of parties’ responses to the Remedies Notice, we propose to recommend Ofgem to conduct RCTs in respect of the following shortlist of measures:
- (a) Changes to bill information including shorter bill length, through the removal of certain information, and different layouts – for example, the display of key information required for switching on the first page of the bill.
 - (b) Changes to test a market-wide ‘Cheapest Tariff Messaging’. By testing the proposal it would be possible to identify the effect on domestic customers’ engagement thereby addressing the second of our reasons for not pursuing this as a stand-alone remedy (ie where we consider that a remedy requiring suppliers to advertise competitors’ tariffs would not provide customers with the correct incentives to engage effectively, as they could rely on their supplier to conduct a search on their behalf and provide them with the results). In this regard, we note that there might be scope for Ofgem to play a role in the collating of pricing information and for providing suppliers (and customers) with an indication of average levels of savings rather than suppliers advertising each other’s tariffs.

- (c) Changes to messaging on bills for domestic customers that are about to be/have moved on to an SVT and/or other default tariff on engagement. This trial may determine how best to capitalise on the potential 'trigger for action' that occurs when such customers reach the end of their fixed-term tariff contracts.
 - (d) Changes to the name for the default tariff from 'standard variable tariff', such as 'emergency' tariff or 'out of contract' tariff.
- 6.44 We consider that the above proposed measures are particularly suitable for testing through RCTs in particular, given the magnitude of the detriment we have observed as resulting from the Domestic Weak Customer Response AEC.

How the remedy should be implemented

- 6.45 We propose to implement this remedy through:
- (a) A recommendation to Ofgem to establish an ongoing programme (the 'Ofgem-led programme') to identify, test (through RCTs, where appropriate) and implement (for example, through appropriate changes to gas and electricity suppliers' standard licence conditions) measures to provide domestic customers with different or additional information with the aim of prompting engagement in the domestic retail energy markets, including a recommendation to conduct RCTs concerning the following shortlist of measures:
 - (i) changes to the information in domestic bills and how this is presented, including a market-wide cheapest tariff message;
 - (ii) changes to the specific messaging that domestic customers receive in bills once they move, or are moved, on to an SVT and/or other default tariffs; and
 - (iii) changes to the name of default tariffs.
 - (b) Either the acceptance of undertakings from suppliers to participate in the Ofgem-led programme, or, absent a satisfactory number of undertakings being agreed with suppliers, either:
 - (i) a recommendation to Ofgem to modify suppliers' standard licence conditions to introduce an obligation to participate in the Ofgem-led programme or requiring the provision of prescribed information;

- (ii) an order on suppliers to participate in the Ofgem-led programme or requiring the provision of prescribed information, (including associated amendments to suppliers' standard licence conditions); or
- (iii) a recommendation to DECC to introduce legislation imposing a requirement on suppliers to participate in Ofgem-led research programmes.

Effectiveness of the proposed remedy

6.46 As we explain below, our provisional view is that the proposed remedy would be effective in achieving its aim of identifying the most appropriate form of information to be included in routine communications from suppliers (eg bills), reducing or minimising the complexity of those communications, and providing domestic customers with different or additional information or messaging that would prompt them to switch tariff or supplier. Accordingly, our provisional view is that the proposed remedy would be effective in addressing (wholly, or in part) the feature that certain domestic customers face actual and perceived barriers to accessing and assessing information that (among other features) gives rise to the Domestic Weak Customer Response AEC (and the resulting customer detriment), and that domestic customers have limited awareness of, and interest in, the ability to switch.

6.47 In assessing the effectiveness of the proposed remedy, we have considered the following factors:

- (a) the effectiveness of the key design elements of the proposed remedy;
- (b) the extent to which the proposed remedy is capable of effective implementation, monitoring compliance and enforcement; and
- (c) the timescale over which the remedy is likely to have an effect.

- *Effectiveness of the key design elements of the proposed remedy*

6.48 We consider that the key design elements of the proposed remedy would be effective in achieving its aim for the following main reasons:

- (a) The proposed remedy would provide for testing of the impact of the measures identified prior to market-wide implementation and for ongoing monitoring of such impact (see paragraph 6.37 above). Accordingly, Ofgem would be able to identify the most effective measures to promote engagement.

- (b) Ofgem is better placed than suppliers to take the lead in a programme to identify and test measures aimed at promoting customer engagement (see paragraphs 6.39 to 6.41) above).
 - (c) The shortlist of proposed measures for testing (see paragraph 6.43) and other guidance noted above provide Ofgem with a high-level steer on when RCTs would be appropriate (for example, see paragraph 6.34), enhancing the likelihood of this proposed remedy being effective.
 - (d) We consider that a recommendation to Ofgem alone would not be sufficient to ensure the effective implementation of this proposed remedy as suppliers could, in principle, object to participating in the programme or otherwise obstruct its progress, which would defeat its aim. Accordingly, we are inviting suppliers to offer undertakings to participate in the programme or, failing that, we propose to require suppliers to participate in the Ofgem-led programme, where appropriate involving RCTs (see paragraph 6.45(b)).
- 6.49 We also consider that the Ofgem-led programme would be responsive to future developments in the markets. For example, the introduction of smart metering and phase 2 of the Midata programme have the potential to change how domestic customers engage in the markets. In the future, customers may have greater access to their data, enabling them to switch more easily and with greater confidence, and may use different forms of technology to communicate with suppliers and PCWs.
- *Implementation, monitoring compliance and enforcement of the remedy*
- 6.50 In determining whether a proposed remedy is effective, we have had regard to how it would be expected to operate. We have also had regard to the need for the proposed remedy to be clear to the persons to whom it is directed, such as Ofgem and suppliers.
- 6.51 As regards the implementation of the proposed remedy, we have set out a number of detailed specifications. In this regard, we have sought to take a detailed approach by describing the terms of the recommendation so that it would not only be clear to Ofgem, in terms of how, when and what to investigate, but also be straightforward for it to implement. In terms of any undertakings or order that may be put in place, we would expect these to specify the nature of the information that would be provided by a supplier to Ofgem, and the level of frequency. It may also place an obligation on suppliers to participate as may be determined by Ofgem, similar to any similar licence condition or legislation that may be introduced.

- 6.52 We have also considered the possible remedies suggested by E.ON, SSE and First Utility as alternatives to the prohibition of the SVT proposed by Centrica and Scottish Power (see our Supplemental Remedies Notice and paragraphs 6.292 to 6.315 below). We consider that both suggestions (of improved messaging in the annual statement and renaming the SVT or other default tariffs) should be incorporated into this proposed remedy.
- 6.53 We have also considered the suggestion by MoneySuperMarket which would involve DECC (or some other trusted intermediaries) writing to customers, and the use of SMS messaging. On the former, we consider that Ofgem, as sector regulator, and which has a principal objective to protect the interests of consumers, would be best placed to decide who (if not the suppliers themselves) should write to customers with the relevant information that has been the subject of the Ofgem-led programme and should consider how best such communications should occur, such as whether letter, SMS messaging, email or other form should be used.
- 6.54 In addition, we would expect Ofgem to put in place a governance structure to ensure effective oversight of the design and implementation of the programme.
- 6.55 As regards monitoring compliance of the proposed remedy, we consider that this should be straightforward given Ofgem's involvement as sector regulator, and irrespective of whether the CMA was responsible for monitoring compliance with undertakings or an order, or Ofgem through a standard licence condition, since it would be likely to merely involve verifying with Ofgem that suppliers have participated in the Ofgem-led programme by providing the relevant information needed within the timescales required.
- 6.56 As regards enforcement, the CMA would be able to directly enforce against any undertakings or order put in place. Ofgem would be able to enforce against any new licence condition.

- *Timescale for the proposed remedy*

- 6.57 In evaluating the effectiveness of the proposed remedy, we have considered the timescale over which the Domestic Weak Customer Response AEC would be expected to endure, and the timescale over which the proposed remedy would be likely to take effect. We consider that the detriment would persist, absent the proposed remedy, and that the impact of future market developments, including the roll-out of smart meters, is somewhat uncertain (see Section 4). Moreover, we consider that the need for rigorous testing of suppliers' communications with domestic customers is likely to be an

ongoing need. Therefore we have provisionally decided that the proposed remedy would not be subject to a sunset provision.

- 6.58 As regards the timescales for implementation, we note that Ofgem has a research team that could take forward the proposed programme.⁵⁹³ We would expect Ofgem to begin developing initial plans for the programme immediately following the CMA's final report concerning the shortlist of measures that we propose to recommend are the focus of RCTs. In particular, we would expect Ofgem to progress such plans simultaneously with other developments concerning suppliers' participation in the Ofgem-led Programme. For instance, if the CMA decides in the final report to pursue undertakings with suppliers, we would expect Ofgem to be able to progress its plans in conjunction with the CMA's negotiations with suppliers. Progress could similarly be made if the CMA is preparing a final order or Ofgem is introducing a new licence condition. We would expect that the first trials could start by mid-2017, by which time the CMA would have concluded the process of drafting and consulting on any final undertakings or order (or Ofgem would have concluded a consultation on any new licence condition) requiring suppliers to participate in the programme.
- 6.59 Ofgem could conduct evaluations of the trials from late 2017 onwards, and where trials proved successful, any interventions could be implemented from late 2018 onwards. Subsequently we would expect Ofgem to monitor the effectiveness of the interventions and continue to update the programme on an ongoing basis.
- 6.60 We would therefore expect the remedy to start having an effect in addressing aspects of the features identified in the provisional findings report, including the actual and perceived barriers in accessing and assessing information, from the beginning of 2019.

Assessment of proportionality

- 6.61 In this section we set out our assessment of whether our proposed remedy would be proportionate to achieve its aim. We do this by considering whether the proposed remedy:⁵⁹⁴
- (a) would be effective in achieving its legitimate aim;

⁵⁹³ Ofgem's Monitoring and Consumer Research Team.

⁵⁹⁴ [CC3](#), paragraph 344, citing the principles established in the *Fedesa* case, Case C-331/88, *the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others*, [1990] ECR I-4023, paragraph 13.

- (b) would be no more onerous than needed to achieve its aim;
- (c) would be the least onerous if there is a choice between several effective measures; and
- (d) would not produce disadvantages which are disproportionate to the aim.

- *Effective in achieving its aim*

6.62 For the reasons set out above, we consider that a programme of rigorous testing (involving RCTs where appropriate) would be effective in achieving its aim of reducing the complexity of the information included in routine communications from suppliers and to provide domestic customers with different or additional information or messaging that would prompt them to switch tariff or supplier. Accordingly, it would be effective in addressing (in whole or in part) two of the features that give rise to the Domestic Weak Customer Response AEC, and the resulting detriment.

- *No more onerous than needed to achieve its aim*

6.63 We also consider that this proposed remedy would be no more onerous than needed to achieve its aim. In particular, given the need for an ongoing programme of rigorous testing, Ofgem is best placed to identify, develop, test and implement measures for providing domestic customers with different or additional information or messaging to prompt them to engage in the markets.

6.64 In designing the programme and, in particular, the extent of any supplier participation that might be needed, Ofgem will be required to assess the proportionality of the various stages involved in the programme, including the testing involved in each specific proposed measure. In this regard, we would expect Ofgem to take into account issues such as the potential costs incurred by suppliers, the duration of the testing process and for how long it will impose costs on suppliers as part of its proportionality assessment.

6.65 As regards implementation, we consider that the proposed remedy would be least interventionist if suppliers were to agree undertakings with the CMA concerning their participation. However, in the event that an insufficient number of suppliers were prepared to offer satisfactory undertakings, as noted above, we are considering requiring supplier participation by a CMA order, recommending a new licence condition for Ofgem, or recommending legislation.

- 6.66 We consider that a programme within the proposed parameters would be proportionate.
- *Least onerous if there were a choice between several effective remedies*
- 6.67 We have considered whether there may be alternative remedies to achieve the same aim. However, we consider that there is no substantive alternative to the proposed remedy that would be effective (for the reasons set out in paragraphs 6.29 to 6.35 above).
- *Would not produce disadvantages that are disproportionate to the aim*
- 6.68 We have provisionally concluded that the proposed remedy would not produce adverse effects that would be disproportionate to its aim. We have compared the potential costs of implementing the proposed remedy relative to the potential detriment at stake.
- 6.69 The gains available to customers from promoting engagement are potentially high (see Section 3, Analysis of detriment). Given the magnitude of the detriment we have observed as resulting from the Domestic Weak Customer Response AEC, we propose to seek to enhance the effective implementation of the Ofgem-led programme by inviting suppliers to offer undertakings to participate in the Ofgem-led programme or, failing that, to require suppliers to participate.
- 6.70 Ofgem currently undertakes some consumer research.⁵⁹⁵ For example, Ofgem commissioned an annual face-to-face survey with over 6,000 consumers to evaluate the impact of the RMR rules.⁵⁹⁶ However, its total consultancy budget on consumer research and evaluation for 2015/16 is £[REDACTED].⁵⁹⁷
- 6.71 We recognise that implementation of our proposal for the Ofgem-led programme would require substantial additional resources over and above Ofgem's current research budget. [REDACTED] Nevertheless, we consider that this proposed remedy will make a major contribution to the success of the overall package of proposed remedies aimed at promoting engagement and competition in the supply to domestic customers, and therefore to

⁵⁹⁵ Ofgem's Monitoring and Consumer research team leads on Ofgem's Consumer First research programme. This provides Ofgem with an understanding of the priorities, views and experiences of a wide range of consumers, including businesses. This involves Ofgem commissioning independent [consumer research and reviewing evidence from a variety of other organisations](#).

⁵⁹⁶ Ofgem commissioned TNS BMRB to conduct the first baseline survey in 2014. Its intention is to conduct further surveys. [Retail Market Review Baseline Survey](#) (July 2014), p1.

⁵⁹⁷ This budget comprises £[REDACTED] on domestic customer research, £[REDACTED] for microbusiness customer research and £[REDACTED] on RMR evaluation.

addressing (in part) the Domestic Weak Customer Response AEC. This is discussed further in Section 8.

- 6.72 We recognise that there would also be costs to suppliers of complying with undertakings agreed with the CMA or with a requirement to participate in the Ofgem-led programme (including, where used, RCTs) and implementing the resulting interventions. However, we note that the Ofgem-led programme will be proportionate given the scale of the detriment, and any potential costs to suppliers would be subject to Ofgem's obligation to consider the proportionality of any testing and supplier participation (and, as regards any agreed undertakings, may be subject to more defined obligations). In this regard, we note that some suppliers have told us they had previously conducted or were already conducting customer research on the design of bills and other communications with their customers.⁵⁹⁸ While some of these tests might be superseded by an Ofgem-led programme, we consider that the impact of the proposed remedy will be lower for those suppliers who already set aside a budget for consumer testing, which could contribute towards a supplier's participation in Ofgem's programme.
- 6.73 We have also been told that making changes to billing systems is costly.⁵⁹⁹ However, we are not proposing any definitive changes to suppliers' systems for the implementation of the proposed remedy. Our view is that it would be possible to conduct tests (including running RCTs) 'off system' and so avoiding the need for suppliers to make premature changes to their billing

⁵⁹⁸ [Centrica response to Remedies Notice](#), p73 (Centrica said it had been unable to act on the results of its research due to the current regulations. Centrica submitted that suppliers were better placed than the regulator to determine the best way to engage customers based on their experience and insight and were incentivised to do so by the need to differentiate themselves from competitors. Centrica suggested that the CMA should replace the existing prescriptive rules with regulations that required suppliers to achieve outcome-based goals); [EDF Energy response to Remedies Notice](#), p32; [E.ON response to Remedies Notice](#), p38; [Scottish Power response to Remedies Notice](#), p27 (p61 of PDF); and [RWE npower response to Remedies Notice](#), p4 (p100 of PDF) (RWE told us it was already conducting customer research in conjunction with The Behavioural Insights Team and Ofgem); [SSE response to provisional findings and Remedies Notice](#), p 63 (p143 of PDF).

⁵⁹⁹ SSE said that the time required to include any additional information on bills for microbusinesses would depend on the extent of the additions. Basic changes to current content and inclusion of short, simple additions (eg one line of text) could be introduced through current systems with minimal time to implement. While a full assessment would need to be made, the timescales involved were estimated to include a period of four weeks to implement system changes that would apply the change to the format of the bills, then a further six months would be required to allow a full billing cycle for all microbusiness customers. If the changes to bills were more substantial or complex then this could require significant development work which would significantly increase the timescales required for implementation. In the most extreme cases, changes could take over a year to implement. ([SSE response to provisional findings and Remedies Notice](#), p68 (p148 of PDF)). Co-operative Energy said that complying with prescriptive RMR billing and communication requirements came at a substantial cost in terms of system changes and the associated financial spend. ([Co-operative Energy response to Remedies Notice](#), p16). Drax said that providing information via bills was costly and had a long lead time as suppliers needed to make changes to systems (sometimes via third parties) ([Drax response to Remedies Notice](#) p5). Ecotricity said, in relation to measures to prompt customers on default tariffs to engage in the market, that system changes came at a cost that the Six Large Energy Firms might be able to absorb, but were challenging for independents ([Ecotricity response to Remedies Notice](#), p8).

and other systems.⁶⁰⁰ Any measures requiring alterations to billing or other systems would therefore only be implemented where these have been shown to be effective in achieving the desired impact on customer behaviour following testing, and are proportionate in meeting that aim. We are also aware that changes to bill formats are routine for suppliers⁶⁰¹ and therefore expect that the cost of such changes to the systems could be incorporated into the normal evolution of billing formats over time.

Relevant customer benefits

- 6.74 We do not consider that any relevant customer benefits will be lost as a result of the Ofgem-led programme. No changes would be made to information for domestic customers unless prior testing proves they would be effective. The programme therefore provides for the identification and implementation of measures that will be proven to help domestic customers engage in the market. In turn, this greater customer engagement will help to promote competition.

Greater use of principles rather than rules in addressing potential adverse supplier behaviour

- 6.75 As set out in Section 5, one of our proposed remedies is to remove aspects of the simpler choices component of the RMR rules with the aim of promoting competition between suppliers and PCWs.
- 6.76 Ofgem introduced these rules to make it easier for customers to make better choices by stripping away unnecessary complexity in tariff choices, particularly for certain groups of customers.^{602,603} The RMR rules also introduced legally binding fairness principles, implemented as Standards of Conduct in standard licence conditions, the aim of which was to place an onus on suppliers to embed fair treatment of their customers in every level of the organisation.
- 6.77 We consider that there is a balance to be struck in the regulation of the retail energy suppliers between rule-based regulation (such as the simpler choices component of the RMR rules) and principles-based regulation (such as the

⁶⁰⁰ We note that The Behavioural Insights Team has run RCTs in other sectors without major system changes.

⁶⁰¹ E.ON said that there had been numerous changes to the information provided to customers over the years ([E.ON response to Remedies Notice](#), p37).

⁶⁰² See Ofgem (March 2013), *The Retail Market Review – final domestic proposals*.

⁶⁰³ In addition, Citizens Advice and EDF Energy said that pre-RMR discounts and incentives might have been used to mislead customers. EDF Energy, E.ON and SSE said that effective standards of conduct were necessary to ensure such behaviour did not occur (or prevent customers from potentially being deliberately misled (E.ON).

Standards of Conduct introduced as part of the ‘fairer treatment’ component of the RMR rules⁶⁰⁴). Our concern with the aspects of the simpler choices component of the RMR rules that we propose to recommend that Ofgem remove is that:

- (a) Given their complexity, the interactions and effects of these rules are difficult to understand and lead to compliance risk for suppliers.
- (b) More broadly, there is a risk that overly prescriptive rules are counterproductive and encourage game playing, by implicitly legitimising any behaviour that is not explicitly proscribed by the rules. Since the publication of our provisional findings, we have received evidence that the simpler choices component of the RMR rules has given rise to such behaviour as a result of exemptions granted from the four-tariff rule for collective switching schemes and white-label tariffs. We consider that these examples illustrate the potential for suppliers to game rules. In particular:
 - (i) Ofgem said that it exempted collective switching schemes from the four-tariff rule because they might benefit otherwise difficult-to-engage customers and collective switching schemes had involved a range of models, tariffs and target customer groups.⁶⁰⁵ First Utility said switching sites had started offering collective switching schemes, and some were using the collective switching rules as a way to create exclusive tariffs. It said there was nothing ‘collective’ about switching site collective switches – such tariffs were shown to all site visitors within the results table. First Utility also said that E.ON had been most aggressive in terms of price in the uSwitch collective switch. This appears to have allowed E.ON to segment the market between existing unengaged customers and new engaged customers, through changes to prices effectively to avoid showing its current customers their market leading rate (as required by the Cheapest Tariff Messaging requirements).
 - (ii) Ofgem implemented temporary arrangements which exempted white labels from some aspects of the ‘simpler choices’ and ‘clearer information’ component of the RMR rules, in particular the four-tariff rule and the information rules. First Utility said that in 2014 British Gas’s best tariff was typically lower or similarly priced to Sainsbury’s best tariff, but British Gas had – since the introduction of ‘simpler choices’ – used the Sainsbury’s brand as a lower priced acquisition

⁶⁰⁴ SLC 25C.

⁶⁰⁵ Ofgem (2013), The Retail Market Review – Final domestic proposals.

vehicle, while not showing this rate to British Gas customers. First Utility also said that as new rules came into force on 1 October 2015, requiring white labels to be included in the Cheapest Tariff Messaging, British Gas has increased the price of the Sainsbury's tariff.

- 6.78 On 18 December 2015, Ofgem published a consultation on placing greater reliance on principles-based regulation in the domestic retail supply markets.⁶⁰⁶ Ofgem observed that principles-based regulation was being increasingly used by a number of sector regulators and said that it was committed to relying more on general principles rather than detailed rules about how companies should run their businesses. It said that this would better protect consumers' interests by:
- (a) focusing its efforts as a regulator on good consumer outcomes and more effective and comprehensive consumer protection;
 - (b) creating room for innovation, so suppliers can be more flexible in how they meet the needs of customers, including those in vulnerable situations; and
 - (c) putting a much greater onus on suppliers, especially senior management, to treat consumers fairly.
- 6.79 Ofgem is consulting on, among other things: which areas lend themselves to more prescriptive rules and which to a greater reliance on principles; which areas should be prioritised to shift to a greater reliance on principles; and whether the existing 'treating customers fairly' principle should be supplemented with additional principles. Ofgem identified SLC 25, relating to domestic sales and marketing, as a priority area,⁶⁰⁷ as it already contains an overall objective which would underpin the principles-based approach in this area. Ofgem said that it intended to publish a response to the consultation in summer 2016 with a view to making significant progress by the end of 2016.
- 6.80 For the reasons given above (see paragraph 6.77), we welcome Ofgem's commitment to a more principles-based approach to regulation. In particular, we would endorse:

⁶⁰⁶ Ofgem (18 December 2015), The future of retail market regulation.

⁶⁰⁷ The overall objective of SLC 25 is to ensure that (i) all information which suppliers provide to domestic customers in the course of marketing activities is complete and accurate, is capable of being easily understood by domestic customers, does not relate to products that are inappropriate to the domestic customer to whom it is directed and is otherwise fair both in terms of its content and in terms of how it is presented; and (ii) suppliers' marketing activities and all contact by suppliers with domestic customers in the course of suppliers' marketing activities are conducted in a fair, transparent, appropriate and professional manner (SLC 25.1).

- (a) Ofgem's statements in relation to the potential benefits of principles-based regulation and its commitment to striking the right balance between rules and principles;
- (b) Ofgem's recognition of the challenges around bringing about the necessary culture change within Ofgem and suppliers for the benefits to customers to be realised; and
- (c) Ofgem's recognition of the need for effective monitoring and enforcement to providing a credible deterrent to non-compliance.

6.81 Against a background of Ofgem moving to a more principles-based approach to regulation, we have considered whether we provisionally have specific recommendations for Ofgem in relation to the specified principles. In the context of our proposed remedy to remove aspects of the simpler choices RMR rules, we noted in Section 5 that this may result in more tariffs and a wider range of products on the market. However, our view is that there are a range of tools which may help customers navigate the tariffs on offer in the market and make decisions and, accordingly, address any such unintended consequences arising from this proposed remedy. We also consider that any such unintended consequence could be substantially mitigated (or possibly entirely eliminated) by recommending that Ofgem introduce an additional principle to its 'Standards of Conduct' standard licence condition that would require suppliers to have regard, in the design of tariffs, to the ease with which customers can compare value for money with other tariffs they offer.⁶⁰⁸

Aim of the remedy

6.82 The aim of our proposed remedy is to work in tandem with our proposed recommendation to Ofgem to remove certain aspects of the simpler choices component of the RMR rules and to strengthen the provisions of the Standards of Conduct standard licence condition to mitigate unintended consequences associated with removing aspects of the simpler choices component of the RMR rules (see paragraph 6.82).

Design considerations

6.83 In designing the proposed remedy we have considered:

⁶⁰⁸ We also noted that this new Standard of Conduct could work with removing the 'whole of the market' requirement from PCW's Confidence Code which should incentivise expansion and investment in the domestic retail energy markets (see paragraph 6.105 below).

- (a) whether there are gaps in the current provisions of the Standards of Conduct that need to be addressed to mitigate the risks associated with removing aspects of the simpler choices component of the RMR rules;
- (b) how effective Ofgem has been in monitoring compliance with the Standards of Conduct and taking enforcement action where suppliers have been in breach of these standards; and
- (c) how to implement this proposed remedy.

Strengthening provisions of the current Standards of Conduct

6.84 The Standards of Conduct are included in the SLC 25C and impose obligations on suppliers regarding their interactions with domestic customers (except price).⁶⁰⁹ The obligations on suppliers cover three broad areas, ie behaviour, information, and process.

- (a) Behaviour: suppliers must behave and carry out any actions in a fair, honest, transparent, appropriate and professional manner.
- (b) Information: suppliers must provide information (whether in writing or orally) which is:
 - (i) complete, accurate and not misleading (in terms of the information provided or omitted);
 - (ii) communicated in plain and intelligible language;
 - (iii) relates to products or services that are appropriate to the customer to whom it is directed; and
 - (iv) fair both in terms of its content and in terms of how it is presented (with more important information being given appropriate prominence).
- (c) Process: the supplier must:
 - (i) make it easy for the consumer to contact them;
 - (ii) act promptly and courteously to put things right when they make a mistake; and

⁶⁰⁹ The Standards of Conduct are broadly based on EU Directives (ie Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity and Directive 2009/73/EC of 13 July 2009 concerning common rules for the internal market in natural gas) and consumer law (ie the Consumer Rights Act 2015).

- (d) otherwise ensure that customer service arrangements and processes are complete, thorough, fit for purpose and transparent.
- 6.85 Ofgem said that, in relation to the tariffs a supplier offered, the provisions applied to the terms and conditions of a tariff and to the information that a supplier provided about the tariff, and that the information provisions helped to reduce the risks that consumers did not understand the details of a tariff. This would include details such as multi-tier prices, multiple tariff components or loyalty discounts.⁶¹⁰
- 6.86 We have found that while the current provisions place an obligation on suppliers to provide customers with information on tariffs that is complete, accurate and not misleading, they place no explicit obligations on suppliers in the design of their tariffs, to help customers compare tariffs.

Effective monitoring and enforcement

- 6.87 Ofgem said it had a two-pronged approach to monitoring compliance with the Standards of Conduct. Ofgem:
- (a) monitors consumer outcomes through indicators and data from across Ofgem and external parties such as Citizens Advice including complaints data; and
 - (b) monitors suppliers' processes for embedding the principles through bilateral engagement and other processes such as the Standards of Conduct Challenge Panel.⁶¹¹
- 6.88 Ofgem has the power to take enforcement action for breaches of relevant conditions and requirements, including the Standards of Conduct. Ofgem's strategic objectives for enforcement include delivering credible deterrence and ensuring meaningful and visible consequences for businesses which do not comply. Before taking enforcement action, Ofgem will consider alternative actions.⁶¹²

⁶¹⁰ Ofgem (18 November 2015), Paper 1: Impact of remedy 3 on consumer engagement, working paper.

⁶¹¹ The 2014 Challenge Panel identified examples of good practice. Overall the Panel thought that more needed to be done by suppliers to ensure customers were placed the heart of their business.

⁶¹² These alternatives are set out in paragraphs 3.25 to 3.30 of Ofgem's enforcement guidelines. These include, among other things: entering into dialogue with a company and warning them about potential unlawful conduct; accepting non-statutory undertakings; agreeing a reporting period for the company to show the issue has been addressed and that it will not be repeated; and voluntary commitments. Ofgem said that voluntary commitments could have the advantage of being able to achieve more than could be achieved through a provisional or final order. Sources: Enforcement Guidelines, September 2014.

- 6.89 Following a finding of breach, Ofgem has the power to impose financial penalties and/or make consumer redress orders.⁶¹³ The central objective of imposing financial penalties and making redress orders, and of determining their amount and type, are to obtain fair outcomes for consumers and to deter future non-compliance. Financial penalties must be reasonable in all the circumstances of a case.⁶¹⁴
- 6.90 Ofgem will normally seek to ensure that any financial penalty, and compensation or other payment under a consumer redress order, or any combination of them, significantly exceeds the gain to the regulated person (where this can reasonably be calculated or estimated) and the detriment caused to consumers affected by the contravention or failure.⁶¹⁵ When determining the amount of a financial penalty and/or consumer redress payment, Ofgem will consider any remedial measures that have been taken. However, Ofgem may impose a financial penalty significantly in excess of the gain or detriment even where the gain or detriment has been mitigated in full. Ofgem considers that this may be necessary in order to deter non-compliance and provide appropriate encouragement for all regulated persons to comply with their obligations.⁶¹⁶
- 6.91 We consider that ultimately it is the credible threat of enforcement action that would provide suppliers with an incentive to comply. In this context, we note that on 18 December 2015 Ofgem imposed a fine of £26 million on RWE for its failure to comply with the obligation to treat its domestic customers fairly in breach of the Standards of Conduct.⁶¹⁷ Ofgem also said that failure to achieve agreed targets could result in npower companies having to stop all proactive domestic selling until they do.^{618,619} Further, Ofgem is currently

⁶¹³ Where Ofgem imposes a financial penalty, makes a consumer redress order requiring payment of compensation, or does both and requires the payment of compensation for the same breach, then the amount (or combined amount) must not exceed 10% of the turnover of the regulated person.

⁶¹⁴ Ofgem's Enforcement Guidelines and Ofgem's Statement of Policy with Respect to Financial Penalties and Consumer Redress under the Gas Act 1986 and Electricity Act 1989.

⁶¹⁵ The Gas and Electricity Markets Authority's Statement of Policy with respect to Financial Penalties and Consumer Redress under the Gas Act 1986 and the Electricity Act 1986, paragraph 2.4.

⁶¹⁶ The Gas and Electricity Markets Authority Statement of Policy with respect to Financial Penalties and Consumer Redress under the Gas Act 1986 and the Electricity Act 1989.

⁶¹⁷ When setting the amount of the fine, Ofgem took into account the fact that RWE had offered to settle the investigation and had also undertaken to make certain consumer redress payments.

⁶¹⁸ SLC 25C requires suppliers, among other things, to provide information to domestic customers which is complete, accurate and not misleading, and to act promptly and courteously to put things right when they make a mistake.

⁶¹⁹ RWE was found to be in breach of the Standards of Conduct set out in SLC 25C, in particular, the requirements regarding the manner in which the information must be provided to domestic customers by suppliers and the requirements concerning complaint handling procedures. Ofgem's investigation mainly showed that RWE's customers received inaccurate bills with little or no detail on how these were calculated, and that RWE failed to deal with complaints effectively. Accordingly, RWE failed to comply with the obligation to treat its domestic customers fairly in breach of SLC 25C.

investigating Scottish Power⁶²⁰ for suspected breaches of the Standards of Conduct.

- 6.92 Based on these findings our provisional view is that Ofgem has the ability and incentive to take effective enforcement action, including imposing fines, in case of breach of the Standards of Conduct. Its recent decision concerning RWE demonstrates that Ofgem is prepared to enforce the Standards of Conduct strongly.

Implementation of this remedy

- 6.93 We propose to implement this proposed remedy through a recommendation to Ofgem to include an additional standard of conduct into SLC 25C that would require suppliers to have regard in the design of tariffs to the ease with which customers can compare value for money with other tariffs they offer.

Assessment of effectiveness

- 6.94 Our provisional view is that the proposed remedy would be effective in mitigating the risks of removing aspects of the simpler choices component of the RMR rules as it would expressly provide for suppliers to have regard to the comparability of tariffs in their design.
- 6.95 As explained above, we consider that effectiveness of the remedy critically depends on Ofgem maintaining its monitoring and enforcement activity. In assessing the effectiveness of the proposed remedy, we have also considered evidence on the impact of the current Standards of Conduct on suppliers' conduct and, by implication, the impact the additional provision could be expected to have on suppliers in the design of tariffs.
- 6.96 In particular, we asked all of the Six Large Energy Firms, Ovo Energy, The Co-operative Energy and First Utility:⁶²¹
- (a) what actions they have taken and what processes are in place to ensure compliance with the Standards of Conduct;

⁶²⁰ Ofgem will assess whether Scottish Power has made it easy for consumers to contact it, whether it has acted promptly and courteously to put things right when it has made a mistake and whether it has ensured that customer service arrangements are fit for purpose ([Investigation into Scottish Power's compliance with Standards of Conduct \(SLC 25C\)](#), [SLC 27 \(provision of final bills\)](#), and the [Gas and Electricity \(Consumer Complaints Handling Standards\) Regulations \(CHRs\) 2008](#)).

⁶²¹ Ofgem and supplier responses to CMA questions about fairer treatment.

- (b) how the Standards of Conduct influence their decision-making in various areas such as tariff terms and conditions and the information provided to customers; and
 - (c) how they ensure PCWs representing them comply with the Standards of Conduct.
- 6.97 The responses were as follows:
- (a) All suppliers said that they had processes to ensure compliance (and went above and beyond) with the Standards of Conduct.⁶²²
 - (b) All of the Six Large Energy Firms provided staff training on the Standards of Conduct.⁶²³
 - (c) Some suppliers said that they also monitored their compliance with the Standards of Conduct.⁶²⁴
 - (d) Suppliers had different methods for ensuring that PCWs representing them complied with the Standards of Conduct.⁶²⁵
- 6.98 Based on these responses, our provisional assessment is that all of the Six Large Energy Firms have been proactive in putting compliance processes in place. It is, however, difficult for us to judge how effectively compliance with the Standards of Conduct is embedded in the culture of these organisations.
- 6.99 We would expect Ofgem's consultation on the new standard of conduct to conclude by the end of 2016, such that it could implement and enforce the new standard of conduct from 2017 onwards.
- 6.100 We have provisionally concluded that the proposed remedy would be effective in mitigating the risks of removing aspects of the simpler choices component of the RMR rules, in light of our findings in relation to Ofgem's monitoring and recent enforcement activity, suppliers' compliance activities,

⁶²² For example, E.ON's Fair Decision Form guides decision makers through the core requirements of the Standards of Conduct. EDF's Trust Test is a set of principles staff must consider when making decisions and Centrica's formal Standards of Conduct assessment is embedded within the process of developing new products and processes.

⁶²³ E.ON said that it developed training and toolkits. EDF Energy said that it carried out extensive staff training on the Standards of Conduct. RWE said it had an e-learning programme on the Standards of Conduct. Scottish Power said that it had extensive staff training including a mandatory DVD and briefing sessions. Centrica said that it had workshops and training and SSE said that implementation of the Standards of Conduct included extensive staff training and briefing documents and a review of SSE's existing policies to ensure compliance.

⁶²⁴ For example, SSE said it monitored performance through KPIs and their internal Treating Customers Fairly Panel, and RWE said it had developed a dashboard showing performance against the Standards of Conduct.

⁶²⁵ [REDACTED]

and Ofgem's appreciation of the challenges it will face in moving towards more principles-based regulation.

Assessment of proportionality

- 6.101 We consider this proposed remedy to be proportionate for the following reasons:
- (a) it should be of minimal cost to implement, given that suppliers will only need to consider taking certain actions to comply with the new Standard of Conduct once the relevant aspects of the simpler choices component of the RMR rules has been removed;
 - (b) Ofgem is moving towards a more principles-based approach to regulation as demonstrated by its recent consultation;
 - (c) Ofgem is well placed to take this forward within its existing programme of monitoring and enforcement activity; and
 - (d) a more principles-based approach to regulation enables suppliers to innovate in the face of opportunities offered by new technologies and allows customers to benefit.
- 6.102 We have also had regard to Ofgem's statutory duties and objectives in reaching a provisional decision concerning the proposed remedy, as set out in paragraphs 6.89 to 6.92.

Provisional conclusion

- 6.103 We welcome Ofgem's consultation on placing greater reliance on principles-based regulation in the domestic retail supply markets. In the meantime we propose to bolster the existing Standards of Conduct to require suppliers to have regard in the design of their tariffs to the ease of comparability with other tariffs they offer. We consider this to be a gap in current provisions that needs to be addressed in order to mitigate the risks associated with the removal of aspects of the simpler choices component of the RMR rules, and for the proposed remedy to be effective and proportionate.

Enhancing the incentives and ability of PCWs to engage customers

- 6.104 We consider that PCWs are an important means by which effective competition can develop in the domestic retail markets. We recognised in our provisional findings that PCWs have a strong commercial incentive to engage with domestic customers and provide access to their services both online and by telephone. PCWs are also well placed to:

- (a) raise awareness among customers of their ability to switch and the potential benefits from doing so;
 - (b) reduce search costs for customers; and
 - (c) exert competitive pressure on energy suppliers by enhancing price transparency and facilitating the purchasing process for customers.
- 6.105 Our aim in considering remedies relating to PCWs in the domestic retail markets is to address (in whole or in part) the features giving rise to the Domestic Weak Customer Response AEC. With this in mind, we propose remedies aimed at enhancing the incentives of PCWs to participate in the domestic retail energy markets and enabling PCWs to offer customers a better service. In particular, we propose:
- (a) to recommend to Ofgem that it remove the requirement on PCWs to show the whole of market from the Confidence Code, which could be damaging to the incentives of PCWs to participate in the domestic retail energy markets and could have particular unintended consequences in light of our proposed recommendation to remove aspects of the simpler choices component of the RMR rules, and introduces a requirement to provide clear messaging concerning what results are displayed. In this context, PCWs will be required to be transparent over the market coverage provided to customers;
 - (b) to require Gemserv and Xoserve (through an order) to give PCWs access to the ECOES and SCOGES databases (subject to satisfying reasonable access conditions) in order to reduce the number of erroneous transfers and failed switches and, more generally, to support PCWs in facilitating the switching process; and
 - (c) to recommend to DECC several changes to the Midata programme that (subject to customer consent) would give PCWs increased access to more customer data and, in so doing, enable PCWs to monitor the market on behalf of their customers and advise them of savings.
- 6.106 We have also considered but do not intend to pursue two further possible remedies:
- (a) Encouraging domestic customers to use more than one PCW.
 - (b) An Ofgem price comparison service for domestic customers, in the light of Citizens Advice's decision to launch a non-transactional PCW listing all tariffs on the domestic retail energy markets.

- 6.107 We set out below our reasons for not pursuing these proposed remedies (see paragraphs 6.130 to 6.148).

The Confidence Code

- 6.108 The Confidence Code⁶²⁶ is a voluntary code of practice for domestic energy price comparison services. The Confidence Code sets out minimum requirements (concerning independence, transparency, accuracy, and reliability) that providers of price comparison services must meet in order to be, and remain, accredited by Ofgem. The main aim of the Confidence Code is to promote consumers' trust in PCWs and thereby increase customers' use of PCWs.
- 6.109 Ofgem recently amended the Confidence Code and introduced a requirement on PCWs to display the whole of the market (the 'Whole of the Market Requirement').⁶²⁷ In our provisional findings we said that accredited PCWs' inability to present (as a default) only those tariffs for which they are paid commission risks undermining the incentive of PCWs to invest in the domestic retail energy markets and the ability of PCWs to exert competitive pressure on suppliers. These risks would be heightened if the four-tariff rule (which itself limits PCWs' ability to agree bespoke supply contracts) were removed, as we propose to recommend to Ofgem (see Section 5).
- 6.110 We also noted that it was too early to assess the impact of this change to the Confidence Code – in particular, whether the Whole of the Market Requirement has resulted in more consumers using accredited PCWs (indicating that trust in PCWs had decreased), and/or whether it has led to an increasing number of suppliers not entering into individual commercial relationships with accredited PCWs (despite the continuation of the four-tariff rule and the possible availability of derogations), resulting in a withdrawal, or reduced competition, by some or all PCWs from the markets or fewer PCWs being accredited.
- 6.111 Since publishing our provisional findings we have conducted some updated analysis that sheds some light on the potential impact of the Confidence Code on accredited PCWs' sustainability since the addition of the Whole of the Market Requirement. In particular, we have looked at the evidence on

⁶²⁶ Ofgem, [The Confidence Code](#).

⁶²⁷ Ofgem letter (25 March 2015), [Publication of revised Confidence Code](#).

changes in the number of fulfillable tariffs⁶²⁸ and the number of acquisitions via PCWs (as a proportion of total acquisitions).

6.112 We consider that a reduction in the number of tariffs in the top 10 (cheapest tariffs) that are not fulfillable since the introduction of the Whole of the Market Requirement could be evidence of a damaging impact on the business model of PCWs. First, it would be consistent with suppliers using PCWs to advertise tariffs while avoiding paying commissions, which could dampen PCWs' incentives to invest in the domestic retail energy markets. Second, it could be damaging to customer engagement by adding additional steps in the switching process and excluding PCWs from facilitating the switching process.

6.113 Table 6.1 shows information on the number of dual fuel direct debit tariffs in 'Top 10' displays on PCWs that were fulfillable on the uSwitch, MoneySuperMarket and Energyhelpline websites in March, September and December 2015. Further results are provided in Appendix 6.1.

Table 6.1: Number of top 10 dual fuel direct debit tariffs that were fulfillable by the PCW

	<i>Total fulfillable out of top 10 dual fuel tariffs</i>		
	<i>March 2015</i>	<i>September 2015</i>	<i>December 2015</i>
uSwitch	6	4	4
MoneySuperMarket	9	6	5
Energyhelpline	10	7	6

Source: Ofgem.

6.114 These results show that, for tariffs available to customers who pay by direct debit (which represent the cheapest deals of all and the most popular form of acquisition tariffs), uSwitch, MoneySuperMarket and Energyhelpline were remunerated for fewer tariffs in the top ten in December 2015 compared with March 2015.

6.115 We also found some evidence that the proportion of acquisitions via PCWs is substantially lower for some suppliers in the period July to December 2015 compared with January to June 2015 (see Table 6.2 below). We consider that if this trend were to continue it could undermine the incentives of PCWs to participate in the energy market.

⁶²⁸ Suppliers determine which of their tariffs are 'fulfillable' via PCWs. A fulfillable tariff is one for which a PCW can facilitate the switch and is paid a commission for doing so. A PCW will receive no commission for displaying results for non-fulfillable tariffs.

Table 6.2: Percentage of acquisitions by PCWs (all tariffs, excluding white labels)

	%				
	Jan 2015 to Jun 2015		Jul 2015 to Dec 2015		
	Electricity	Gas	Electricity	Gas	Both
[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]			[X]
[X]	[X]	[X]			
[X]	[X]	[X]	[X]	[X]	
[X]	[X]	[X]	[X]	[X]	
[X]	[X]	[X]	[X]	[X]	

Source CMA calculations based on information provides by Six Large Energy Firms and Mid-tier Suppliers.

6.116 In the Remedies Notice we also recognised the implications of the coexistence of the proposed remedy to remove aspects of the simpler choices component of the RMR rules with the application of the Whole of the Market Requirement. In particular:

- (a) The Whole of the Market Requirement risks reducing the effectiveness of our proposed remedy to remove the simpler choices component of the RMR rules, by reducing the ability and incentive on the part of suppliers and accredited PCWs to negotiate exclusive deals available via particular PCWs. This would be the case if the Whole of the Market Requirement meant that exclusive deals had to be displayed on all PCWs, not just on those through which they are fulfillable (which may not be practicable in practice).
- (b) Without the proposed amendment to Ofgem’s Confidence Code, suppliers could ‘game’ the removal of aspects of the simpler choices component of the RMR rules by releasing many similar-priced tariffs to crowd out competitors on PCW results pages (which could also be confusing for customers).⁶²⁹ Citizens Advice,⁶³⁰ uSwitch⁶³¹ and MoneySuperMarket⁶³² said that this behaviour was evident pre-the RMR rules. Ofgem said ⁶³³that such ‘crowding out’ of the top listings on search results had been raised with it by stakeholders as a risk.
- (c) The Whole of the Market Requirement could be impractical with an increase in the number of tariffs offered in particular where PCWs agree different tariff levels and commissions with energy suppliers.

⁶²⁹ The Whole of the Market Requirement prevents PCWs from responding to such behaviour by consolidating very similar/identical tariffs offered by the same supplier into one entry on their results page.

⁶³⁰ Citizens Advice response to Remedies Notice, p12.

⁶³¹ uSwitch response to Remedies Notice, p9.

⁶³² MoneySuperMarket response to Remedies Notice, p6.

⁶³³ Ofgem response to Remedies Notice, p1.

(d) In any event, in light of parties' responses clarifying the definition of the Whole of the Market Requirement currently in operation, the Whole of the Market Requirement could be misleading (and so undermine trust) as we have been told that an accredited PCW adhering to the Confidence Code is allowed not to show tariffs that are only available from other PCWs (for example, the Whole of the Market Requirement does not require PCWs to display the E.ON collective switching tariff available through uSwitch⁶³⁴).

6.117 We therefore propose to recommend to Ofgem that it amends the Confidence Code to remove the Whole of the Market Requirement from the Confidence Code, and to require accredited PCWs to be transparent over the market coverage provided to domestic customers (by, for instance, displaying a clear message explaining the results on display and clarifying that certain tariffs are not available through their site).

Aim of the remedy

6.118 The aim of the proposed remedy would be to help ensure that the potential for PCWs to promote competition to the benefit of domestic customers is realised. More specifically:

- (a) it would help to ensure that requirements in relation to listing do not undermine the incentive accredited PCWs have to invest in services in the domestic retail energy markets and to promote the use of these services, helping to increase domestic customer engagement;
- (b) it would help to address concerns that the Whole of the Market Requirement could undermine the effectiveness of the proposal to remove certain aspects of the simpler choices component of the RMR rules by dampening the incentives of accredited PCWs to negotiate exclusive deals (if these had to be advertised on rival PCW sites);
- (c) it would help to address concerns that the proposed removal of aspects of the simpler choices rule would make the application of the Whole of the Market Requirement impractical (as PCWs might not be aware of exclusive deals negotiated by rival sites) or confusing for customers (if, for example, exclusive deals were to be excluded from the requirement); and
- (d) it would allow PCWs to manage any attempts by suppliers to game to their advantage the removal of the simpler choices component of the

⁶³⁴ [uSwitch press release](#).

RMR rules (in particular, the constraints on the number of tariffs a supplier can offer) by releasing many similar priced tariffs in order to crowd out competitors on PCW results pages.

Parties' views

- 6.119 We invited views on whether the Whole of the Market Requirement should be removed, and if so, whether alternative measures to increase confidence in PCWs would be required.
- 6.120 Centrica⁶³⁵ and EDF Energy⁶³⁶ said that the Whole of the Market Requirement should be removed. E.ON said that the Whole of the Market Requirement would become less practical as the number of tariffs, and potentially their structures, increased.⁶³⁷ RWE⁶³⁸ said that the Whole of the Market Requirement should be removed, if PCWs were able to promote exclusive offers and tariffs. To maintain trust, Centrica,⁶³⁹ E.ON⁶⁴⁰ and RWE⁶⁴¹ said that PCWs should be transparent about the market coverage they provided, and EDF Energy⁶⁴² said that PCWs should be subject to direct regulation or standards of conduct. Which?⁶⁴³ and Ofgem⁶⁴⁴ said that if the Whole of the Market Requirement were removed, alternative measures to increase confidence in PCWs might be necessary.
- 6.121 Co-operative Energy,⁶⁴⁵ Citizens Advice⁶⁴⁶ and MoneySavingExpert⁶⁴⁷ said that the removal of the Whole of the Market Requirement would be detrimental to consumers. MoneySavingExpert⁶⁴⁸ said that the tariffs not displayed needed to be clear to customers. Utility Warehouse⁶⁴⁹ said the Whole of the Market Requirement became more important than ever with more tariffs. Age UK⁶⁵⁰ said that the Whole of the Market Requirement might not be ideal, but it would need to be policed and enforced.

⁶³⁵ Centrica response to provisional findings and Remedies Notice, p56.

⁶³⁶ EDF Energy response to Remedies Notice, paragraph 3.19, p15.

⁶³⁷ E.ON response to provisional findings, p22, paragraph 96.

⁶³⁸ RWE response to Remedies Notice, p36, paragraph 2.8.

⁶³⁹ Centrica response to provisional findings and Remedies Notice, p56.

⁶⁴⁰ E.ON response to provisional findings, p22, paragraph 97.

⁶⁴¹ RWE response to Remedies Notice, p36, paragraph 2.8.

⁶⁴² EDF Energy response to Remedies Notice, paragraph 3.19, p15.

⁶⁴³ Which? response to Remedies Notice, p3.

⁶⁴⁴ Ofgem response to Remedies Notice, p3.

⁶⁴⁵ Co-operative Energy response to Remedies Notice, p5.

⁶⁴⁶ Citizens Advice response to Remedies Notice, p16.

⁶⁴⁷ MoneySavingExpert response to Remedies Notice, p3.

⁶⁴⁸ MoneySavingExpert response to Remedies Notice, p3.

⁶⁴⁹ Utility Warehouse response to Remedies Notice, p6.

⁶⁵⁰ Age UK response to Remedies Notice, p3.

6.122 Following the publication of our Remedies Notice, we received further information on the Whole of the Market Requirement.

- (a) Ofgem said that to date, it had not asked sites to display collective switch offerings (including collective switch offerings from competitor sites) under the Whole of the Market Requirement. If the four-tariff cap rule were removed, it would not expect accredited sites to show exclusive site/supplier deals and it would not be Ofgem's current policy intention to request accredited sites to provide information on the exclusive offerings of competitor sites.⁶⁵¹
- (b) uSwitch said that generally PCWs did not show collective switch tariffs available from other TPIs. uSwitch understood that this was considered acceptable by Ofgem under the Whole of the Market Requirements of the Confidence Code as such tariffs were limited to one sales channel and not available directly through the energy supplier. The Whole of the Market Requirement was better understood as covering tariffs available directly from suppliers.⁶⁵²
- (c) Gocompare.com said that collective switch tariffs did not have to appear on accredited PCWs, even if the 'whole of market' view was chosen, and the 'whole of market' view could result in customers being shown tariffs that they might not be able to apply to through any channel.⁶⁵³

Implementation of this remedy

6.123 We propose to implement this proposed remedy through a recommendation to Ofgem to remove the Whole of the Market Requirement in the Confidence Code and introduce a requirement for PCWs accredited under the Confidence Code to be transparent over the market coverage that they provide to energy customers.

Assessment of effectiveness

6.124 In assessing the effectiveness of the proposed remedy, we have considered not only the extent to which it would be effective in achieving its aims, but also the extent to which the proposed remedy is capable of effective implementation, monitoring compliance and enforcement, and the timescale over which the remedy is likely to have an effect.

⁶⁵³ Gocompare.com response to Remedies Notice, paragraph 2.9.

- 6.125 As regards the implementation of the proposed remedy, we consider that Ofgem is well placed to implement the necessary changes to the Confidence Code, as it is responsible for managing the Confidence Code, monitoring compliance and accrediting and withdrawing accreditation from PCWs. In particular, given our proposed recommendation to Ofgem to remove aspects of the simpler choices component of the RMR rules, we consider that Ofgem will be best placed to coordinate the timing of the implementation of the removal of the Whole of the Market Requirement.
- 6.126 We consider that the proposed changes to the Confidence Code could be implemented simultaneously with our proposed recommendations concerning suppliers' licence conditions. In this regard, Ofgem would consult on the proposed removal the Whole of the Market Requirement from the Confidence Code immediately after we publish our final report, with this process expected to conclude by the end of 2016. The change could then be implemented by the beginning of 2017.
- 6.127 In addition, Ofgem would be well placed as the sector regulator to adapt and develop the Confidence Code in light of further developments in the retail markets.

Assessment of proportionality

- 6.128 We consider this proposed remedy to be proportionate because it will be effective at achieving its legitimate aims of minimising any potential unintended adverse consequences from the removal of aspects of the simpler choices component of the RMR rules and promoting the role of PCWs the energy market. It will also involve minimal costs to implement, and PCWs would overall face a reduced regulatory burden by replacing a need to verify their own compliance with the Whole of the Market Requirement with a requirement for accredited PCWs to be transparent over the market coverage provided to domestic customers (by, for instance, displaying a clear message explaining the results on display and clarifying that certain tariffs are not available through their website). We believe that requiring PCWs to be transparent over the market coverage they provide would facilitate customer engagement, and work synergistically with our other proposed remedies concerning domestic customer engagement.
- 6.129 Accordingly, we believe this proposed remedy is no more onerous than necessary and the least onerous of equally effective remedies.

Remedy minded not to adopt: an Ofgem price comparison service for domestic and/or microbusiness customers

6.130 In our provisional findings we identified a number of features of the markets for the retail supply of energy to domestic customers that combine to give rise to the provisional Domestic Weak Customer Response AEC. One of these features is that certain domestic customers face actual and perceived barriers to accessing and assessing information arising from a lack of confidence in and access to PCWs.

6.131 To address our provisional concerns in this area one proposed remedy included in our Remedies Notice was for Ofgem to provide an independent price comparison service for domestic customers.

Aim of the remedy

6.132 The aim of this possible remedy was to improve trust in PCWs, and thereby, to encourage greater use by domestic customers. As discussed above, this might be particularly desirable given our proposed recommendation to remove aspects of the simpler choices component of the RMR rules and the Whole of the Market Requirement in the Confidence Code, with a view to addressing the concerns of those domestic customers that do not wish to shop around different PCWs to understand the best deals available from suppliers.

Design considerations

6.133 In the Remedies Notice we invited responses on certain key design features including whether the service should;

- (a) be an online-only service, or should also operate a call centre for customers who do not have access to the internet to obtain information over the telephone;
- (b) quote suppliers' list prices only or provide coverage of the whole of the markets, including exclusive deals negotiated between suppliers and third parties, such as other PCWs;
- (c) provide information on tariffs only or also allow customers to transact (ie switch suppliers or tariffs) via the service;
- (d) obligate suppliers to provide tariff information to Ofgem to facilitate the operation of the price comparison service; and
- (e) provide any additional information.

6.134 We also consulted on how domestic customers should be made aware of the service.

Parties' views

6.135 In the Remedies Notice we invited views on the effectiveness and proportionality of this proposed remedy. In particular, we asked if this proposed remedy would be effective in increasing domestic and/or microbusiness customers' trust in PCWs, whether there is a risk this proposed remedy could undermine the development of PCWs in the retail energy markets, and the likely costs to Ofgem of setting up a price comparison service.

6.136 There was a mixed response to this proposed remedy overall:

- (a) EDF Energy,⁶⁵⁴ Ovo Energy⁶⁵⁵ and Co-operative Energy⁶⁵⁶ supported the proposed remedy.
- (b) RWE,⁶⁵⁷ E.ON⁶⁵⁸ and Utility Warehouse⁶⁵⁹ supported the remedy under specific circumstances. RWE said that it supported the proposal provided it concerned an information-only service and commercial PCWs could offer exclusive tariffs.⁶⁶⁰ E.ON said it supported the proposed remedy if it was information only and covered the whole of the markets and did not undermine existing commercial PCWs.⁶⁶¹ Utility Warehouse⁶⁶² said an Ofgem comparison service should only be introduced if it provided something new and that was unlikely to be delivered by commercial PCWs.
- (c) Centrica,⁶⁶³ First Utility,⁶⁶⁴ MoneySavingExpert,⁶⁶⁵ Which?⁶⁶⁶ and the Behavioural Insights Team⁶⁶⁷ opposed the remedy.

⁶⁵⁴ EDF Energy response to Remedies Notice, p21.

⁶⁵⁵ Ovo Energy response to Remedies Notice, p21. Ovo Energy supported this remedy, but suggested that Citizens Advice was likely to be a better host of an independent, trustworthy PCW service.

⁶⁵⁶ Co-operative Energy response to Remedies Notice, p11.

⁶⁵⁷ RWE response to Remedies Notice, p52, paragraph 1.4.

⁶⁵⁸ E.ON response to Remedies Notice, p33.

⁶⁵⁹ Utility Warehouse response to Remedies Notice, p9.

⁶⁶⁰ RWE response to Remedies Notice, p52, paragraph 1.4.

⁶⁶¹ E.ON response to Remedies Notice, p33.

⁶⁶² Utility Warehouse response to Remedies Notice, p9.

⁶⁶³ Centrica response to provisional findings and Remedies Notice, p66.

⁶⁶⁴ First Utility response to provisional findings and Remedies Notice, p32.

⁶⁶⁵ Money Saving Expert, response to Remedies Notice, p7.

⁶⁶⁶ Which? response to Remedies Notice, p6.

⁶⁶⁷ The Behavioural Insights Team response to Remedies Notice, p6.

- (d) SSE⁶⁶⁸ said it was exploring further to ensure in practice that it would be effective in meeting its stated aim of ‘improving trust in PCWs’. SSE highlighted that one unintended consequence might be that it could decrease trust in other PCWs and so it suggested a trial period to test the feasibility and proportionality of the remedy.
- (e) Scottish Power⁶⁶⁹ thought it could be worth exploring further but expressed caution over the signals it would send.

Citizens Advice domestic price comparison service

- 6.137 Following the publication of our Remedies Notice, Citizens Advice has launched a new domestic price comparison service operated as a white-label solution with source data provided by Energylinx, which is Confidence Code accredited. This was launched alongside the Big Energy Saving Week on 26 October 2015.
- 6.138 This Citizens Advice service is information-only (ie users cannot use it to sign up for a particular deal) and provided face to face and online. Citizens Advice said that at some point the service may become transactional, with this decision based on user needs and whether it would be the right approach for Citizens Advice to take. Citizens Advice said it would monitor the service to see if customers would benefit from having assistance over the phone. Where possible Citizens Advice has said it will endeavour to monitor user profiles by channel.^{670,671}
- 6.139 The tool provides full market coverage and the default is set to show all tariffs to customers. Citizens Advice said that the comparison service will display suppliers who currently do not feature on commercial PCWs including Utility Warehouse and other small specialist suppliers. Citizens Advice said it had been able to encourage some additional suppliers to list their tariffs on Energylinx (and, therefore, Citizens Advice’s comparison service) including Economy Energy, and E Gas and Electric.
- 6.140 Citizens Advice said that the service was promoted through its website, the telephone Consumer Service, the network of local Citizens Advice, media

⁶⁶⁸ SSE response to Remedies Notice, page 44, paragraph 3.9.

⁶⁶⁹ Scottish Power response to Remedies Notice, pp20–21, paragraphs 6.1 & 6.3.

⁶⁷⁰ The Citizens Advice bureau statistics summarises the profile of bureau clients for England and Wales. These show: (a) the majority (31%) of bureau clients are aged 35 to 49 years old and a further 27% are aged 50 to 64 years old (age not recorded for 10%); (b) 18% are from black and minority ethnic groups (ethnic origin not recorded for 11%); (c) 38% have long-term health problems and/or a disability (disability or health status not recorded for 21%), (d) the majority (33%) are social tenants and a further 27% private tenants (housing tenure not recorded for 41%).

⁶⁷¹ Results for Citizens Advice Scotland show that during November 2014: (a) one-third of clients were aged 45 to 59 years old, and 29% lived in council-let properties.

messages and videos it was launching to help customers understand how to use a prepayment meter. Citizens Advice said that certain larger suppliers had also agreed to signpost customers to the tool via their websites.

6.141 Citizens Advice also said that it had recently launched a new suite of energy content on its website, including advice on how to use a PCW and how to switch. The content would also include supplier performance statistics, including comparable information about service performance and customer service and educational information to help customers understand the benefits of switching and where to get further help with energy issues.

6.142 The cost of the service is funded out of the Citizens Advice programme budget which is from the grant received from BIS to fund its energy work.

[✂]

Our assessment of an Ofgem price comparison service for domestic customers

6.143 Our provisional view is that an Ofgem price comparison service would not add significant further value to that already provided by the Citizens Advice service. We also note that Ofgem itself has stated that it does not currently have the expertise to set up and run such a service, although we have not given material weight to this.

Provisional conclusion

6.144 Given that the Citizens Advice service is now available, we have provisionally decided not to pursue this proposed remedy. We believe that the Citizens Advice service will be sufficient to address the concerns of those customers that do not wish to shop around PCWs to understand the best deals available from suppliers. We note that there may still be better PCW-specific deals available for those customers prepared to use more than one PCW.

Remedy not minded to adopt: encouraging domestic customers to use more than one PCW

6.145 In the Remedies Notice we recognised that our proposed remedy to remove aspects of the simpler choices component of the RMR rules was likely to increase the range of tariffs on offer and result in different tariffs being offered on different PCWs. We therefore considered whether to propose a remedy to encourage domestic customers to use more than one PCW.

Parties' views

- 6.146 The response to this proposed remedy was generally negative. E.ON,⁶⁷² RWE,⁶⁷³ Scottish Power,⁶⁷⁴ First Utility,⁶⁷⁵ Citizens Advice⁶⁷⁶ and The Behavioural Insights Team⁶⁷⁷ said that such a remedy should not be considered. However, Which?⁶⁷⁸ said that if people were not willing to use multiple PCWs, possible remedies should be considered to encourage 'multi-homing'.

Our assessment

- 6.147 We have found that 59% of survey respondents who used a PCW to search energy suppliers used more than one PCW.⁶⁷⁹
- 6.148 We have provisionally decided not to propose additional remedies to encourage domestic customers to use more than one PCW. This is primarily because actively encouraging domestic customers to use more than one PCW could have the unintended consequence of discouraging searching by making it seem more complicated and time-consuming and undermining existing levels of customer trust in PCWs. In addition, we consider that a market solution may develop with a PCW offering a search facility which aggregates deals available on PCWs including those deals exclusively available only via a particular PCW.

Providing PCWs with access to the ECOES and SCOGES databases

- 6.149 In our provisional findings report, we provisionally found that customers face actual and/or perceived barriers to switching, such as where they experience erroneous transfers which have the potential to cause material detriment to those who suffer from them. Erroneous transfers may thereby affect customers' ability to switch as well as their perception of switching.⁶⁸⁰ While we acknowledge that erroneous transfers represent a small percentage of all successful domestic switches in energy supply, around 1%,⁶⁸¹ they may

⁶⁷² E.ON response to provisional findings, p21, paragraph 95.

⁶⁷³ RWE response to Remedies Notice, p35, paragraph 2.6. RWE said that if suppliers were able to offer different tariffs and offers on different PCWs, this would result in consumers having to visit more than one PCW in order to find the most appropriate tariff.

⁶⁷⁴ Scottish Power response to Remedies Notice, p9, paragraph 3.7.

⁶⁷⁵ First Utility response to Remedies Notice, p23.

⁶⁷⁶ Citizens Advice response to Remedies Notice, p14.

⁶⁷⁷ BiT response to Remedies Notice, p1.

⁶⁷⁸ Which? response to Remedies Notice, p3.

⁶⁷⁹ See Appendix 8.3: Price comparison websites and collective switches, paragraph 81.

⁶⁸⁰ [Provisional findings report](#), pp323–324, paragraph 8.118.

⁶⁸¹ [Provisional findings report](#), pp323–324, paragraph 8.119.

nonetheless affect customers' ability to switch as well as more broadly their perception of switching. Further, we noted in our provisional findings report that the complexity of the switching process can lead to delays, errors and costs, which, in turn, may have an impact on broader customer confidence and the propensity of domestic customers to switch.⁶⁸²

- 6.150 We considered whether PCWs should be given access to the Electricity Central Online Enquiry Service (ECOES) database⁶⁸³ in order to allow them to facilitate the switching process for customers. ECOES, managed by Gemserv, was designed to assist suppliers in the customer transfer process by allowing the triangulation of data (pre-registration checking of Meter Point Administration Number (MPAN),⁶⁸⁴ address and meter serial number). The ECOES database includes MPAN address, meter profile class and meter serial number database. ECOES can be accessed directly by suppliers, Meter Point Administration Service (MPAS) providers, distribution businesses, supplier agents and non-domestic customers with at least two MPANs.⁶⁸⁵ TPIs such as PCWs may have limited access to the ECOES database through login details provided by suppliers but suppliers remain responsible for PCWs' usage.
- 6.151 Since the publication of our Remedies Notice we have been told that there is a similar database for gas; the Single Centralised On-Line Gas Enquiry Service⁶⁸⁶ (SCOGES), managed by Xoserve. Access to the SCOGES database is available to all gas transporters, shippers and suppliers, and some non-domestic customers⁶⁸⁷. This database includes Meter Point Registration Number (MPRN),⁶⁸⁸ address, meter serial number, Local Distribution Zone ID, Gas Act Owner, Meter Asset Manager ID, designation⁶⁸⁹ and other data available only to large transporter sites.⁶⁹⁰

⁶⁸² [Provisional findings report](#), p325, paragraph 8.125.

⁶⁸³ It is funded by electricity Suppliers and Distribution Business and governed under the Master Registration Agreement.

⁶⁸⁴ MPAN or S Number might be needed when a customer wants to switch energy supplier. See [The Energy Shop: How to find your MPAN and MPRN meter reference numbers](#).

⁶⁸⁵ Access to other users can be granted subject to fulfilling access criteria and agreeing to terms and conditions. Applications are considered in accordance with the principles set out in Section 4.6.2 of MAP 15.

⁶⁸⁶ The database is also known as the Data Enquiry Service. See [On-Line Meter Point Search Facility: GTC User Guide](#).

⁶⁸⁷ Access to other users can be granted subject to fulfilling access criteria and agreeing to terms and conditions. Applications are considered in accordance with the principles set out in Section 7.3 of Schedule 23 of the Supply Point Administration Agreement.

⁶⁸⁸ MPRN or M Number is the equivalent of MPAN for gas and might be needed when a customer wants to switch gas supplier. See [The Energy Shop: How to find your MPAN and MPRN meter reference numbers](#).

⁶⁸⁹ Indication if the site is domestic or industrial or commercial.

⁶⁹⁰ There are other data fields that are available only to large transporter sites. Suppliers receive a quarterly CD-ROM with the following data: MPRN, Meter Point address and postcode, meter serial number and Local Distribution Zone ID.

- 6.152 We have therefore also considered whether PCWs should be given access to the SCOGES database as part of our proposed remedy.

Aim of the remedy

- 6.153 The aim of the proposed remedy would be to reduce actual and perceived barriers to switching resulting from erroneous transfers and failed switches by giving PCWs access to the ECOES and SCOGES databases. Accordingly, the ultimate aim of this proposed remedy would be to partly address one of the features contributing to the Domestic Weak Customer Response AEC.
- 6.154 To obtain a quote from a PCW, a customer usually has to provide: postcode, current provider, current tariff name and payment method, meter type and annual consumption (although this last piece of information is not essential). To switch supplier, the customer usually needs to provide: address, contact details and other personal and payment information, and may have to provide their MPAN and/or MPRN. An incorrect MPAN/MPRN entered by a customer can result in an erroneous transfer or a failed switch. By giving PCWs access to the ECOES and SCOGES databases; PCWs could retrieve MPAN/MPRN numbers using the address provided by customers, therefore potentially avoiding an erroneous transfer or a failed switch.

Parties' views

- 6.155 In our Remedies Notice we invited views on whether PCWs should be given access to the ECOES database in order to allow them to facilitate the switching process for customers.
- 6.156 Ofgem and several suppliers⁶⁹¹ supported giving PCWs access to the ECOES database as they considered that it would allow PCWs to carry out earlier verification of customer data, thus reducing the number of cancelled and failed switches, reduce the cost of validating data to suppliers,⁶⁹² as well as speeding up the switching process. EDF Energy said it had no objection to giving PCWs access to the ECOES database as it considered that it would help to reduce the rate of cancellations once the switching process was initiated. Restrictions on the use of the data would have to be enforced so that only the checking of information on customer-initiated switches was

⁶⁹¹ Ofgem response to Remedies Notice, p2; RWE response to Remedies Notice, p39; Scottish Power response to Remedies Notice, paragraph 4.8, p12 (p46 of PDF); and Spark Energy response to Remedies Notice, p4.

⁶⁹² If PCWs are able to perform a more accurate validation earlier in the switching processes.

allowed.⁶⁹³ E.ON⁶⁹⁴ said the CMA should not introduce the proposed remedy directly; instead, the Master Registration Agreement working group should be allowed to finish its report and make recommendations on this. SSE⁶⁹⁵ said that it welcomed appropriate measures to make switching more reliable and hassle free. It also said that giving PCWs access to the ECOES database would allow PCWs to carry out verification of customer data before passing an application to a supplier, thus reducing the number of cancelled and failed switches. SSE,⁶⁹⁶ Co-operative Energy⁶⁹⁷ and Utilities Savings⁶⁹⁸ said that there were errors in the ECOES data which would still be present whether accessed by PCWs or suppliers.

6.157 Make It Cheaper⁶⁹⁹ said that a similar system worked well in Australia, improving the speed and number of successful SME energy switches.

6.158 E.ON, SSE and Scottish Power said that giving PCWs access to more accurate data such as the data available through Midata/the ECOES database would reduce the number of erroneous transfers and failed switches.⁷⁰⁰ In particular:

- (a) E.ON⁷⁰¹ said that inaccurate information provided by TPIs was a key driver of failed switches and erroneous transfers;
- (b) SSE⁷⁰² said it saw a higher rate of [X] PCWs than from any of its other direct customer acquisition channels; and
- (c) Scottish Power⁷⁰³ said that it estimated that 50% of erroneous transfers, where it was the gaining supplier, arose from incorrect MPANs or MPRNs, generally due to address mismatch. Of these, around 40% of erroneous transfers occurred because the customer had selected the incorrect address. It estimated that allowing PCWs to access the ECOES database would eliminate around 10% of erroneous transfers.

⁶⁹³ EDF Energy response to Remedies Notice, p18 paragraph 4.6.

⁶⁹⁴ E.ON response to provisional findings, p25, paragraph 111.

⁶⁹⁵ SSE response to Remedies Notice, p28.

⁶⁹⁶ SSE response to Remedies Notice, p28.

⁶⁹⁷ Co-operative Energy response to Remedies Notice, p7.

⁶⁹⁸ Utilities Savings response to Remedies Notice, p7. It said this was based on ECOES/MRA documents and some of its experiences with suppliers and customers.

⁶⁹⁹ Make It Cheaper response to Remedies Notice, paragraph 6.

⁷⁰⁰ SSE said that giving PCWs access to ECOES would reduce the number of failed switches.

⁷⁰¹ E.ON response to Remedies Notice, p26.

⁷⁰² SSE response to Remedies Notice, pp27–28 and 30.

⁷⁰³ Scottish Power response to Remedies Notice, pp12–13.

- 6.159 However, some parties said that giving PCWs access to the ECOES database would not result in a significant reduction in the number of erroneous transfers and failed switches. In particular:
- (a) EDF Energy⁷⁰⁴ said that only 2.5% of applications it received from PCWs suffered from a meter number error or other data issue;
 - (b) SSE⁷⁰⁵ said that the erroneous transfer rate was low (industry average of 1% January to September 2014) compared with other industries such as telecoms (7.3%);
 - (c) Gocompare.com⁷⁰⁶ said that failed switches were ‘not commonplace’; and
 - (d) Ofgem said that before the licence modification of 1 September 2014 came in to effect, erroneous transfers made up 1% of successful switches. The most recent data showed that it had fallen below 1%.
- 6.160 Citizens Advice⁷⁰⁷ said that the potential benefit of giving PCWs access to the ECOES database was unknown. Other parties said that there would not be a reduction in failed switches (Co-operative Energy,⁷⁰⁸ First Utility⁷⁰⁹) or erroneous transfers (Centrica⁷¹⁰). First Utility said that this measure alone would not reduce failed switches or erroneous transfers, as data quality issues remained unaddressed.⁷¹¹
- 6.161 Some suppliers⁷¹² and Energy Action Scotland⁷¹³ did not support the proposed remedy. Centrica⁷¹⁴ said that all PCW sales passed on to suppliers were checked against the ECOES database, and a further check by PCWs would not add value. Others⁷¹⁵ expressed concerns about the potential for misuse of ECOES data by PCWs and for nuisance calling if the

⁷⁰⁴ EDF Energy response to Remedies Notice, p18, paragraph 4.6.

⁷⁰⁵ SSE response to Remedies Notice, p27.

⁷⁰⁶ Gocompare.com response to Remedies Notice, paragraph 3.1.

⁷⁰⁷ Citizens Advice response to Remedies Notice, p20.

⁷⁰⁸ Co-operative response to Remedies Notice, p7.

⁷⁰⁹ First Utility, response to Remedies Notice, p26.

⁷¹⁰ Centrica response to Remedies Notice, p58.

⁷¹¹ In its response to our working paper on Gas and Electricity Settlement and Metering, First Utility submitted that the biggest driver of erroneous transfers was poor quality address data.

⁷¹² Centrica response to Remedies Notice, p58; Utility Warehouse response to Remedies Notice, p8; E.ON response to Remedies Notice, p25; Ovo Energy response to Remedies Notice (remedy 4a) and Co-operative Energy response to Remedies Notice, p7.

⁷¹³ Energy Action Scotland response to Remedies Notice, p5.

⁷¹⁴ Centrica response to Remedies Notice, p55.

⁷¹⁵ Co-operative Energy response to Remedies Notice, p7; Co-operative Energy expressed concerns about the potential for misuse of ECOES data by PCWs and said additional data protection caveats may be needed to prevent unwanted marketing. Utility Warehouse response to Remedies Notice, p8; Centrica response to Remedies Notice, p58 and Ofgem response to Remedies Notice (remedy 4), p3.

data was used for marketing purposes. Ofgem⁷¹⁶ mentioned it was aware of incidents when TPIs had cold-called customers using data believed to be from the ECOES database. Co-operative Energy⁷¹⁷ and Ofgem⁷¹⁸ shared these concerns. Utilities Savings⁷¹⁹ said that TPIs with indirect access to ECOES might actually be causing erroneous transfers.

Design considerations

6.162 In designing the proposed remedy we have considered:

(a) evidence on PCWs' access to the ECOES and SCOGES databases;
and

(b) how to implement this proposed remedy.

- *Evidence on PCWs' access to the ECOES and SCOGES databases*

6.163 We asked PCWs whether they had ever applied or considered applying to obtain access to the ECOES or SCOGES databases.

(a) uSwitch said its application to access the SCOGES database in July 2011 was rejected on the grounds that the Uniform Network Code did not allow for the release of information to a non-Uniform Network Code party. It had recently submitted an application for access to the ECOES database which was being processed by the MRA Executive Committee. uSwitch also said that it had been told that previous applications from PCWs for access to the ECOES database had been rejected. Along with the rejection of the SCOGES application, this had deterred uSwitch from formally applying for access to the ECOES database until recently.

(b) EnergyHelpline said it had made three enquiries for access to the ECOES database over the last five years, with the last one about a year ago, but had been told that it did not qualify for access as it was not a supplier.

(c) Make It Cheaper said that it applied for access to the ECOES database in 2007/8 but it was rejected. It said it was given no explanation by Gemserv that it could find.

⁷¹⁶ Ofgem response to Remedies Notice (remedy 4), pp2–3.

⁷¹⁷ Co-operative Energy response to Remedies Notice, p7.

⁷¹⁸ Ofgem response to Remedies Notice (remedy 4), pp2–3.

⁷¹⁹ Utilities Savings response to Remedies Notice, p58. It said it understood this to be likely where supply addresses were multiple at one location or at odds with Post Office postcodes etc. This was also based on some of its experiences of customers who had suffered erroneous transfers.

6.164 We asked the ECOES database administrator, Gemserv, and the SCOGES administrator, Xoserve, whether there is any legal requirement or other barrier preventing PCWs from accessing these databases.

(a) Gemserv said that any PCW could apply for access to the ECOES database and would, in principle, be given access if they met a number of access criteria. It said it had received only one application from a PCW over the last few years but the application was incomplete and the PCW had not provided the additional information required for it to be able to process the application. In response to a recent request for information, Gemserv said that it had recently received a number of applications for access to the ECOES database [REDACTED].

(b) Xoserve said that it did not have any record of PCWs applying for access to the SCOGES database. It said that access was governed by the SPAA industry code⁷²⁰ which sets out the rules and processed for 'Other Users Access'. It added that PCWs' access is dependent upon amendments being made to both the SPAA industry code and the Uniform Network Code.

6.165 Most PCWs said that they currently used a third party data provider, GB Group, to retrieve MPAN and MPRN information on behalf of their customers, but the ECOES and SCOGES databases were generally considered more accurate and up to date than the GB Group database.

6.166 uSwitch said that the GB Group data provided meter numbers based on address, but coverage was limited to approximately 90% of Great Britain and this meant that 10% of customers were required to enter their meter number manually to complete their application, which could act as a barrier to switching. uSwitch also said that in some cases the postcode list in the GB Group database was out of date and an energy region could not be sourced. This meant that some customers would be unable to progress beyond the uSwitch homepage. uSwitch estimated that approximately 1 to 2% of customers attempting to use its website would be unable to receive a quote due to errors caused by this incomplete postcode data.

6.167 PCWs [REDACTED]:

(a) The GB Group database is compiled using a limited MPAS data set supplied by Gemserv on a monthly basis and other various data sources. We also understand that Gemserv and the GB Group have a

⁷²⁰ See Schedule 23, Section 7.

commercial agreement in place, whereby they share some of the revenues received from the sale of the GB Group database.⁷²¹

- (b) Xoserve submitted that the GB Group currently provided an address management service to Xoserve but that it does not provide any data or information to enable the GB Group to provide this service.

6.168 It therefore appears to us that, in practice, PCWs do not have direct access to the ECOES and SCOGES databases. The precise reasons for this are unclear. Whilst they do have access to the GB Group data, at a cost of [X], this information is not as accurate or up-to-date as the ECOES and SCOGES databases.

6.169 We therefore consider that the proposed remedy should expressly provide for PCWs to be granted access (upon request, and upon satisfaction of reasonable access conditions) to the ECOES and SCOGES databases on terms that would enable PCWs to be able to check or obtain MPAN and MPRN numbers for customers seeking to switch supplier and to check other information provided by these customers against that held on the databases. Use of the data by PCWs would be strictly limited to these purposes (in order to address Ofgem's and some suppliers' concerns around the misuse of data – see paragraph 3.253 above). Any charge to PCWs for access should be based on the incremental cost to the database administrators of providing this access. We propose to order Gemserv and Xoserve to provide access on such reasonable terms.

6.170 Some parties⁷²² considered that access to the ECOES and SCOGES databases would still be relevant after the roll-out of smart meters, although uSwitch⁷²³ said that after the roll-out of smart meters there might be a reduced need for access to the ECOES database by PCWs, and Co-operative Energy⁷²⁴ said that PCWs would be able to access data directly through the DCC. Ofgem said that there would still be a need for a central database⁷²⁵ to facilitate switching.

6.171 Ofgem concluded that it should introduce a centralised registration service to facilitate reliable and fast switching for gas and electricity customers.

⁷²¹ [GB Group announces new data agreement for products to detect fraud and prevent terrorism.](#)

⁷²² E.ON response to Remedies Notice, p25, paragraph 115 (E.ON just referred to the ECOES database); RWE response to Remedies Notice, p7; Scottish Power response to Remedies Notice, paragraph 4.14, p13 (p47 of PDF); and Utilities Savings response to Remedies Notice, p7.

⁷²³ uSwitch response to Remedies Notice, p15.

⁷²⁴ Co-operative Energy response to Remedies Notice, p7.

⁷²⁵ Ofgem's response to Remedies Notice (Remedy 4), p3.

Ofgem's ambition was for customers to be able to switch next day.⁷²⁶ As part of the next-day switching programme, Ofgem would examine if there should be a single online enquiry service operated by the DCC,⁷²⁷ and which parties (including TPIs) should have access to it.⁷²⁸

6.172 In addition, PCWs would have access to meter number information through phase 2 of Midata, when implemented, and subject to implementation of our proposed remedy described below, on enhanced access terms. Midata will also allow PCWs to access consumption data and allow them to provide a more accurate comparison of the potential gains from switching (see paragraphs 6.188 to 6.223).

6.173 We recognise that with these developments PCWs might, in the future, not need access to the ECOES and SCOGES databases for the purposes set out in the proposed remedy. However, given that the time frame for the development of Midata phase 2 and any centralised registration system is uncertain, and that there would still be a need for PCWs to access the ECOES and SCOGES databases despite the roll-out of smart meters, we have provisionally decided not to include a sunset provision for this proposed remedy.

- *Implementation of this remedy*

6.174 We propose to implement this proposed remedy through:

- (a) an order to Gemserv to give PCWs access upon request to the ECOES database on reasonable terms and subject to satisfaction of reasonable access conditions; and
- (b) an order to Xoserve to give PCWs access upon request to the SCOGES database on reasonable terms and subject to satisfaction of reasonable access conditions.

Assessment of effectiveness

6.175 As we explain below, our provisional view is that the proposed remedy would be effective in achieving its aims of reducing actual and perceived barriers to switching resulting from erroneous transfers and failed switches.

⁷²⁶ Ofgem's response to Remedies Notice (Remedy 4), p3.

⁷²⁷ The DCC, due to be operational in August 2016, will be responsible for the communications infrastructure that enables the secure transfer of data between smart meters from domestic properties and energy suppliers, network companies and other authorised parties. It is regulated by Ofgem under a price control regime and funded by energy suppliers.

⁷²⁸ Ofgem (2015), [Moving to reliable next-day switching Target Operating Model and Delivery Approach](#), p18.

Accordingly, our provisional view is that the proposed remedy would be effective in partly addressing one of the features giving rise to the Domestic Weak Customer Response AEC (and the resulting detriment).

- 6.176 Our assessment of effectiveness of the proposed remedy has considered the following factors:
- (a) the extent to which the proposed remedy may reduce erroneous transfers and failed transfers; and
 - (b) the extent to which the proposed remedy may encourage switching.
- 6.177 We consider that providing PCWs with access to the ECOES and SCOGES databases has the potential to reduce erroneous and failed transfers by avoiding the need for customers switching using a PCW to enter their meter numbers or for PCWs to rely on the GB Group database, which is less accurate than direct access to the ECOES and SCOGES databases. While, in absolute terms, the number of cases of switching that access to the ECOES and SCOGES databases may directly facilitate may be small, cases of erroneous and failed transfers could be expected to have a wider and disproportionate impact on domestic customers' confidence in the use of PCWs and perception about the ease of switching more generally.
- 6.178 We also consider that giving PCWs access to the ECOES and SCOGES databases may encourage switching by reducing the need to ask customers to find and enter their meter numbers into PCWs. For example:
- (a) Citizens Advice⁷²⁹ said that people were more likely to abandon the comparison process when asked for additional data; and
 - (b) uSwitch⁷³⁰ said that for the 10% of customers that had to input their meter numbers manually, this reduced the chance of them completing an application form by [X]%; and having to input the data manually led to a higher risk of making an error, which reduced the probability of a switch going live by [X]%.
- 6.179 As regards the implementation, monitoring compliance and enforcement of the proposed remedy, we believe that Gemserv and Xoserve will readily be able to comply with an order specifying that access must be granted (upon request) to PCWs on reasonable terms and subject to satisfying reasonable access conditions. We would propose not to be prescriptive as regards the terms and conditions for access, since their determination should rest with

⁷²⁹ [Consumer groups multi party hearing](#), 2 September 2015.

⁷³⁰ uSwitch response to Remedies Notice, p14.

the bodies responsible for managing the ECOES and SCOGES databases, respectively, and adapt what is 'reasonable' according to how the retail markets develop. In terms of monitoring compliance and enforcement, we consider that PCWs will be incentivised to inform the CMA if they are unreasonably refused access to either database.

- 6.180 In terms of timescale for implementation, the CMA would draft and consult on an order requiring Gemserve and Xoserve to provide PCWs with access to data in the six-month period following publication of the final report, with this process expected to conclude by the end of 2016. Gemserv and Xoserve could then be expected to provide access to PCWs from the beginning of 2017 onwards.
- 6.181 Our assessment of effectiveness of this proposed remedy has also assessed compliance with existing laws and regulations. We acknowledge that access to the ECOES and/or SCOGES databases may involve data protection issues arising, in particular, from the potential misuse of the data by PCWs (ie PCWs using the data for sales and marketing rather than to facilitate a switching request), and may therefore be subject to the Data Protection Act 1998 (DPA).
- 6.182 The Information Commissioner's Office (ICO)⁷³¹ has informed us that the ECOES data linked to a domestic property was likely to be personal data and therefore access to the ECOES database by PCWs would need to be compliant with the DPA. We understand that this includes having a legitimate justification for accessing the information held on the ECOES database, and ensuring that individuals are made aware of what information is being accessed and why. We consider that this advice would apply equally to SCOGES data. We understand the ICO believes that PCWs would only be justified in accessing the ECOES database if it was the result of a direct request from an individual for the PCW to facilitate switching to another supplier. We think that, in practice, this could be addressed by PCWs seeking a customer's consent before accessing their data in the ECOES and SCOGES databases.
- 6.183 We have also considered the potential for this proposed remedy to interact with our proposed remedies concerning the Microbusiness Weak Customer Response AEC, in particular, the proposed remedy concerning price transparency which may facilitate PCWs' entry into the microbusiness segments. Given that any such PCW will also be able to access the ECOES and SCOGES databases pursuant to this proposed remedy, we consider

⁷³¹ The Information Commissioner's Office response to Remedies Notice, paragraph 59.

that the beneficial effect of this proposed remedy will also be felt in the microbusiness segments and has the potential to address (in part) the equivalent feature giving rise to the Microbusiness Weak Customer Response AEC.

Assessment of proportionality

- 6.184 In addition to assessing how the proposed remedy will be effective in achieving its aim of reducing actual and perceived barriers to switching resulting from erroneous transfers and failed switches, we have also assessed whether the proposed remedy would be no more onerous than needed to achieve its aim, would be least onerous if there is a choice between several effective measures, and would not produce disadvantages which are disproportionate to its aim.
- 6.185 As noted above, we have provisionally decided not to be prescriptive as regards the terms and conditions for PCWs to be given access, to allow for Gemserv and Xoserve to refuse unmeritorious applications where a set of reasonable criteria are not satisfied. Our order will also allow Gemserv and Xoserve the flexibility to change access conditions over time. In doing so, we consider that the proposed remedy will be no more onerous than necessary and is the least onerous of equally effective measures.
- 6.186 In terms of the costs of implementing this proposed remedy, we consider that these would be negligible, in terms of limited additional processing costs for Gemserv and Xoserve and the potential loss to Gemserv of any fee-sharing arrangement with the GB Group (in the event that fewer PCWs purchase the GB Group database having accessed the ECOES database directly).

Provisional conclusion

- 6.187 Our provisional conclusion is that the proposed remedy would be effective and proportionate in reducing the number of erroneous transfers, failed switches and facilitating the switching process more generally in the short term and prior to future developments which have potential to address this issue.

Revising the Midata programme

- 6.188 In our provisional findings, we provisionally found that:
- (a) Customers have limited awareness of and interest in their ability to switch energy supplier. This arises partly from the role of traditional

meters and bills, which give rise to a disparity between actual and estimated consumption. This can be confusing and unhelpful to customers in understanding the relationship between the energy they consume and the amount they ultimately pay. The full roll-out of smart meters over the next five years may have a potentially significant positive impact on engagement, although we have limited evidence concerning the likely magnitude and timescales of any such impact.

- (b) Customers face actual and/or perceived barriers to switching, such as where they experience erroneous transfers which have the potential to cause material detriment to those who suffer from them. Erroneous transfers may thereby affect customers' ability to switch as well as their perception of switching. We considered that this again is an area where the introduction of smart meters should in time help bring improvements.

6.189 In the interim period pending the introduction of smart meters, and notwithstanding their introduction, we have considered whether any other possible remedies may be required to address the existing, and residual, level of confusion around consumption and barriers to switching for domestic customers in the short and long term respectively. We consulted in the Remedies Notice on whether the Midata programme, as currently envisaged, provides sufficient access to customer data by PCWs to facilitate ongoing engagement in the domestic retail markets, and whether PCWs should be able to access consumer data at a future date (with customers' permission).

The Midata programme as currently envisaged

6.190 Midata is a voluntary programme the government is currently developing with the energy and other industries.⁷³² Its overall aim is to provide consumers with information that companies hold on their transactions in electronic, machine-readable format, and make it easier to compare the different offers available.⁷³³

⁷³² The programme has been voluntary since its launch in November 2011. In 2013 the government gained the powers to require companies to release data through the Enterprise and Regulatory Reform Act 2013 for the energy, personal current accounts, credit cards and mobile phones sectors.

⁷³³ Department for Business, Innovation and Skills, [midata: Government response to the 2012 consultation](#), p3.

- 6.191 Other sectors where Midata has been considered are banking (personal current accounts and credit cards)⁷³⁴ and mobile phones.⁷³⁵ Implementation of Midata in the domestic retail energy markets is being led by DECC. Phase 1 of the project, which has already been implemented, allows consumers to view and download their consumption data as a csv file from their supplier's website. Currently, it is offered by the seven largest suppliers,⁷³⁶ whose combined market share in the domestic markets totals 93% for both gas and electricity.⁷³⁷
- 6.192 Phase 2 of Midata is expected to be launched by the end of 2016 but we consider this unlikely given that the implementation of phase 1 has been subject to several delays.
- 6.193 We also note that implementation of phase 2 of Midata requires the resolution of a number of technical issues such as identifying and clarifying outstanding points from design specification; needing suppliers and third parties to build solutions (the timing of which depends on the systems and work schedules of participating suppliers and TPIs); needing suppliers and third parties to carry out joint testing and launch an additional alternative authentication route for a consumer which does not involve online account management; conform inconsistencies around data items (such as tariff names) and the specified sequence of data; enter into third party and supplier agreements; and agree the participation of other suppliers.
- 6.194 When implemented, domestic customers under current proposals for phase 2 will be able to give a third party (eg a PCW) access to download their Midata file in a 30-minute window, without having to download or upload the csv file themselves, and PCWs could then use this data to provide a comparison between tariffs.⁷³⁸

⁷³⁴ In the personal accounts sector, a number of retail banks have signed up to the Midata initiative, allowing their customers to download their own transaction data from the previous 12 months for their current account in a single file, which can then be uploaded to a PCW to obtain the comparison. However, only one PCW (GoCompare) currently offers a Midata comparison tool in this sector (see CMA Retail Banking market investigation: provisional findings report, [Appendix 3](#)).

⁷³⁵ In the mobile phones sector, all of the major telecoms companies provide customers with online accounts and the ability to download .pdf bills, but most do not provide the facility to download mobile phone usage data in a machine-readable, reusable format. There are already comparison sites that exist that provide automated access to customers' usage records (eg Billmonitor). BIS (July 2014), [Personal data: Review of the midata voluntary programme](#).

⁷³⁶ The Six Large Energy Firms and First Utility.

⁷³⁷ Source: Cornwall Energy data submitted to the CMA (data from Q1 2015 on meter points), in the [provisional findings report](#), Table 7.4.

⁷³⁸ In terms of process, the third party will redirect the customer to their current supplier's website for authentication and consent. The current supplier will then create an access token that the third party will use to be able to access the customer's Midata within a 30-minute window. The customer will then be redirected to the third party's website and be shown a list of the switching options.

- 6.195 According to the most recent specification, Midata will include, but will not be limited to, the following data: postcode, current gas and electricity provider(s), current electricity and gas tariff(s), actual annual electricity and gas usage,⁷³⁹ MPAN and MPRN.⁷⁴⁰

Aim of the remedy

- 6.196 The aim of the proposed remedy would be to help domestic customers understand the best tariffs available for their consumption levels and consumption patterns, and to simplify the search and switching process for domestic customers, by giving PCWs direct access through Midata to customer data held by suppliers. Accordingly, the ultimate aim of this proposed remedy is to address the features that customers have limited awareness of, and interest in, their ability to switch energy supplier and that certain customers face actual and perceived barriers to accessing and assessing information, and to help address the Domestic Weak Customer Response AEC.

Parties' views

- 6.197 In our Remedies Notice we invited views on whether the Midata programme, as currently envisaged, would provide PCWs with sufficient access to customer data to facilitate ongoing engagement in the domestic retail energy markets. In particular, we asked if PCWs should also – with customer permission – be able to access consumer data at a later date, to provide an updated view on the potential savings available.
- 6.198 With the exceptions of Centrica⁷⁴¹ and EDF Energy,⁷⁴² the Six Large Energy Firms said that Midata provided PCWs with sufficient access to customer data.^{743,744} E.ON said that no data beyond the current tariff, payment method, MPAN, annual usage and start date of existing contract was needed to facilitate ongoing engagement by customers. SSE said that it

⁷³⁹ Annual usage, estimated annual consumption and estimated annual cost are only available after a consumer has been with the current energy supplier for over 12 months.

⁷⁴⁰ Other data fields: customer reference number, current electricity payment method, current gas payment method, start date of the contract with the current energy supplier, estimated annual consumption, estimated annual cost, payload creation date, last updated date and contract end date.

⁷⁴¹ Centrica said it supported the remedy to give PCWs access to Midata for a longer period of time provided it was accompanied by appropriate consumer protection mechanisms. Centrica response to provisional findings and Remedies Notice, p56.

⁷⁴² EDF Energy said that it supported Midata and believed it would help overcome barriers to switching. EDF Energy response to Remedies Notice, p18, paragraph 4.10.

⁷⁴³ Scottish Power response to Remedies Notice, paragraph 4.21, p15 (p49 of PDF); RWE response to Remedies Notice, paragraph 2.1, p43; and E.ON response to Remedies Notice, paragraph 126, p27.

⁷⁴⁴ SSE did not comment on whether Midata provided PCWs with sufficient access to customer data. SSE response to Remedies Notice, p33.

would support providing PCWs with continuous access to customer data, provided that appropriate measures, including data protection and security, were applied.⁷⁴⁵

- 6.199 Some PCWs said that the following data fields could be added to the Midata specification: meter type, energy region, tariff end date, Warm Home Discount, consumption data by time of use for those customers on Economy 7 or other time-of-use tariffs, and an indication of whether the customer had opted into online account management. Co-operative Energy said that in order to facilitate switching, Midata should contain all the information held in the ECOES and SCOGES databases.⁷⁴⁶ Scottish Power said that annual electricity and gas usage was only available in Midata after a consumer had been with the current energy supplier for over 12 months.⁷⁴⁷
- 6.200 E.ON and First Utility said that Midata was a voluntary scheme which needed a stronger mandate,⁷⁴⁸ and that it should be implemented by all, or the majority, of suppliers to fully realise the benefits for which it was set up. [redacted]⁷⁴⁹ [redacted]. Scottish Power said that since the aim of Midata was to assist customers in switching to another supplier, their continued participation would depend on participation by substantially all suppliers, to ensure a level playing field.⁷⁵⁰
- 6.201 uSwitch submitted that PCW access to Midata would facilitate a quicker and simpler comparison process. uSwitch said that when using its comparison engine, [redacted]% of customers entered their annual consumption, [redacted]% entered their monthly direct debit payment, [redacted]% used the uSwitch estimator, and the remainder used a combination of the above.⁷⁵¹ Ofgem said that consumers might estimate their consumption or guess at tariff names when entering these in themselves, or struggle to identify these even if they had a bill or annual summary to hand, or they might make errors when entering data manually.⁷⁵² Citizens Advice said that people were more likely to abandon the switching process when asked for additional data, and automating the process would be helpful.⁷⁵³

⁷⁴⁵ The measures mentioned by SSE also included: (b) customers were required to give consent and be sure of what they were giving consent to; (c) customers were able to revoke access; and (d) appropriate mechanisms were in place so that customers could see who had access to their data. SSE response to Remedies Notice, paragraph 3.6.32, p33.

⁷⁴⁶ Co-operative Energy response to Remedies Notice, p8.

⁷⁴⁷ Scottish Power response to Remedies Notice, paragraph 4.20, p15 (p49 of PDF).

⁷⁴⁸ First Utility said it needed a stronger mandate (paragraphs 3.20 & 3.30 of its Remedies Notice response).

⁷⁴⁹ [redacted]

⁷⁵⁰ Scottish Power response to Remedies Notice, paragraph 4.19, p14 (p48 of PDF).

⁷⁵¹ Meeting with uSwitch, 2 October 2015.

⁷⁵² Ofgem response to Remedies Notice, paragraph 60 (a), p6.

⁷⁵³ [Consumer groups multiparty hearing](#), 2 September 2015.

- 6.202 We also asked for views on whether PCWs should be allowed – with a customer’s permission – to access their original (or updated) Midata file at a later date. For example, around the end of a fixed-term contract to which the customer had switched.
- 6.203 The Behavioural Insights Team said that this would allow PCWs to prompt customers, particularly around the end of their contracts.⁷⁵⁴ Citizens Advice said it would help avoid consumers being put onto a standard tariff and reduce the burden of continually searching markets for best deals.⁷⁵⁵ Gocompare.com said that Midata would negate the need for consumers to keep or access a number of different bills to carry out more accurate comparisons.⁷⁵⁶
- 6.204 uSwitch said that it would allow consumers to gain updated, accurate information at regular intervals, and increase engagement with personalised prompts. It added that a number of customers had signed up for these alerts, and ongoing access to energy profile details through Midata would eliminate the need for a customer to update their details manually when their usage or address changes.⁷⁵⁷
- 6.205 Scottish Power⁷⁵⁸ and EDF Energy⁷⁵⁹ said that third parties should not be given ongoing access, without a customer’s consent each time access was sought. Energy Action Scotland⁷⁶⁰ and First Utility⁷⁶¹ said that customers who had switched were more likely to engage further, and that there was greater need to target disengaged customers. First Utility did not consider it necessary for such access, noting that PCWs providing subsequent views on potential savings could lead to customer confusion and annoyance, eg. future home occupiers receiving unwanted communications and based on previous occupants’ data.⁷⁶² EDF Energy said that customers might not understand what they were being asked for permission to share, for example ongoing access to consumption data could show when the customer was present at home or not.⁷⁶³
- 6.206 Scottish Power said that customers should be required to give explicit consent for PCWs to access their data, separately for one-off and ongoing

⁷⁵⁴ The Behavioural Insights Team response to Remedies Notice, p5.

⁷⁵⁵ Citizens Advice response to Remedies Notice, p23.

⁷⁵⁶ Gocompare.com response to Remedies Notice, paragraph 3.7.

⁷⁵⁷ uSwitch response to Remedies Notice, p18.

⁷⁵⁸ Scottish Power response to Remedies Notice, paragraph 4.21, p15 (p49 of PDF).

⁷⁵⁹ EDF Energy response to Remedies Notice, p18, paragraph 4.10.

⁷⁶⁰ Energy Action Scotland response to Remedies Notice, p5.

⁷⁶¹ First Utility response to Remedies Notice, p28.

⁷⁶² First Utility response to Remedies Notice, p28.

⁷⁶³ EDF Energy response to Remedies Notice, p18.

access in two consecutive questions.⁷⁶⁴ SSE said that appropriate measures should include: (a) suitable data protection and security measures in place; (b) customers to give explicit consent for PCWs to access their data and be sure of what they were giving consent to; (c) customers should be able to revoke access; and (d) appropriate mechanisms in place so that customers could see who had access to their data.⁷⁶⁵ Scottish Power⁷⁶⁶ and Centrica⁷⁶⁷ said that ongoing access should be time-limited without fresh consent and that the frequency of customer contact should be limited.

6.207 The ICO said that PCWs, to comply with the Data Protection Act 1998, must inform a customer if they wished to access at a later date personal data provided by the customer.⁷⁶⁸ The ICO also said that PCWs would need customers' consent for sending electronic messages encouraging them to switch tariff.⁷⁶⁹

6.208 Ofgem,⁷⁷⁰ Citizens Advice⁷⁷¹ and Which?⁷⁷² said that consumer concerns over data protection and contractual restrictions that suppliers placed on PCWs contacting customers after a switch had happened could adversely impact on the effectiveness of allowing PCWs to access Midata.

Design considerations

6.209 In the design of this proposed remedy, we have considered:

- (a) whether any specifications concerning phase 2 of Midata proposed by DECC should be amended; and
- (b) if so, how to implement this proposed remedy.

- *Key design elements*

6.210 We have considered whether the following specifications concerning phase 2 of Midata should be amended:

- (a) We note that participation in Midata is not currently intended to be mandatory. Given our concerns around the first-mover disadvantage, which have been broadly endorsed in parties' responses, and the delays

⁷⁶⁴ Scottish Power response to Remedies Notice, paragraph 4.22, p15 (p49 of PDF).

⁷⁶⁵ SSE response to Remedies Notice, paragraph 3.6.32, p33.

⁷⁶⁶ Scottish Power response to Remedies Notice, paragraph 4.22, p15 (p49 of PDF).

⁷⁶⁷ Centrica response to Remedies Notice, p59.

⁷⁶⁸ Information Commissioner's Office response to Remedies Notice, p4.

⁷⁶⁹ Information Commissioner's Office response to Remedies Notice, p4.

⁷⁷⁰ Ofgem response to Remedies Notice, p6.

⁷⁷¹ Citizens Advice response to Remedies Notice, pp23–24.

⁷⁷² Which? response to Remedies Notice, p5.

we have seen concerning the implementation of phase 1, we consider that participation in Midata should be made mandatory for all suppliers. This would allow for the timely and successful implementation of phase 2, which will allow PCWs direct access to their Midata file, without having to download or upload the csv file, and so avoiding the need for customers to input data manually. In this regard, we understand that the government already has, but has not used, power to make participation in phase 2 of Midata mandatory, and we therefore propose to recommend to DECC to use this power.

- (b) We note that Midata is intended to involve certain information listed in paragraph 6.195. In light of PCWs' submissions concerning additional data fields that would assist the tariff comparison process, our provisional finding concerning the complexity of information available to consumers concerning their meter and consumption, and the likely growth in time-of-use tariffs (with the roll-out of smart meters), we have provisionally decided to recommend that DECC amends the specification for Midata to include access to the following data fields: meter type, Warm Home Discount indicator, consumption data by time of use for those customers on Economy 7 or other time-of-use tariff. These fields will help PCWs to provide accurate personalised estimates on the potential gains from switching.⁷⁷³
- (c) We consider that giving PCWs only one 30-minute window in which to access a customer's Midata data will restrict PCW's ability to prompt customers to engage at the end of a fixed-term contract. We have received several responses endorsing these concerns. Accordingly, we have provisionally decided to recommend to DECC that it amends the specifications for Midata to allow customers the ability to choose the frequency of PCWs' access to Midata when giving their consent. This would:
 - (i) enable PCWs to send personalised savings alerts to customers, based on their updated actual consumption (which could have changed since the original comparison), and accounting for new tariffs in the markets;
 - (ii) give PCWs direct access to Midata and, as a result, customers subscribing to such services would no longer have to update their

⁷⁷³ uSwitch told us that only [X]% of its customers used their annual consumption figure to obtain their quote. The rest of the customers entered their direct debit payment, or used the estimator.

details manually (eg when they change their address, energy usage or switch supplier via a different route); and

- (iii) enable PCWs to target consumers around the end of their fixed-term tariff, thereby helping them avoid being put on a default tariff.

6.211 In light of the above design considerations, we have provisionally decided that the proposed remedy would be to make a recommendation to DECC that it makes the following changes to the current specifications of Midata phase 2:

- (a) Participation in Midata is mandatory for all gas and electricity suppliers.
- (b) The scope of Midata is expanded to include the following data fields: meter type, Warm Home Discount indicator, consumption data and time-of-use for those customers on Economy 7 meters or other time of use tariffs.
- (c) PCWs are given the ability to seek customer consent on the frequency with which they can access the customer's data through Midata; are required to present at least two options to a customer when seeking consent to access Midata (including one option concerning access on an annual or ongoing basis); and are given the ability to send updated tariff comparison information based on any subsequent access granted to a customer's Midata.

6.212 We therefore consider that the above design elements would be particularly effective in helping domestic customers to realise the benefits from Midata at least until the roll-out of smart meters is complete (ie 2020 according to current plans), and possibly beyond, when more complex time-of-use tariffs are likely to be more prevalent.

Assessment of effectiveness

6.213 As we have explained above, our provisional view is that we that the proposed remedy would be effective in achieving its aims of helping domestic customers understand the best tariffs available for their consumption, and to simplify the search and switching process, and to prompt engagement. Accordingly, our provisional view is that the proposed remedy would be effective in partly addressing two of the features giving rise to the provisional Domestic Weak Customer Response AEC.

6.214 In our provisional view, access to Midata will make the searching and switching process easier and more reliable, as more people are likely to complete the process:

- (a) Citizens Advice said that people were more likely to abandon the switching process when asked for additional data.⁷⁷⁴ For example, we received responses that asking for the MPAN and MPRN might be a barrier to switching;⁷⁷⁵ and
- (b) those of uSwitch's customers who had to input their meter number manually were []% less likely to complete their application,⁷⁷⁶ or more likely to make an error, which reduced the probability of a successful switch.⁷⁷⁷
- 6.215 In assessing the effectiveness of the proposed remedy we have considered the extent to which the proposed remedy is capable of effective implementation, monitoring compliance and enforcement. As regards implementation, given that our proposed changes either exist in current legislation as a power for DECC to exercise, or concern the future specification of Midata as will be set out in legislation, we consider that a recommendation to DECC to implement the proposed remedy would be effective. The CMA would make its recommendation to DECC in the final report to make changes to the Midata programme. We envisage that DECC would consult on the proposed changes immediately following publication of our final report, with a view to introducing the requisite changes in its ongoing legislative programme for inclusion in the next energy sector or omnibus bill.
- 6.216 We note that smart meters will provide customers with near real-time information about their energy use and costs and Midata has some limitations as a channel for accessing smart data. In particular, the current Midata specification does not support multi-tier readings (eg customers with a smart meter would only be able to see an aggregated consumption figure). However, we propose that the changes we are recommending to DECC to make to the Midata specification do not address this aspect of phase 2 of Midata, as following the roll-out of smart meters there will be alternative means for domestic customers to access smart data. As part of the smart meter roll-out, suppliers will be required to provide customers with the in-home display for access to their half-hourly consumption data, as well as historical consumption. There are also plans to allow customers to share this

⁷⁷⁴ [Consumer groups multiparty hearing](#), 2 September 2015.

⁷⁷⁵ See Appendix 6.1: Creating stronger incentives for third party intermediaries to engage customers, Parties' views on the proposed remedy to give PCWs access to the ECOES database.

⁷⁷⁶ PCWs can usually find meter numbers from an address, but sometimes their database is incomplete, or incorrect.

⁷⁷⁷ uSwitch response to Remedies Notice, p14. See paragraph 6.178(b) above.

data with PCWs. Additionally, customers could pair a smart device⁷⁷⁸ to their home area network⁷⁷⁹ and be able to access half-hourly consumption data which they could then forward to a service provider.

- 6.217 In addition, we consider that even when the vast majority of customers have a smart meter, Midata might still be of some additional value for two main reasons: (i) Midata will contain data fields such as MPAN, MPRN and Warm Home discount which will not be stored on a smart meter under current proposals,⁷⁸⁰ and (ii) Midata will continue to benefit those customers who for various reasons (eg installation of smart meter being not possible) will not have a smart meter.

Assessment of proportionality

- 6.218 In this section we set out our assessment of whether the proposed remedy would be proportionate.
- 6.219 For the reasons set out above, we consider that the proposed remedy would be effective in achieving its aim.
- 6.220 In addition, given that this proposed remedy will not involve any costs or restrictions on DECC, suppliers or PCWs, we provisionally consider that this proposed remedy is no more onerous than necessary and there is no alternative remedy that is less onerous but as effective.
- 6.221 In addition, allowing PCWs to make the searching and switching process easier and more reliable for customers, and to prompt customers (for example, when a tariff is near term), should help customers to realise the gains from switching.
- 6.222 Accordingly, we have provisionally concluded that the proposed remedy would not produce adverse effects that would be disproportionate to its aim.

Provisional conclusions

- 6.223 Our provisional view is that the proposed remedy would be effective and proportionate in simplifying the search and switching process for customers, prompting engagement and helping customers to realise the benefits from

⁷⁷⁸ The device would need to be speaking the right language to be able to connect to the smart meter home area network. See DECC: additional submission (Follow up information for the CMA on Midata), p7.

⁷⁷⁹ A home area network is a network that is deployed and operated within a small boundary, typically a house or small office/home office. See Appendix 5.1: Smart meter roll-out in Great Britain for further details.

⁷⁸⁰ We understand that a limited amount of information can be stored on a smart meter and that at the moment this includes: half-hourly consumption data for both gas and electricity; current tariff information; and conversion factor for gas. See DECC leaflet, *Smart Meters, Smart Data and Smart Growth*.

switching, by giving PCWs direct access through Midata to customer data held by suppliers.

Prompts for customers on default tariffs

- 6.224 In the provisional findings report, we identified features that give rise to the Domestic Weak Customer Response AEC, ie that customers have limited awareness of, and interest in, their ability to switch energy supplier, and that customers face actual and perceived barriers to accessing and assessing information.

The Database remedy

- 6.225 In the Remedies Notice and Supplementary Remedies Notice we sought views on possible remedies aimed at prompting domestic customers, who are on tariffs that they have not actively chosen, to engage in the domestic retail energy markets by providing them with the information that they need to identify options available to them and make informed choices. In particular, we sought views on a possible remedy requiring suppliers to place contact details for all SVT customers or a subset of SVT customers (eg those who have been on the default tariff for several years in a row) on a shared centrally managed database, available to all licensed energy suppliers upon request, in order to allow targeted marketing to these customers. A similar possible remedy was proposed in our Second Supplemental Remedies Notice in relation to prepayment customers.
- 6.226 In order to enable suppliers to prompt domestic customers of rival suppliers on default tariffs, the proposed remedy would require energy suppliers to disclose certain details of their domestic customers (on any meter type⁷⁸¹) who have been on their SVT (or any other default tariff) for three or more years (the Disengaged Domestic Customers) to Ofgem, and would recommend to Ofgem that it retain, use, and disclose this data (via a centrally managed database) to rival suppliers. The Disengaged Domestic Customers would have the option to opt out of the disclosure process at any point in time.
- 6.227 A limited number of the design considerations of this proposed remedy are specific to customers on restricted meters (see paragraph 6.261) in order to enhance the effectiveness of this proposed remedy in relation to this type of customer.

⁷⁸¹ This proposed remedy would apply to domestic customers on unrestricted meters (including prepayment meters), restricted meters and Economy 7 meters.

6.228 We consider that a lack of information in relation to the limited number and location of customers with restricted meters, and the wide range of types of restricted meters is a particular barrier to competition for customers with such meters. In particular, we have been told that the cost to suppliers of designing tariffs to support restricted meters and/or then marketing their products to customers with restricted meters is prohibitively high (see Appendix 3.1). This is because these customers account for only a small proportion of electricity customers across GB, and they have installed in their homes many different meter types supporting different space and heating systems.

Aim of the remedy

6.229 The aim of the proposed remedy would be to enable rival retail energy suppliers to identify the Disengaged Domestic Customers that have not opted out and prompt such customers to engage in the markets. The ultimate aim of this proposed remedy would be to partly address two of the features identified in our provisional findings report giving rise to the Domestic Weak Customer Response AEC (and resulting detriment), ie that domestic customers have limited awareness of, and interest in, their ability to switch energy supplier and that domestic customers face actual and perceived barriers to accessing and assessing information.

Parties' views

6.230 We invited views on new measures to prompt customers on default tariffs to engage.

(a) Most of the Six Large Energy Firms said they would generally support such measures. Several offered suggestions for the most appropriate prompts.⁷⁸² A number said it would be wrong to categorise all customers on default tariffs as disengaged.⁷⁸³

(b) SSE said it was broadly supportive of proportionate and well-considered prompts to customers to engage with the market, but that customers on

⁷⁸² Centrica in its response to Remedies Notice, p75, suggested prompts at the end of fixed-term contracts. EDF Energy in its response to Remedies Notice, p36 (p37 of PDF) suggested that presenting clear messages triggered by key events was most effective. E-ON in its response to Remedies Notice, p41 suggested that prompts should include additional information for less engaged customers including statements about how easy it was for customers to obtain information and look for savings (eg via PCWs) and the trade-off between engaging and the benefits

⁷⁸³ RWE npower response to Remedies Notice, p77 (p173 of PDF); Scottish Power response to Remedies Notice, paragraph 10.4, p29 (p63 of the PDF). Scottish Power said it would be wrong to categorise all customers on default tariffs as disengaged, noting that some were 'intermittently engaged'.

‘default’ tariffs were not less well engaged than other customer groups, nor had an AEC been adequately demonstrated in the microbusiness or domestic segments. SSE said that the remedy had potential for unintended consequences, which could discourage customer engagement.⁷⁸⁴

- (c) Some of the Mid-tier Suppliers expressed support for more prompts⁷⁸⁵ and other smaller suppliers had mixed views about providing more prompts.⁷⁸⁶
- (d) Consumer groups also had mixed views on providing new prompts.
 - (i) Citizens Advice said it would not support adding more regulated content to energy bills.⁷⁸⁷
 - (ii) National Energy Action,⁷⁸⁸ Energy Action Scotland,⁷⁸⁹ and Age UK⁷⁹⁰ said more prompts could be helpful so long as they were not construed or perceived as a nuisance.
 - (iii) Which? said there was no simple answer about how to prompt consumers to engage.⁷⁹¹
- (e) Ofgem said there was no single proven prompt to increase engagement and that disengaged consumers were not a homogenous group.⁷⁹²

⁷⁸⁴ [SSE in its response to Remedies Notice](#), p73 (p153 of the PDF).

⁷⁸⁵ [Co-operative Energy response to Remedies Notice](#), p17 (Co-operative Energy said that, as an independent supplier, its customers had all made an active choice to switch from their previous suppliers. Its customers were engaged in the market and it actively promoted its most competitive products. It did not think it was proportionate that obligations should be applied across all suppliers. In its view the largest energy suppliers had benefited from the disengagement of customers. [First Utility response to Remedies Notice](#), p39; [Ovo Energy response to Remedies Notice](#), p18 (Ovo said it supported additional prompts for customers on either deemed tariffs, or the proposed safeguard tariff. Its proposal was that the bills of deemed or safeguard customers must have a prominent section set aside for a direct message from Ofgem. It was not in favour of suppliers having to increase the number of customer communications outside these circumstances) and [Utility Warehouse response to Remedies Notice](#), p11.

⁷⁸⁶ [Drax and Haven Power Ltd response to Remedies Notice](#), p5. Drax and Haven Power were supportive of engagement prompts to customers of the Six Large Energy Firms who had not previously engaged with the market. Drax and Haven also suggested an alternative remedy which included telephone prompts for such customers to boost their engagement with the market but [Flow Energy response to Remedies Notice](#), p9, [Good Energy response to Remedies Notice](#), p8 and [Opus Energy response to Remedies Notice](#), p19 (p20 of the PDF) were not supportive of more prompts.

⁷⁸⁷ [Citizens Advice/Citizens Advice Scotland response to Remedies Notice](#), p44.

⁷⁸⁸ [National Energy Action response to Remedies Notice](#), p10.

⁷⁸⁹ [Energy Action Scotland response to Remedies Notice](#), p11.

⁷⁹⁰ [Age UK response to Remedies Notice](#), p5.

⁷⁹¹ [Which? response to Remedies Notice](#), p6.

⁷⁹² [Ofgem response to Remedies Notice](#), pp63–64.

6.231 We invited views on the benefits of other participants in the markets, such as rival energy providers and TPIs, being made aware of which customers remain on default tariffs:

- (a) All of the Six Large Energy Firms raised concerns about such disclosure. Several said this might result in customers receiving lots of unwanted communications from different parties⁷⁹³ and that there could be data protection issues.⁷⁹⁴
- (b) Some of the Mid-tier Suppliers supported disclosure of customers on default tariffs. Co-operative Energy said it could provide for independent suppliers to reach the most disengaged customers but it did not think it would be proportionate for such an obligation to be applied across all suppliers.⁷⁹⁵ First Utility said that, in principle, it saw some benefit to a trusted third party using this customer data for targeted switching campaigns, subject to data protection and privacy rules.⁷⁹⁶
- (c) Some consumer groups raised issues about the potential disclosure. Citizens Advice said it could result in third parties targeting certain sets of customers but not those on low incomes or the vulnerable.⁷⁹⁷ National Energy Action said such data should not be shared.⁷⁹⁸
- (d) Several other parties commented on the potential for the disclosure to result in customers being inundated with communications.⁷⁹⁹
- (e) The Behavioural Insights Team said the proposal required careful consideration because suppliers could target customers with tariffs which were very attractive in the short term but that then increased in

⁷⁹³ [Centrica response to remedies notice \(Remedies Notice\)](#), p75; [EDF Energy response to Remedies Notice](#), p39, paragraph 10.14; [E-ON response to Remedies Notice](#), p41 and [SSE response to Remedies Notice](#), p76 (p152 of the PDF). SSE raised fundamental concerns. It said this could result in customers receiving lots of unwanted communications from different parties (which could increase distrust in the market).

⁷⁹⁴ [RWE npower response to Remedies Notice](#), p80 (p176 of PDF); [Scottish Power response to Remedies Notice](#), paragraphs 10.18 & 10.19, p32 (p66 of the PDF); [Centrica response to remedies notice \(Remedies Notice\)](#), p75; [SSE response to Remedies Notice](#), p76 (p152 of the PDF).

⁷⁹⁵ [Co-operative Energy response to Remedies Notice](#), p18. Co-operative Energy said it believed that such remedies implemented should be proportionate and focused on the companies that benefited from the harm the CMA had identified. In its view independent suppliers should be given access to this data to allow them to continue to actively address the issue of reaching the most disengaged of consumers.

⁷⁹⁶ [First Utility response to Remedies Notice](#), p40.

⁷⁹⁷ [Citizens Advice response to Remedies Notice](#), p45.

⁷⁹⁸ [National Energy Action response to Remedies Notice](#), p10.

⁷⁹⁹ [uSwitch response to Remedies Notice](#), p21; [ICOSS response to Remedies Notice](#), p11; [University of East Anglia Centre for Competition Policy response to Remedies Notice](#), p10; [Total Gas & Power response to Remedies Notice](#), p7; [CIPS response to Remedies Notice](#), p7.

price. The Behavioural Insights Team said it might be better if other parties such as Ofgem contacted the customers.⁸⁰⁰

- (f) Ofgem said it welcomed the idea of disclosing details of customers on default tariffs because it had the potential to deliver significant benefits for disengaged consumers. Ofgem said rival suppliers and TPIs would have a natural incentive to contact such customers. Ofgem said there was a risk of consumers receiving unwanted communications but this could be mitigated by allowing customers to opt out of the disclosure.⁸⁰¹

6.232 In our Second Supplemental Remedies Notice, we invited views on a variant of the remedy which would require suppliers to disclose details of any prepayment customers to Ofgem (provided they had not opted out of the proposed disclosure) so Ofgem could put these customers' details on a secure cloud database for other suppliers to access.

6.233 Ofgem expressed support for this proposed remedy, provided sufficient protections were put in place to address concerns about safeguarding consumers' personal data and consumers receiving large volumes of unwanted marketing. It also said consideration should be given to targeting the database at a broader group of 'sticky' customers, irrespective of payment type.⁸⁰²

6.234 All of the Six Large Energy Firms, apart from E.ON, raised concerns about the proposed remedy. Several said it might result in customers receiving lots of unwanted communications⁸⁰³ and that the proposed remedy was not required to facilitate market entry by new suppliers.⁸⁰⁴ In addition:

- (a) Centrica said the proposed remedy was potentially incompatible with the new EU General Data Protection Regulation, which placed more emphasis on gaining explicit opt-in customer consent for the sharing of data.⁸⁰⁵

⁸⁰⁰ [The Behavioural Insights Team response to Remedies Notice](#), p10.

⁸⁰¹ [Ofgem response to Remedies Notice](#), p64.

⁸⁰² Ofgem response to second supplemental notice of possible remedies, pp1–2.

⁸⁰³ Centrica's response to second supplemental notice of possible remedies, p9 and RWE npower's response to second supplemental notice of possible remedies, p4.

⁸⁰⁴ Scottish Power's response to second supplemental notice of possible remedies, p3 and EDF Energy's response to second supplemental notice of possible remedies, p3.

⁸⁰⁵ Centrica's response to second supplemental notice of possible remedies, p9.

- (b) RWE npower said the CMA had not offered evidence to suggest that the decision to opt in (or not opt out) would be made by sufficient numbers of customers to make the proposed remedy effective.⁸⁰⁶
- (c) SSE said the proposed remedy was disproportionate and would be ineffective in practice because prepayment customers were not obliged to supply any personal information to their supplier and it would be time-consuming and expensive to gather the data required.⁸⁰⁷
- 6.235 E.ON said it was not opposed in principle to sharing information with Ofgem to allow Ofgem to prompt customers directly. However, it disagreed with sharing the information with other suppliers because of the risk that customers would be inundated with unsolicited communications.⁸⁰⁸
- 6.236 Some other suppliers expressed concerns about the proposed remedy,⁸⁰⁹ including about the risk of customers receiving unwanted communications.⁸¹⁰
- 6.237 Several other parties expressed support,⁸¹¹ suggesting the proposed remedy might allow suppliers to better target marketing at prepayment customers.⁸¹²
- 6.238 Citizens Advice said it remained unconvinced about the potential impact of the proposed remedy. While the proposed database could make it easier for suppliers to identify and target prepayment customers, it was worried that the database might not make any difference to suppliers' limited motivation to compete for these customers. It also said the proposed remedy could facilitate unsolicited marketing and suggested that telephone numbers were not included on the database to minimise intrusive contact.⁸¹³

Design considerations

- 6.239 We have considered the following matters in the design of this proposed remedy:

⁸⁰⁶ RWE npower's response to second supplemental notice of possible remedies, p4.

⁸⁰⁷ SSE's response to second supplemental notice of possible remedies, p5.

⁸⁰⁸ E.ON's response to second supplemental notice of possible remedies, p7.

⁸⁰⁹ Good Energy's response to second supplemental notice of possible remedies, pp1–2 and Our Power Community Benefit Society's response to second supplemental notice of possible remedies, p1.

⁸¹⁰ First Utility's response to second supplemental notice of possible remedies, p1 and Ovo Energy's response to second supplemental notice of possible remedies, p3.

⁸¹¹ Ecotricity's response to second supplemental notice of possible remedies, p1 and BGL Group's response to second supplemental notice of possible remedies, p2.

⁸¹² Robin Hood Energy's response to second supplemental notice of possible remedies, pp1–2.

⁸¹³ Citizens Advice's response to second supplemental notice of possible remedies, p4.

- (a) the French competition authority's successful application for an interim order requiring Engie (formerly GDF Suez) to disclose details of its customers on regulated gas tariffs to other suppliers;
 - (b) what approach should be taken to prompt engagement;
 - (c) who should be targeted by the proposed remedy;
 - (d) what data protection issues need to be addressed and how;
 - (e) what should be the role of Ofgem and suppliers in implementing this remedy;
 - (f) specific requirements regarding the Disengaged Domestic Customers on restricted meters; and
 - (g) how this proposed remedy should be implemented.
- *The French competition authority's successful application for an interim order requiring Engie (formerly GDF Suez) to disclose details of its customers on regulated gas tariffs to other suppliers*

6.240 In September 2014, L'Autorité de la concurrence (the French competition authority), in the context of an investigation into the abuse of a dominant position by the incumbent gas supplier (ie Engie (formerly GDF Suez)), successfully applied for an interim order requiring Engie to share certain customer details with other gas suppliers. In particular, Engie was required to:

- (a) provide the name, address, home telephone number, annual consumption, type of regulated tariff and gas usage profile for each of its domestic customers on regulated gas tariffs to competing suppliers; and
- (b) provide the same information for each of its business customers on regulated gas tariffs, plus details of the person in charge of buying gas at the relevant business.

6.241 Engie was required to provide this customer data by January 2015 through an Engie-maintained database which could be accessed, for free, by its licensed competitors. Engie was required to update the database on a monthly basis to ensure it no longer included customers who had switched to unregulated market tariffs either with Engie or with other suppliers.

6.242 In the context of this interim order the French competition authority liaised with the French data protection agency to ensure that the process to disclose Engie's customer data would comply with French data protection

legislation (which is subject to the same EU legislation as applies in the UK). The data protection agency advised of the need to provide an ‘opt-out’ system for customers who did not wish their data to be disclosed. The French competition authority therefore required Engie to send a letter to all the relevant customers advising them of the proposal to share their data with other suppliers and giving the customers an opportunity to object to this proposed disclosure and use of their data. The French competition authority agreed the content of the letter from Engie before it was sent to the customers.

6.243 The French competition authority required Engie to set up the database and to sign up to a data processing agreement with each licensed gas supplier that wished to have access to the customer data (for free). These agreements mainly concerned the other suppliers’ use of the data. Engie was solely in charge of the internet platform that provided the data to other suppliers.

6.244 The French competition authority advised us that a reasonably large proportion of domestic customers, [§]. As a consequence, [§] were included in the first iteration of the database.

- *What approach should be taken to prompt engagement*

6.245 We recognise that customers on default tariffs already receive bills, annual statements, and notices of contract variations, and suppliers are required to provide standardised reminders (including Cheapest Tariff Messaging) and standardised information on the customer’s current tariff (including the tariff comparison rate).⁸¹⁴ As discussed above, we also propose to recommend an Ofgem-led programme for identifying, testing and implementing measures for promoting engagement.

6.246 We consider that the proposed disclosure to rival retail energy suppliers of certain details of the Disengaged Domestic Customers that have not opted out would further contribute to prompting engagement. In particular, we consider that rival suppliers have an incentive to contact these customers to try to win their custom. Hence, the proposed remedy would encourage existing suppliers and/or new entrants to compete more intensively for the Disengaged Domestic Customers.

⁸¹⁴ [Ofgem response to supplementary Remedies Notice](#), Annex 2, p6.

- *Who should be targeted by the proposed remedy*

6.247 In our provisional findings report, we identified that around 70% of the domestic customers of the Six Large Energy Firms were on an SVT. Our analysis of more recent data shows that as at 30 June 2015⁸¹⁵ approximately 72% of electricity customers and 69% of gas customers were on an SVT. Of these, approximately 90% had been on an SVT for more than one year, 70% for more than three years and 55% for more than five years.⁸¹⁶ However, the proportions vary considerably among suppliers. For electricity this ranges from [X]% of British Gas's SVT customers that had been on the SVT for more than three years to [X]% of SSE's SVT customers. For gas this ranges from [X]% of [X] and [X] SVT customers that had been on the SVT for more than three years to [X]% of SSE's customers.

6.248 We also found that all of the Six Large Energy Firms have, in recent years, consistently offered direct debit and credit customers fixed-term tariffs at substantial discounts to their SVTs.⁸¹⁷ While this has not been the case for prepayment customers, the prices of SVTs have differed between suppliers meaning that there were, for some, savings to be had from switching suppliers.⁸¹⁸

6.249 While customers may roll on to default tariffs and choose not to move tariff immediately, we consider that if customers are still on default tariffs with the same supplier after three years they are, for the reasons given above, unlikely to have actively chosen to be on such tariffs, especially where such tariffs are at a substantial premium to fixed-term tariffs. We therefore consider the proposed remedy should apply to all customers who have been on an SVT (or any other default tariff) with the same supplier for a total of three or more years.

- *What data protection issues need to be addressed and how*

6.250 The ICO has told us that the key piece of data protection legislation that needs to be considered in the context of the proposed remedy is the Data Protection Act 1998 (the DPA). The ICO informed us that any electronic

⁸¹⁵ Note that E.ON provided data as at 27 June 2015 and EDF Energy's data has been provided as at 2 July 2015.

⁸¹⁶ For electricity the exact figures are 90%, 73% and 58% and for gas 90%, 71% and 56%, respectively.

⁸¹⁷ We found that across for the Six Large Energy Firms and the periods Q1 2012 to Q2 2015: dual fuel direct debit SVT customers could have saved, on average, 6% on their annual bills by switching with the same supplier to cheaper direct debit tariffs; and standard credit customers could have saved, on average, 4% on their annual bills by switching to cheaper standard credit tariffs

⁸¹⁸ We found that across for the Six Large Energy Firms and the periods Q1 2012 to Q2 2015: dual fuel prepayment SVT customers could have saved, on average, 1% on their annual bills by switching internally and 11% by switching supplier.

communications (eg email, phone calls and text messaging) would also need to comply with the Privacy and Electronic Communications Regulations 2003 (PECR).

6.251 The ICO advised us that the DPA would be unlikely to prevent the disclosure of the details of the Disengaged Domestic Customers (including some 'personal data') by energy suppliers to Ofgem, provided that a condition for processing under the DPA was identified and met (most likely to be a legal requirement or consent). If operating on the basis of a legal requirement, this would need to be done within the framework of an opt-out system (ie where the Disengaged Domestic Customers are clearly informed of issues such as the disclosure process, the recipients of the data and the potential use of the data, and are given the opportunity to object to and prevent the proposed disclosure and use of the data). The ICO also advised us that the DPA would be unlikely to prevent suppliers to prompt the Disengaged Domestic Customers of rival suppliers that had not opted out through letters sent by post as long as the process had been clearly explained to those customers previously.⁸¹⁹

6.252 Drawing on advice from the ICO, we have provisionally decided to require suppliers to disclose details of the Disengaged Domestic Customers that have not opted out to Ofgem, and for Ofgem to make this data available to other suppliers, pursuant to the following process:

(a) All energy suppliers would be required (pursuant to an order) to send a letter to their Disengaged Domestic Customers (the 'Opt-out Letter').

The Opt-out Letter would:

- (i) inform them of the CMA's order requiring them to disclose certain of their details, ie each customer's full name, billing address, consumption address, current supplier, meter type (eg unrestricted, Economy 7 etc), name of their current tariff, annual energy consumption, and MPAN/MPRN to Ofgem;
- (ii) inform them of the restrictions on how the data would be used by Ofgem and rival suppliers, which could include limiting the amount of correspondence and/or limiting the content of such correspondence (the 'Use Restrictions');

⁸¹⁹ Before contacting customers by electronic message, such as email or SMS, the PECR would require suppliers to obtain explicit (and direct) consent so an 'opt-in' system would have to be established for such correspondence.

- (iii) allow them the possibility to opt out of having Ofgem and rival suppliers use their information in this way at any point and the manner for doing so;⁸²⁰ and
 - (iv) be subject to the CMA's and Ofgem's approval before it is sent to the Disengaged Domestic Customers, to ensure that it clearly explained the proposed disclosure and use of the customer's data, the reasons for this, and the mechanisms for opting out.
- (b) Ofgem would collect, from each supplier, the relevant details of the Disengaged Domestic Customers who had not opted out (the 'Domestic Customer Data').
 - (c) Ofgem would put the Domestic Customer Data in a secure cloud database⁸²¹ which it would operate, control and maintain.
 - (d) Ofgem would enter into agreements with energy suppliers which would include the Use Restrictions, and any other restriction concerning access to the Domestic Customer Data that Ofgem considers appropriate, before providing access to such energy suppliers.
 - (e) Energy suppliers granted access to the Domestic Customer Data could contact the Disengaged Domestic Customers to whom the data relates by post.
- *What should be the roles of Ofgem and suppliers in implementation*

6.253 Under the proposed remedy, suppliers would be required to disclose the Domestic Customer Data to Ofgem and we would propose to recommend that Ofgem develops, operates and maintains a secure cloud database to hold the Domestic Customer Data (in an accessible format). Ofgem could use external IT/database experts to develop this database but, once created, Ofgem would operate, control and maintain it.

6.254 We consider that Ofgem, as the industry regulator, would be best placed to collect and disclose the Domestic Customer Data to rival suppliers because it could represent the interests of the Disengaged Domestic Customers fairly. In this regard, the incentives of energy suppliers to control and share

⁸²⁰ The customers would have a variety of ways to opt out including sending a freepost reply in the post or sending an email to their supplier, and calling a freephone telephone number.

⁸²¹ A database accessible from the cloud (a space on transmission lines) and delivered to authorised users via the internet from a cloud database provider's servers.

the Domestic Customer Data with each other may not align with the interests of the Disengaged Domestic Customers.

- 6.255 The database would also need to be updated regularly. Accordingly, we would also propose to require, as part of our order, suppliers to provide Ofgem with updated information on any (new or existing) Disengaged Domestic Customers, who had not opted out, every six months to enable Ofgem to remove the details of domestic customers who have moved off SVTs (or any other default tariff), and to include the details of customers who have become eligible to be on the database because they had been on an SVT (or any other default tariff) with the same supplier for a total of three or more years. Before the details of any eligible customers were added to the database, they would first be notified of the disclosure process through the Opt-out Letter, as at the outset of the creation of the database.
- 6.256 We would also propose to recommend that Ofgem enters into agreements with suppliers seeking access to the Domestic Customer Data. These agreements would include the Use Restrictions and any other restriction concerning access to the Domestic Customer Data that Ofgem considers appropriate (which could include limiting suppliers' access to the database⁸²² and withdrawing access to the database if suppliers fail to comply with the agreements).
- 6.257 Rival suppliers would be allowed to prompt the Disengaged Domestic Customers who have not opted out by sending them marketing correspondence by letter. Electronic communications (eg email or SMS text message) from suppliers would be subject to the PECR and consumer protection legislation.⁸²³ Rival suppliers could seek explicit (opt-in)/direct consent from customers to be able to send prompts via electronic means.
- 6.258 All communications and/or information from suppliers would have to be compliant with relevant standard licence conditions including SLC 25⁸²⁴ which governs sales and marketing practices, and SLC 25C the Standards of Conduct introduced by the 'Fairer Treatment' component of the RMR

⁸²² For instance, give suppliers access to the database every six months, and require suppliers to contact customers within a certain period to mitigate the risk of customers who have moved off the SVT (or any other default tariff) being contacted.

⁸²³ Including the Consumer Rights Act 2015.

⁸²⁴ Under SLC 25, the stated Objective is that: (a) all information which the supplier provides to domestic customers in the course of the marketing activities must be complete and accurate, is capable of being easily understood by domestic customers, does not relate to products which are inappropriate to the domestic customer to whom it is directed, does not mislead the domestic customer to whom it is directed and is otherwise fair both in terms of its content and in terms of how it is presented (with more important information being given appropriate prominence); and (b) the suppliers' market activities must be conducted in a fair, transparent, appropriate and professional manner. All suppliers are required to take all reasonable steps: (a) to secure the achievement of the Objective; and (b) to avoid doing anything which jeopardises its ability to achieve the Objective.

rules⁸²⁵ (and our proposed new Standard of Conduct described above in paragraph 6.81).⁸²⁶ In addition, as set out above, all marketing letters sent by existing suppliers to customers could be tested as part of our proposed remedy providing for an Ofgem-led programme to identify, test and implement measures to improve customer information.

- *Specific requirements concerning Disengaged Domestic Customers on restricted meters*

6.259 As explained in Section 3, our further analysis has shown that there are additional aspects of the domestic retail energy markets concerning customers on restricted meters that reduce their awareness of their ability to switch energy supplier and increase the actual and/or perceived barriers to accessing and assessing information to help them switch.

6.260 To enhance the effectiveness of this proposed remedy in achieving its aim in relation to the Disengaged Domestic Customers on restricted meters, we have considered whether the proposed remedy should require suppliers to provide further details for customers on restricted meters than those provided for customers on unrestricted meters (ie each customer's full name, billing address, consumption address, their current supplier, meter type (eg unrestricted, Economy 7) and name of their current tariff; and annual energy consumption and MPAN/MPRN).

6.261 Our provisional view is that for domestic customers on restricted meters who have been on an SVT or other default tariff with the same supplier for a total of three or more years, who have not opted out, suppliers should also be required to provide the following information to Ofgem:

- (a) Consumption by specified periods of time. The granularity of this information and the definition of these time periods would be a matter for Ofgem to determine in further discussion with the suppliers. However, for the purposes of our initial order, and for the analysis we have conducted, we have identified five broad periods (peak general

⁸²⁵ SLC 25C requires suppliers to carry out any actions in a Fair, honest, transparent, appropriate and professional manner. One of the specific requirements set out in SLC 25C is that the licensee provide information (whether in writing or orally) to each domestic customer which: (i) is complete, accurate and not misleading (in terms of the information provided or omitted); (ii) is communicated in plain and intelligible language; (iii) relates to products or services which are appropriate to the domestic customer to whom it is directed; and (iv) is otherwise fair both in terms of its content and in terms of how it is presented (with more important information being given appropriate prominence).

⁸²⁶ Following a finding of breach, the Gas and Electricity Markets Authority has the power to impose financial penalties and/or make consumer redress orders.

consumption, off-peak, off-peak heating (1), off-peak heating (2), and peak heating).

- (b) Details of the standing charges and volume rates, by region and payment method, for each of the tariffs named in the database, over the relevant period.

6.262 We consider that a requirement on suppliers to provide this additional information is essential to achieving the aims of the proposed remedy. This is because rival suppliers would need this information in order to understand what customers on restricted meters of their rivals have been paying, which would be a necessary input to understanding the commercial opportunities, providing potential customers with personalised offers, and appropriately targeting their marketing efforts.

- *How we should implement this remedy*

6.263 We propose to implement this proposed remedy through:

- (a) a CMA order requiring suppliers to:

- (i) send Opt-out Letters to their Disengaged Domestic Customers;
- (ii) disclose the Domestic Customer Data to Ofgem; and
- (iii) provide Ofgem with updated Domestic Customer Data every six months; and

- (b) a recommendation to Ofgem to

- (i) create, operate and maintain a secure cloud database for the purposes of holding the Domestic Customer Data;
- (ii) hold the Domestic Customer Data;
- (iii) enter into agreements with suppliers including the Use Restrictions and any restrictions concerning access to the Domestic Customer Data; and
- (iv) provide access to the Domestic Customer Data by any rival supplier that has entered into such an agreement.

6.264 We propose that our order would expire after the sooner of five years or upon substantial completion of the smart meter roll-out (due by the end of 2020). Smart meters are expected to change the competitive dynamic in the retail markets, and the way that customers and suppliers interact so the

database may no longer be required once smart meter roll-out has been concluded.

Assessment of effectiveness

- 6.265 As we explain below, our provisional view is that the proposed remedy (including the additional requirements concerning the Disengaged Domestic Customers on restricted meters) would be effective in achieving its aims of enabling rival energy suppliers to identify and market to the Disengaged Domestic Customers who have not opted out and prompt them to engage in the domestic retail energy markets. Accordingly, the proposed remedy would be effective in partly addressing two of the features giving rise to the Domestic Weak Customer Response AEC, ie that domestic customers have limited awareness of, and interest in, their ability to switch supplier and that domestic customers face actual and perceived barriers to assessing and accessing information.
- 6.266 In assessing the effectiveness of the proposed remedy we have considered the following:
- (a) the effectiveness of the key design elements of the proposed remedy;
 - (b) the extent to which the proposed remedy is capable of effective implementation, monitoring and enforcement;
 - (c) the timescale over which the proposed remedy is likely to have an effect; and
 - (d) compliance with existing or expected laws and regulations.
- *Effectiveness of the key design elements*
- 6.267 We consider that the following key design elements of the proposed remedy (including the specific elements concerning the Disengaged Domestic Customers on restricted meters) would be effective in achieving its aim. In particular:
- (a) Rival suppliers would be able to easily identify the Disengaged Domestic Customers. The database would provide all the necessary information about the Disengaged Domestic Customers that had not opted out in one place that was straightforward to access.

- (b) Ofgem's role in operating, controlling and maintaining the database, and providing access to it, would ensure that it will be set up and administered fairly in customers' interests.⁸²⁷
- (c) The database would be readily accessible to rival suppliers upon request (subject to entering into agreement with Ofgem containing the Use Restrictions and any other access terms) and would include data that is accurate and up to date. The proposed remedy provides for the information to be updated every six months.
- (d) Rival suppliers that have an incentive to compete for the Disengaged Domestic Customers would have access to certain of their details, provided that they had not opted out.
- (e) Rival suppliers would be able to provide the Disengaged Domestic Customers that have not opted out with personalised information as they would know their current supplier, tariff and annual consumption. The database would provide this information in an easily accessible format for each Disengaged Domestic Customer that had not opted out.
- (f) Survey results suggest that if the Disengaged Domestic Customers can be prompted to engage then the experience of doing so should help to build their confidence in switching and that they will not revert to high-priced default tariffs at the end of any fixed-term tariff to which they may switch.

6.268 We consider that a requirement on suppliers to provide limited additional information for the Disengaged Domestic Customers on restricted meters is essential to achieving the aims of the proposed remedy. This is because rival suppliers would need this information in order to understand the consumption patterns of the restricted meter customers of their rivals which would be a necessary input to understanding the commercial opportunity, provide potential customers with personalised offers and target their marketing efforts effectively.

6.269 Although a number of Disengaged Domestic Customers may choose to 'opt out' of the proposed disclosure, we consider based on the opt-out rate for the similar measure implemented in France, that many customers would not and suppliers would therefore be able to contact a large proportion of Disengaged Domestic Customers to prompt them to engage. For instance, the opt-out rate in France was [X]%. We also note that some of those customers that choose to opt out may do so because they are content with

⁸²⁷ Ofgem's principal objective is to protect the interests of existing and future gas and electricity consumers.

their existing supply arrangements, thus making the proposed remedy more effective at targeting suppliers' customers who are more disengaged.

- *Implementation, monitoring compliance and enforcement*

6.270 In determining whether the proposed remedy is effective, we have had regard to the operation and implications of the proposed remedy.

6.271 As regards the implementation of the proposed remedy, we have set out a number of detailed specifications (see paragraphs 6.260 to 6.261 above). We have necessarily taken a detailed approach to describing the terms of the proposed remedy so that it would not only be clear to Ofgem and suppliers to understand, but also be straightforward for them to implement (as the addressees of our proposed remedy).

6.272 We note that Ofgem has already expressed broad support for the proposed remedy.⁸²⁸ In response to our variant of the proposed remedy relating to prepayment customers, Ofgem agreed with the proposed remedy, provided sufficient protections were put in place to address concerns about safeguarding consumers' personal data and consumers receiving large volumes of unwanted marketing. It also said that consideration should be given to targeting the database at a broader group of 'sticky' customers, irrespective of payment type.⁸²⁹

6.273 As regards monitoring compliance with the proposed remedy, we note that this should also be straightforward, as Ofgem will be the recipient of the Domestic Customer Data and can therefore report to the CMA if any supplier fails to comply with the order. In addition, as sector regulator, Ofgem will be well placed to receive any allegations of mistreatment of the Domestic Customer Data by a rival supplier and would be able to take action under the agreements put in place concerning access to and use of the Domestic Customer Data, or under a supplier's licence.

- *Timescales for the proposed remedy*

6.274 As regards the timescales for implementation, following publication of our final report the CMA would start drafting and consulting on an order requiring suppliers to send the Opt-out Letter to their Disengaged Domestic Customers. During this period, we would also expect Ofgem to begin developing the database and associated agreements, and following

⁸²⁸ Ofgem response to second supplemental notice of possible remedies, pp1–2.

⁸²⁹ *ibid*, pp1–2.

publication of the CMA's final order, we would require suppliers to send the Opt-out Letter to all Disengaged Domestic Customers by mid-2017.

6.275 We would require suppliers to pass the Domestic Customer Data to Ofgem by the end of 2017 at the latest. We would therefore expect rival suppliers to start accessing the database, and contacting the Disengaged Domestic Customers who have not opted-out by the end of 2017. The database would then be updated every six months from the beginning of 2018 onwards.

6.276 In evaluating the effectiveness of the proposed remedy, we have also considered the timescale over which the Domestic Weak Customer Response AEC would be expected to endure, and the timescale over which the proposed remedy would be likely to take effect. We would propose that our order would expire after the sooner of five years or upon substantial completion of the smart meter roll-out (due by the end of 2020). Smart meters are expected to change the competitive dynamic in the retail markets and the way that customers and suppliers interact, so the database may no longer be required once smart meter roll-out has been concluded.

- *Compliance with existing or expected laws and regulations*

6.277 As part of our consideration of the effectiveness of the proposed remedy, we have considered whether any elements of it would not be consistent with relevant laws and regulations. A particular focus of our assessment of this aspect has been the interaction of our proposed remedy with data protection legislation (in particular, the DPA) and the PECR. We have also considered the impact of the reform of EU data protection rules and, in particular, the proposal for a General Data Protection Regulation.⁸³⁰ In this regard, we have taken into account the above legislation when designing the proposed remedy, and have also discussed the proposed remedy with the ICO and adapted the proposed design in light of those discussions.

Assessment of proportionality

6.278 In this section we set out our assessment of whether the proposed remedy would be a proportionate remedy.

- *Effective in achieving its aim*

6.279 For the reasons set out in paragraphs 6.265 to 6.277 above, we consider that the proposed remedy would be effective in achieving its aim of enabling

⁸³⁰ European Commission, [Proposal for a General Data Protection Regulation](#).

rival retail energy suppliers to identify the Disengaged Domestic Customers that have opted out. Accordingly, it would be effective in partly addressing two of the features giving rise to the Domestic Weak Customer Response AEC (and the resulting detriment), ie that domestic customers have limited awareness of, and interest in, their ability to switch energy supplier and that domestic customers face actual and perceived barriers to accessing and assessing information.

- *No more onerous than needed to achieve its aim*

- 6.280 We also consider that this proposed remedy (including the additional requirements concerning the Disengaged Domestic Customers on restricted meters) would be no more onerous than needed to achieve its aim. In particular, we have considered very carefully the requirements in relation to the data suppliers would be required to disclose, the customers for whom suppliers would be required to disclose data, the frequency with which suppliers would be required to update the database, and the procedures providing for the disclosure and access to the database, and consider that we have designed the proposed remedy so that it would be no more onerous than needed to achieve its aim
- 6.281 With regard to the data that suppliers would be required to disclose, it is our view (informed by the evidence provided by PCWs (see paragraph 6.154) that the Domestic Customer Data would be sufficient for rival suppliers to be able to identify and contact the Disengaged Domestic Customers (who have not opted out) and to provide potential customers with personalised information on the savings they could make by switching.
- 6.282 With regard to the customers for whom suppliers would be required to disclose information, we consider that an approach targeted specifically at the Disengaged Domestic Customers would be more proportionate than a similar remedy affecting customers who have been on an SVT (or other default tariff) for a shorter duration. In particular, our judgement is that if customers were to actively engage in the market at least every three years, it is likely that would be sufficient for customers to exert an effective competitive constraint on suppliers.
- 6.283 Finally, with regard to the frequency with which suppliers would be required to update the database, we considered whether suppliers should be required to do so more regularly than every six months. Our provisional view is that six-months is proportionate in the expectation that if the process of extracting, formatting and disclosing the Domestic Customer Data would be moderately costly for suppliers. Otherwise we would consider whether a requirement to update the database more frequently would be more

proportionate to the aims of the remedy. In particular, more frequent updating would reduce the risk of rival suppliers contacting customers who had recently switched away from an SVT, based on out-of-date information, which may cause annoyance and confusion.

- *Least onerous if there were a choice between several effective remedies*

6.284 We have also considered whether there may be alternative designs of this proposed remedy to achieve the same aim that are less onerous. For the reasons noted above, we consider that the proposed remedy, as designed, appropriately balances the need for the proposed remedy to be effective, and proportionate, in terms of the proportion of a supplier's existing customer base to which the proposed remedy will apply (ie customers on an SVT or other default tariff for three or more years).

6.285 We have also considered below the possible remedies suggested by Centrica and Scottish Power, which would involve a prohibition on evergreen default tariffs. For the reasons discussed below, we consider that these suggested remedies are either not effective and/or are disproportionate in terms of the potential unintended consequences. We have also considered the current existence of multiple reminders sent by suppliers to their own customers to help them engage (see paragraph 6.251) and whether it may be effective (and more proportionate) to suggest changes to such existing reminders. However, given the limited available evidence on the effectiveness of the 'clearer information' component of the RMR rules, we consider that such measures are best assessed through our proposed remedy concerning the Ofgem-led programme. This proposed remedy, and its detailed and tightly controlled design, would in our provisional view be the least onerous effective means of introducing a customer prompt by rival suppliers.

- *Would not produce disadvantages that are disproportionate to the aim*

6.286 We have provisionally concluded that the proposed remedy (including the additional requirements concerning the Disengaged Domestic Customers on restricted meters) would not produce adverse effects that would be disproportionate to its aim. We have compared the potential costs of implementing the proposed remedy relative to the potential gains. In particular:

- (a) the costs of physically implementing the proposed remedy would be small relative to the potential gains (see paragraph 6.288);

- (b) the proposed remedy would specifically allow the Disengaged Domestic Customers to opt out when first contacted by their supplier and at any point thereafter; and
 - (c) we consider that general consumer and data protection legislation, the PECR, domestic retail suppliers' licence conditions (in particular SLC 25 and SLC 25c), the Use Restrictions and other terms and conditions for accessing the Domestic Customer Data will protect the Disengaged Domestic Customers that have not opted out from mistreatment by rival suppliers of their personal data.
- 6.287 In contrast, the potential gains available to the Disengaged Domestic Customers that have not opted out from promoting engagement are potentially substantial (see estimates in Section 3 of the domestic retail detriment).
- 6.288 With regard to the costs of implementing the proposed remedy, more specifically, we have estimated that the costs of setting up a secure cloud database in which to store details of the Disengaged Domestic Customers could be in the region of £50,000–£100,000.⁸³¹ We do not think it would be an expensive web-based application to build and maintain because it would not require significant, or complex, functionality. The database would simply need to provide the data in an accessible, secure format to a relatively small number of permitted users. For instance, we consider that a cloud database would provide a more straightforward and secure means of sharing the data than through Excel spreadsheets.
- 6.289 There would be certain costs to the suppliers associated with putting in place agreements with Ofgem, and developing and sending letters (including the Opt-out Letter) to customers. We note that communicating with customers is a routine activity for any retail domestic energy supplier. However, we are conscious that, in order for the proposed remedy to be as effective as possible, and to minimise a potential unintended consequence of unsettling, confusing and/or otherwise increasing mistrust in the retail energy markets, the CMA would propose to work closely with Ofgem and suppliers to ensure that the Opt-out Letter is suitably worded so as to mitigate such risks by explaining only to recipient customers the context for, and implication, of the Opt-out Letter.
- 6.290 We also consider that given the potential estimated savings from switching and the estimated cost of the proposed remedy, only a relatively small

⁸³¹ Based on informal discussions with the Greater London Authority (GLA), which hosts the London datastore database, and data developers.

number of Disengaged Domestic Customers would need to switch externally from the SVT of the Six Large Energy Firms to the best alternative tariff to make the proposed remedy cost-effective. For example, if the cost of the database was £100,000, around 1,000 Disengaged Domestic Customers would need to switch to realise £100,000 of savings⁸³². This would be a very small proportion of the number of Disengaged Domestic Customers likely to be put on the database, even if we assume that around [X]% of Disengaged Customers opt out.⁸³³

Any relevant customer benefits that may be lost

- 6.291 We do not consider that any relevant customer benefits would be lost as a result of the disclosure of details of the Disengaged Domestic Customers that have not opted out to Ofgem and rival suppliers subject to the Use Restrictions. As noted above, the proposed remedy has several detailed design mechanisms to mitigate the risk of customers receiving unwanted correspondence that may cause them to disengage further. Instead the proposed remedy will provide for customers who have been on an SVT or other default tariff for a substantial period of time – and who are likely to be paying substantially more for gas and electricity than engaged consumers – to engage in the markets. This greater level of customer engagement will, in turn, help to foster competition and generate lower prices and more choice of tariffs.

Remedy minded not to consider – Centrica and Scottish Power proposals to prohibit evergreen default tariffs

- 6.292 In response to our provisional findings and Remedies Notice, we received two separate, but similar, proposals from Centrica and Scottish Power which would prohibit the use of evergreen tariffs. We have considered these as proposals for prompting customers on default tariffs to engage with the domestic retail energy markets.
- 6.293 Our Supplemental Remedies Notice set out details of the proposals and invited views on their effectiveness and proportionality, and the specification and implementation of the possible remedies.
- 6.294 We have provisionally decided not to implement the Centrica and Scottish Power proposals.

⁸³² See Section 3 estimates of domestic customer detriment.

⁸³³ This is based on the proportion of customers who opted out of the Engie scheme in France.

The proposals

- 6.295 The aim of Centrica's and Scottish Power's proposals would be to increase domestic customer engagement in the domestic retail energy markets by introducing an end date for the supply of energy on an evergreen basis (eg on a standard variable or other default tariff), and providing periodic prompts to customers on evergreen tariffs prior to this date and once they had transitioned to a new fixed-term contract. The industry would move to a system where all customers would be on fixed-term contracts with notifications provided when those contracts came to an end.
- 6.296 Centrica and Scottish Power said that, in their experience, domestic customers on fixed-term contracts tended to engage in significant numbers following the receipt of an end-of-contract notification from their supplier. This response was said to be much greater than that seen following receipt of an annual statement or a price increase notification. They suggested, therefore, that if all domestic customers were to receive such notifications on an annual basis, levels of engagement would increase materially.
- 6.297 Customers who received a notification that their contract was coming to an end but who did not take action, would be rolled onto a fixed-term 'default' tariff. Both Centrica and Scottish Power said that this should be a one-year tariff without exit fees.⁸³⁴ As a result, customers who rolled onto it could switch to an alternative tariff at any time without penalties. They also said that the level of the default tariff should be set by each energy supplier, rather than being regulated. Once on this default tariff, customers would receive a notification at the end of each year that their fixed-term default tariff was coming to an end and would be provided with information on the range of tariffs they could choose from, including the one they would be rolled onto if they failed to make a choice. These customers could also receive additional prompts, for example, quarterly or at the mid-year stage.
- 6.298 We envisaged that a proposal to increase engagement by prohibiting the use of evergreen tariffs would need to be phased in over a period of time, with energy suppliers being required to take the following steps (although not necessarily in the order set out):
- (a) prohibiting the supply of energy to new and existing customers on an evergreen basis as from a future date;

⁸³⁴ Centrica also said this should be a variable priced tariff. In contrast, the Scottish Power proposal allowed for this to be variable or fixed-price.

- (b) informing existing evergreen/SVT customers that their tariffs were being phased out and that they would need to choose a new tariff; and
 - (c) moving those existing customers who did not respond to these prompts onto the default tariff.
- 6.299 Within a given period of time, all evergreen tariffs would thus be removed from the markets.
- 6.300 While Centrica and Scottish Power's proposals are similar, they have some notable differences. Centrica proposed a variable price for the fixed-term default tariff and a phased implementation of the proposal according to the length of time customers have been on the tariff. By contrast, Scottish Power proposed a fixed-rate for the fixed-term default tariff and a phased implementation by region which it said could facilitate suppliers targeting rivals' customer bases and thus increase competition.

Parties' views

- 6.301 Overall there was a mixed response to any proposal to increase customer engagement by prohibiting evergreen default tariffs:
 - (a) Ofgem said it saw an intuitive logic in the proposal but was mindful that consumers on SVTs already received a number of periodic prompts. Ofgem also said that there was a question as to whether less engaged customers would respond to an end-of-contract notice to the same degree as customers that had actively chosen a fixed-term tariff.⁸³⁵
 - (b) With the exceptions of Centrica and Scottish Power, the Six Large Energy Firms questioned the effectiveness of the proposal.
 - (i) EDF Energy said the proposal could be effective but only if combined with other measures.⁸³⁶
 - (ii) E.ON said the proposal could be effective but might not benefit all customers. Some customers who rolled onto the default tariffs might believe that they could not switch until the end of the contract, and some customers on prepayment or complex meters would not

⁸³⁵ [Ofgem response to Supplementary Remedies Notice](#), p1.

⁸³⁶ [EDF Energy response to Supplementary Remedies Notice](#), p4, paragraph 1.27.

benefit because of current restrictions on choice of tariff and switching due to infrastructure.⁸³⁷

- (iii) RWE npower said the proposal could increase customer engagement but it was unclear by how much.⁸³⁸
 - (iv) SSE said the proposal would have material unintended adverse consequences. It would undermine competition by unduly restricting customer choice through eliminating SVTs and restricting suppliers' ability to innovate and compete. SSE also said it would undermine the pro-competitive measures contained in the CMA's other proposed remedies.⁸³⁹
- (c) Of the Six Large Energy Firms, only Centrica and Scottish Power said the proposal would be effective. Centrica said the proposal would be effective at encouraging customers to engage more frequently in the market if it was phased in as other remedies and market developments were taking effect.⁸⁴⁰ Scottish Power said the proposal would be effective in securing a substantial improvement in engagement.⁸⁴¹
- (d) Several of the Mid-tier Suppliers also raised issues about its effectiveness:
- (i) First Utility said that while the proposal was a step in the right direction, it would not be effective in encouraging greater customer engagement because it would only provide for one additional mandatory communication each year.⁸⁴²
 - (ii) Utility Warehouse said that, in practice, the proposal amounted to the maintenance of the status quo with an additional single annual communication, which would have marginal impact.⁸⁴³
 - (iii) Ovo Energy said the removal of evergreen contracts might produce an overall positive outcome for customers but should not be seen as a means of providing direct protection to disengaged customers.⁸⁴⁴

⁸³⁷ [E.ON response to Supplementary Remedies Notice](#), pp5–6.

⁸³⁸ [RWE npower response to Supplementary Remedies Notice](#), p18.

⁸³⁹ [SSE response to Supplementary Remedies Notice](#), pp4–p6.

⁸⁴⁰ [Centrica response to Supplementary Remedies Notice](#), p2.

⁸⁴¹ [Centrica response to Supplementary Remedies Notice](#), p2 and [Scottish Power response to Supplementary Remedies Notice](#), pp1–2.

⁸⁴² [First Utility response to Supplementary Remedies Notice](#), p1.

⁸⁴³ [Utility Warehouse response to Supplementary Remedies Notice](#), p1.

⁸⁴⁴ [Ovo Energy response to Supplementary Remedies Notice](#), pp2–3.

(e) Several smaller suppliers opposed the proposal outright.⁸⁴⁵

- (i) Citizens Advice said it was unlikely that the proposal would be effective because of substantive similarities with what it would replace, and existing prompts did not work.⁸⁴⁶
- (ii) The Behavioural Insights Team said there were potentially very significant customer benefits from the proposed approach.⁸⁴⁷
- (iii) MoneySuperMarket said customers who had not previously responded to written notifications at the end of contracts or to cheaper tariff messaging were unlikely to respond to similar notifications from their supplier while on default tariffs.⁸⁴⁸
- (iv) uSwitch said it could see merits in the proposal but it would not have the impact necessary to raise engagement levels sufficiently.⁸⁴⁹
- (v) Utiligroup said there did not seem to be an obvious or evidential link between contract period and customer engagement. It said the remedy was unbalanced, unrepresentative of all customer interests and could have unforeseen consequences.⁸⁵⁰

6.302 Several of the Six Large Energy Firms indicated that it could take some time to implement any proposal to prohibit evergreen tariffs. In particular:

- (a) Centrica said it would be important to ensure that implementation was phased in over at least three years to minimise the risk of unintended consequences.⁸⁵¹
- (b) EDF Energy said that implementation would need careful consideration in order to maintain current customer service levels and trust.⁸⁵²
- (c) E.ON said that many features of the proposals would require extensive development before implementation.⁸⁵³ Most customers would expect to

⁸⁴⁵ [Opus response to Supplementary Remedies Notice](#), p1, [Green Energy response to supplementary Remedies Notice](#), p1-3, [Corona Energy response to Supplementary Remedies Notice](#), p1-2 and [Good Energy response to Supplementary Remedies Notice](#), p1.

⁸⁴⁶ [Citizens Advice response to Supplementary Remedies Notice](#), pp1–2.

⁸⁴⁷ [The Behavioural Insights Team response to Supplementary Remedies Notice](#), p1.

⁸⁴⁸ [Moneysupermarket.com response to Supplementary Remedies Notice](#), p2.

⁸⁴⁹ [uSwitch response to Supplementary Remedies Notice](#), p2.

⁸⁵⁰ [Utiligroup response to Supplementary Remedies Notice](#), p2.

⁸⁵¹ [Centrica response to Supplementary Remedies Notice](#), pp8–9. Centrica said that at least six months' pre-implementation was required followed by a two-year notification period during which each customer would be given an SVT end date 12 months after notification (encouraging them to switch prior to this).

⁸⁵² [EDF Energy response to Supplementary Remedies Notice](#), p8, paragraph 1.54.

⁸⁵³ [E-ON response to Supplementary Remedies Notice](#), p10.

receive a fixed-term, fixed-rate contract (or ‘fixed means fixed’) contract which would need to be considered when designing the contract.

- (d) Scottish Power said that suppliers would need sufficient time to prepare their systems so at least a six-month planning phase and a one-year roll-out phase would be necessary.⁸⁵⁴
- (e) SSE said the complexity and cost made the proposal unjustifiable to implement. It said that such a material and complicated market change would require at least one year for preparation (ie before migration from SVTs could even commence), and a further year to 18 months for the migration of customers to the new default tariffs.⁸⁵⁵ These steps did not take into account possible further delays resulting from changes that would be required to the regulatory framework.

6.303 Several of the Six Large Energy Firms said the proposal could be costly. In particular:

- (a) EDF Energy said suppliers would be likely to incur significant operational costs associated with the expansion of systems.⁸⁵⁶
- (b) E.ON said there were likely to be various costs for implementing the remedy, including for research to identify the best messaging for customers and for renewal, which would be occurred every year the remedy was in place.⁸⁵⁷
- (c) RWE npower said the costs could potentially act as a barrier to entry.⁸⁵⁸
- (d) SSE said significant back office investment would be required, which risked undermining the delivery of innovative market changes that would have a positive benefit to customers.⁸⁵⁹

6.304 Good Energy and Utility Warehouse also raised concerns about costs.⁸⁶⁰

⁸⁵⁴ [Scottish Power response to Supplementary Remedies Notice](#), pp9–10.

⁸⁵⁵ [SSE response to Supplementary Remedies Notice](#), pp6–7.

⁸⁵⁶ [EDF Energy response to Supplementary Remedies Notice](#), p10 paragraph 1.67.

⁸⁵⁷ [E.ON response to Supplementary Remedies Notice](#), pp14–15.

⁸⁵⁸ [RWE npower response to Supplementary Remedies Notice](#), p17.

⁸⁵⁹ [SSE response to Supplementary Remedies Notice](#), p8.

⁸⁶⁰ [Good Energy response to Supplementary Remedies Notice](#), p1, [Utility Warehouse response to Supplementary Remedies Notice](#), p5-6, [UEA Centre for Competition Policy response to Supplementary Remedies Notice](#), p6 and [Citizens Advice response to Supplementary Remedies Notice](#), pp12–13.

6.305 We also received a number of alternative proposals that parties thought would be as effective or more effective than the Centrica and Scottish Power proposals but would be less costly and/or intrusive:

- (a) E.ON⁸⁶¹ and SSE⁸⁶² suggested an enhanced annual statement. E.ON said the statement should have improved messaging and a strong 'call to action'. SSE said an enhanced statement would have material benefits for customers and be capable of fast and effective implementation. We have considered this suggestion as part of our proposed remedy concerning the Ofgem-led programme.
- (b) First Utility proposed a package of alternative measures including renaming the SVT or any default tariff to 'out of contract' tariff and introducing more communications and frequent billing for SVT customers.⁸⁶³ We have considered this suggestion as part of our proposed remedy concerning the Ofgem-led programme.
- (c) Utility Warehouse proposed a maximum permitted 'delta' (£ or %) that a supplier would be permitted to charge its SVT customers relative to the cheapest price that it charged its newly acquired customers.⁸⁶⁴ We have considered this suggestion as part of a proposed remedy concerning the temporary price cap.
- (d) Ovo Energy proposed a regulatory principle of cost reflectivity which it said could help protect customers on SVTs from being overcharged.⁸⁶⁵ We have considered this suggestion as part of a proposed remedy concerning the temporary price cap.
- (e) MoneySuperMarket suggested more direct communication to SVT customers via a letter from DECC (or other trusted intermediaries) and SMS messaging.⁸⁶⁶ We have considered this suggestion as part of our proposed remedy concerning the Ofgem-led programme.
- (f) Citizens Advice suggested a mandatory switch of certain consumers fitting a vulnerability profile (broadly matching the Cold Weather Payments group) or an extension of the current Warm Home Discount to

⁸⁶¹ E.ON response to Supplementary Remedies Notice, p15.

⁸⁶² SSE response to Supplementary Remedies Notice, pp9–10.

⁸⁶³ First Utility response to Supplementary Remedies Notice, p1.

⁸⁶⁴ Utility Warehouse response to Supplementary Remedies Notice, p8.

⁸⁶⁵ Ovo Energy response to Supplementary Remedies Notice, pp3 & 7.

⁸⁶⁶ MoneySuperMarket response to Supplementary Remedies Notice, p3.

cover all suppliers and a broader group of consumers.⁸⁶⁷ We have considered this suggestion below.

Our assessment of effectiveness

- 6.306 Our assessment of the likely effectiveness of this proposed remedy differs as between the Centrica and Scottish Power variants.
- 6.307 In relation to the Centrica proposal, we do not consider this to be a substantial departure from the status quo, in that:
- (a) the default tariff would still be a variable tariff, such that the periodic prompt would not be associated with a change in price, which may be expected to reduce its effectiveness in engaging customers; and
 - (b) the proposed roll-out by customer tenure would not facilitate other suppliers engaging with customers on default tariffs.
- 6.308 In effect, the Centrica proposal amounts to a rebranding of the SVT with an additional periodic prompt. Customers on SVTs already receive regular communications from their suppliers so receiving further prompts from them might not in itself prompt these customers to engage. As noted above, we propose to recommend that Ofgem test new approaches to providing information to customers to help them engage and we do not consider that this proposal is likely to deliver benefits on top of that. In addition, we propose to set up a new rival-led prompt, through our proposed Database remedy.
- 6.309 The Scottish Power proposal is, in contrast, a substantial change to the status quo:
- (a) Default tariffs would be fixed-term and fixed-price, such that that end-of-contract prompt would be associated with a price change, resulting in a meaningful decision point for customers.
 - (b) The proposed roll out by geographical area would be expected to help rival suppliers target their marketing efforts on customers facing a change in contract, which is likely to increase the effectiveness and reduce the costs of such marketing activity.
- 6.310 We also note, in relation to both proposals, that while customers who have actively chosen fixed-term tariffs may respond to end-of-contract

⁸⁶⁷ [Citizens Advice response to Supplementary Remedies Notice](#), p13.

notifications, it is not clear that far less engaged customers would respond in the same way.

- 6.311 In the light of the above, our provisional view is that the Centrica proposal would not be effective in addressing any aspect of the features giving rise to the Domestic Weak Customer Response AEC and resulting detriment. We consider that that the Scottish Power proposal is, on balance, possibly effective for the reasons set out above, although we recognise that there is considerable uncertainty about how disengaged customers are likely to respond to end-of-contract prompts. However, we have not addressed the likely effectiveness of the Scottish Power proposal in detail, because we provisionally consider that it would not be proportionate (see below).

Our assessment of proportionality

- 6.312 Centrica and Scottish Power said the potential costs could be proportionate to the benefits of increased engagement.⁸⁶⁸ As regards Centrica's views, this was because the benefits of increased engagement would outweigh the costs provided suppliers were able to set their variable-priced default tariff at a level that was not capped by the regulator and that implementation took place over the timescale proposed.⁸⁶⁹
- 6.313 We note that other suppliers were concerned that the costs of implementation would be high. In addition, several suppliers commented on relevant customer benefits which could be adversely affected by the proposals.
- (a) E.ON said that if the default contract was a fixed-rate, fixed-term contract which, as a result of its design, was at a higher rate than the current SVT then this would result in a loss of customer benefit.⁸⁷⁰
 - (b) RWE npower said it was unlikely that discounts currently enjoyed by customers on non-standard tariffs would continue at the same levels if this remedy was introduced due to price convergence between the default and non-default tariffs.⁸⁷¹
 - (c) SSE said the cost and complexity of the implementation of the proposals could result in material customer harm: consumers could face a reduced choice of products, increased costs and unnecessary disruption during

⁸⁶⁸ Centrica response to Supplementary Remedies Notice, p13 and Scottish Power response to Supplementary Remedies Notice, pp12–13.

⁸⁶⁹ Centrica response to Supplementary Remedies Notice, p13.

⁸⁷⁰ E.ON response to Supplementary Remedies Notice, p14.

⁸⁷¹ RWE npower response to Supplementary Remedies Notice, p17.

transition (and over the longer term) which might actually discourage their engagement.⁸⁷²

(d) Utility Warehouse said that moving to a marketplace dominated by fixed-term contracts would result in a material transfer of wholesale commodity price risk from suppliers to consumers.⁸⁷³

(e) Good Energy said that locking customers into fixed-rate deals could result in them not receiving the benefits of any wholesale market price reductions until their fixed-rate deal ended. It also said the remedy could adversely affect engaged customers through a restriction of choice.⁸⁷⁴

6.314 We have taken into account each of the above potential unintended adverse consequences or potential losses of relevant customer benefits, when provisionally deciding not to proceed with Centrica's and Scottish Power's proposals.⁸⁷⁵ In particular, we note that neither the Centrica nor the Scottish Power proposal provides for an explicit constraint on the level of the default tariff. We also note that, under the status quo, the public visibility of changes to the SVT might plausibly provide a partial constraint on the ability of suppliers to raise prices rapidly for certain categories of disengaged customer. This potential constraint would be lost under the Centrica and Scottish Power proposals. We are therefore concerned that, under both proposals, there is risk that default tariffs for disengaged customers increase as a result of the reforms, due to the absence of this constraint.

6.315 We also note that the reforms would be relatively costly to implement and difficult to reverse in short order. Therefore, on balance, we have concluded that both proposals are unlikely to be proportionate.

Engagement remedies for customers on restricted meters

6.316 In our provisional findings, we found that a combination of features of the markets for domestic retail supply of gas and electricity in Great Britain give rise to the Domestic Weak Customer Response AEC.

6.317 As set out in detail in Section 3, our further analysis of the retail supply of electricity to domestic customers with restricted meters has confirmed our provisional view that the same features also affect domestic customers on restricted meters, and has shown that there are additional aspects of the

⁸⁷² SSE response to Supplementary Remedies Notice, p8.

⁸⁷³ Utility Warehouse response to Supplementary Remedies Notice, pp7–8.

⁸⁷⁴ Good Energy response to Supplementary Remedies Notice, p8.

⁸⁷⁵ We have also considered these factors when considering the proposed temporary price cap.

domestic retail electricity market concerning customers on restricted meters that contribute to some of these features.⁸⁷⁶ In particular, we have provisionally found that customers on restricted meters have lower awareness of, and interest in, their ability to switch; face higher barriers to accessing and assessing information; and higher actual and/or perceived barriers to switching.

6.318 In this section, we set out the proposed remedies that are aimed at addressing certain aspects of the domestic retail electricity market concerning customers on restricted meters⁸⁷⁷ contributing to the above features and (together with the other proposed engagement remedies we have provisionally decided upon concerning both the domestic retail gas and electricity markets) that we consider would be effective and proportionate in addressing the Domestic Weak Customer Response AEC and the resulting customer detriment.

6.319 In particular, the proposed remedies are:

- (a) to require all suppliers to make all their single-rate tariffs available to all domestic customers on restricted meters, and that switching to these tariffs cannot be made conditional on a restricted meter being replaced; and
- (b) to ensure that domestic customers on restricted meters have access to information on the options available to them.

Removing the barriers to switching

6.320 We have received little, if any, evidence that either the Six Large Energy Firms as a group or the Mid-tier Suppliers as a group are actively competing to attract customers with restricted meters. We were also told that there are no technical reasons why suppliers cannot make their single-rate tariffs available to customers on restricted meters. This requires suppliers to be able to either: aggregate consumption across registers (and, possibly, meters) and to apply the single-rate tariff to the aggregated consumption on an ex post basis; or by setting up meter-specific tariffs where the standing charge and all unit rates are the same as those for the relevant single-rate tariff. That this is technically feasible is demonstrated by the practice of two

⁸⁷⁶ For these purposes, we define 'restricted meters' to exclude customers with Economy 7 meters unless otherwise specified. Ofgem found that for customers with Economy 7 meters their choice of tariff and suppliers was similar to that for customers on unrestricted meters. Ofgem presentation: Briefing on customers on restricted electricity meters for CMA, August 2015.

⁸⁷⁷ For the avoidance of doubt, the remedies proposed in this section concern all customers on restricted meters (including customers on Economy 7 meters).

suppliers. First Utility told us that it did not offer specific tariffs for customers on restricted meters and that single-rate tariffs were available to customers with these meters. Utility Warehouse told us that all its current tariffs were available on restricted meters. (See Appendix 3.1 for further details).

6.321 We asked all of the Six Large Energy Firms whether they allow their existing customers on restricted meters to switch to their single-rate tariffs and whether they offer their single-rate tariffs to potential customers on restricted meters. We found that:

- (a) RWE npower will require [REDACTED]⁸⁷⁸ [REDACTED];
- (b) all of the other of the Six Large Energy Firms said that they might require the replacement of a customer's existing meter; and
- (c) Centrica (£70), E.ON (£65 to £82) and Scottish Power said that they would charge the customer to replace their meter. Additionally Scottish Power told us that if some rewiring in the home was required, this would be an additional expense to the customer.

Aim of the remedy

6.322 The aim of the proposed remedy would be to promote competition in the restricted meter segment from single-rate tariffs being available to be applied to tariffs designed to support restricted meters by:

- (a) ensuring that all customers on restricted meters have the option of switching to any single-rate tariff offered by suppliers; and
- (b) reducing the costs to customers on restricted meters of switching supplier and switching to single-rate tariffs.

6.323 The ultimate aim of the proposed remedy would be to partly address two of the features giving rise to the Domestic Weak Customer Response AEC (and resulting detriment), that are particularly relevant to customers on restricted meters, ie that such customers face actual and/or perceived barriers to switching. It also partly addresses such customers' limited awareness of, and interest in, their ability to switch energy supplier.

⁸⁷⁸ [REDACTED]

Design considerations

- 6.324 As noted above (see paragraph 6.321), we found that some suppliers require any new customer or existing customer switching to an Economy 7 or single-rate tariff to replace their restricted meter and they may also charge the customer for the replacement costs. We consider that this increases the actual and perceived barriers to switching faced by customers on restricted meters. In particular, this requirement adds to the number of factors that a customer needs to take into account in making an assessment of the options available to them and create uncertainties around the costs of switching (including the loss of the ability to take advantage of any efficiencies provided for by their meter and the heating systems that the meter supports).
- 6.325 Accordingly, our proposed remedy is an order on gas and electricity suppliers with more than 50,000 domestic customers (and amendments to suppliers' standard licence conditions) (i) requiring such suppliers to make all their single-rate electricity tariffs available to all (existing and new) domestic electricity customers on restricted meters, and (ii) prohibiting such suppliers from making their single-rate electricity tariffs available to domestic electricity customers on restricted meters conditional upon the replacement of their existing meter.
- 6.326 Licensed gas and electricity suppliers have an obligation to install smart meters for all their domestic customers by the end of 2020. An order to require all licensees that supply gas or electricity to more than 50,000 domestic customers to make single-rate tariffs available to all their customers on the basis set out above would therefore have a sunset provision linked to the roll-out of smart meters.

Assessment of effectiveness

- 6.327 In assessing the effectiveness of the proposed remedy, we have considered the following factors:
- (a) whether our proposed remedy would be expected to promote engagement among customers with restricted meters;
 - (b) the extent to which the proposed remedy is capable of effective implementation, monitoring and enforcement; and
 - (c) the timescale over which the proposed remedy is likely to have an effect.
- 6.328 Our provisional view is that the proposed remedy could be expected to achieve the aims as set out in paragraph 6.322 as it would have the effect of

making all single-rate electricity tariffs offered by the relevant suppliers available to customers on restricted meters.

- 6.329 In particular, for the reasons given above (see paragraph 6.324), we consider that ensuring that all customers on restricted meters have the option of switching to single-rate tariffs (offered by suppliers with more than 50,000 domestic customers) with no requirement to change their meter will contribute to reducing the barriers to searching and switching for these customers. The proposed remedy would work in combination with the second of our proposed remedies that focuses on customer on restricted meters, the aim of which is to ensure that all customers on restricted meters are aware of the options available to them and can access the information they need to make informed decisions.
- 6.330 Increasing customer awareness (and possibly also their interest in switching), and reducing actual and perceived barriers to switching in the manner proposed, in turn would increase the constraints that suppliers face in pricing tariffs designed for any specific restricted meter. As a result of this increased competitive constraint, and likely higher levels of customer engagement, we would expect a lower proportion of customers on restricted meters to remain on meter-specific tariffs that are more expensive than the cheapest single-rate tariff available to them, either because:
- (a) the tariffs designed for restricted meters that are currently more expensive than existing single-rate single-fuel tariffs would be reduced or withdrawn; and/or
 - (b) customers on restricted meters that are currently on meter-specific tariffs would move to a cheaper single-rate tariff.
- 6.331 We are proposing to implement the proposed remedy by way of an order, and, in order to give effect to the order, we are proposing to modify the gas and electricity supply standard licence conditions.
- 6.332 Given the straightforward nature of the requirement that will be imposed on suppliers to make all single-rate tariffs available to customers on restricted meters, and the prohibition on suppliers making such availability conditional on such customers replacing their meter or paying a replacement fee or other cost associated with replacement (or both), we consider that our order would be clear to suppliers. It will also be simple to implement since suppliers can apply the single-rate tariff to the aggregated consumption of the customer on an ex post basis or set up meter-specific tariffs where the standing charge and all unit rates are the same as those for the relevant single rate tariff (as First Utility and Utility Warehouse currently do). As

regards monitoring and compliance of this proposed remedy, we note that, by introducing a new standard licence condition, Ofgem would be under a duty to perform a monitoring role and could periodically check suppliers' compliance, for example, by mystery shopping. Ofgem could also require suppliers to provide information evidencing compliance.

- 6.333 In terms of timescale for implementation, the CMA would start drafting and consulting on an order in the six-month period following publication of our final report. We would expect suppliers to be able to make the necessary adjustments to their billing systems within three months of the date of a CMA order, and therefore to start offering all customers on restricted meter tariffs the ability to switch to their single-rate unrestricted meter tariffs, by April 2017. We would expect this to lead to increased engagement from customers on restricted meters from April 2017.

Assessment of proportionality

- 6.334 In this section we set out our assessment of whether the proposed remedy would be a proportionate remedy.

- *Effective in achieving its legitimate aim*

- 6.335 For the reasons given above (see paragraphs 6.328 to 6.330), our provisional view is that the proposed remedy would be effective in achieving its aim of promoting competition in the restricted meter segment from single-rate tariffs being available to customers on restricted meters. Accordingly, it would be effective in partly addressing two of the features giving rise to the Domestic Weak Customer Response AEC (and resulting detriment) that are particularly relevant to customers on restricted meters, ie that such customers face higher actual and/or perceived barriers to switching and have limited awareness of their ability to switch.

- *No more onerous than needed to achieve its aim*

- 6.336 As regards the proposed remedy being no more onerous than necessary, we note that the proposed remedy provides only for suppliers making their existing single-rate tariffs available to restricted meter customers without certain conditions. It would not require suppliers to design tariffs specifically to support restricted meters. The proposed remedy is also limited to suppliers with more than 50,000 domestic customers. We consider this to be consistent with the current regulatory position on the scale of operation at which it is appropriate for suppliers to comply with certain obligations. For example, SLC 27.2 – which requires suppliers to offer a wide range of

payment methods – applies only to suppliers with more than 50,000 domestic customers.

6.337 We recognise that the implementation of the proposed remedy might impose costs on suppliers. In particular, billing systems would need to be able to record and aggregate consumption across all registers on a meter and, possibly, all meters in a home or allow for meter-specific tariffs where the standing charge and all unit rates are the same as those for the relevant single-rate tariff. However, given that First Utility and Utility Warehouse currently make their single-rate SVT and single-rate fixed-term tariffs available to new and existing customers (with no requirement to change meters), we would not expect these costs to suppliers to be significant.

6.338 In addition, as set out in Appendix 3.1 (see paragraphs 10 to 16), given the efficiencies inherent to the operation of the heating systems supported by restricted meters, we would expect the direct costs to suppliers of supplying customers with these systems to be lower.

- *Least onerous if there is a choice between several effective measures*

6.339 As regards potential alternative remedies, our view is that there are no alternatives to the proposed remedy that would be both less onerous and as effective in achieving the aims of the remedy. The options we have considered for making the remedy less onerous would be to either exclude more suppliers from the obligation to comply with the proposed remedy (but this could have the effect of removing some of the cheapest single-rate tariffs from the scope of the remedy) or exclude certain customers on restricted meters from the scope of the remedy (which would undermine the aim of the proposed remedy for all customers on restricted meters). Therefore neither alternative would be as effective as the proposed remedy.

- *Does not produce disadvantages which are disproportionate to the aim*

6.340 In relation to potential unintended adverse consequences arising from this proposed remedy, we note that, according to our analysis, it will not necessarily be in the interests of all customers on restricted meters to move to a single-rate meter tariff, so it is important that customers are able to make an informed choice about the value for money of the options available to them. In this regard, this proposed remedy complements our proposed recommendation to Citizens Advice (see below).

Access to information and advice

6.341 In order to address the heightened feature we have provisionally found (among others) to be giving rise to the Domestic Weak Customer Response AEC concerning customers on restricted meters, ie that such customers face additional barriers to accessing and assessing information, we propose to implement a remedy concerning the information provided to, and available to, customers on restricted meters about their ability to switch supplier. This proposed remedy would also address, in part, the limited awareness that customers on restricted meters have of their ability to switch. In particular, we propose to implement:

- (a) An order on gas and electricity suppliers (and amendments to suppliers' standard licence conditions) requiring suppliers to:
 - (i) remind their domestic electricity customers on restricted meters, in their regular communications with them, that they have the option to switch supplier or to switch to a single-rate tariff without having to change their meter or incur replacement costs;
 - (ii) provide their domestic electricity customers on restricted meters with contact details for Citizens Advice; and
 - (iii) provide, on a timely basis, Citizens Advice with the information it may reasonably require concerning customers on restricted meters in the format specified by Citizens Advice.
- (b) A recommendation to Citizens Advice to become a recognised provider of information and support to domestic electricity customers on restricted meters.

Aim of the remedy

6.342 The aim of the proposed remedy would be to reduce barriers to accessing and assessing information by customers on restricted meters and to increase the awareness of customers on restricted meters of their ability to switch. Accordingly, the ultimate aim of this proposed remedy would be to partly address two of the features giving rise to the Domestic Weak Customer Response AEC (and resulting detriment).

Design considerations

6.343 In the following section, we have considered:

- (a) whether we should make a recommendation to a designated body that it should become a recognised provider of information and support for customers on restricted meters;
 - (b) whether Ofgem or Citizens Advice would be better placed to be a recognised provider of information and support for customers on restricted meters; and
 - (c) whether we should specify the scope of the information and support provided to customers on restricted meters.
- 6.344 We consider that we cannot rely on suppliers to provide their customers on restricted meters with the information they need to understand the options available to them and to make informed decisions, as suppliers' incentives are not, in this instance, aligned with those of their customers. In particular, an existing supplier will not have the incentive to provide its customers with information that could result in its customers switching to rival suppliers. In addition, an existing supplier will not necessarily be in a position to advise its customers on what rival suppliers could offer them.
- 6.345 For these reasons, our provisional view is that having a recognised and trusted source of market-wide information is essential to promoting engagement among customers on restricted meters.
- 6.346 With regard to who this body should be, we have considered Ofgem and Citizens Advice. On balance, our provisional view is that Citizens Advice is better placed. In particular, this role seemed to have a good fit with the remit of Citizens Advice. Citizens Advice is already providing information online, by telephone and face-to-face on energy suppliers and their offers; and it has an established reputation for providing advice to customers. Finally it was consumer bodies including Citizens Advice that drew our attention to particular problems faced by customers with certain types of restricted meters and the outcomes for them. In contrast, Ofgem is less widely recognised by customers and does not provide detailed advice to specific consumers.
- 6.347 With regard to the scope of the information and support provided by Citizens Advice to energy customers, we would expect Citizens Advice to be in a position:
- (a) to advise customers on their rights to switch suppliers and to switch to single-rate tariffs retaining their current meter;
 - (b) to advise customers on the factors to take into account in comparing the options available to them; and

- (c) to help customers access the information they need to compare their options. We consider that Citizens Advice is well placed with the launch of its price comparison facility to help energy customers to access and understand information on how tariffs and bills might compare.

Assessment of effectiveness

6.348 In assessing the effectiveness of the proposed remedy, we have considered the following factors:

- (a) whether our proposed remedy would be expected to promote engagement amongst customers on restricted meters;
- (b) the extent to which the proposed remedy is capable of effective implementation, monitoring and enforcement; and
- (c) the timescale over which the remedy is likely to have an effect.

6.349 Our provisional view is that the proposed remedy could be expected to achieve the aims as set out in paragraph 6.342. In particular this proposed remedy would be effective in reducing barriers to accessing and assessing information by customers on restricted meters and increase customers' awareness of their ability to switch. Accordingly, the ultimate aim of this proposed remedy would be to partly address two of the features giving rise to the Domestic Weak Customer Response AEC (and resulting detriment).

6.350 As regards the implementation of the proposed remedy, our approach (as set out above) is to specify what the proposed remedy would require of suppliers and Citizens Advice. For suppliers the remedy should be straightforward to implement. All that would be required of them would be to advise their customers on restricted meter of their rights to switch suppliers and to switch to single-rate tariffs using existing routine communications, and to cooperate with requests for information from Citizens Advice.

6.351 As set out above, we consider that Citizens Advice is well placed to provide information and support to customers on restricted meters. In particular, this would just be an extension of its existing activities in the provision of the information and support it provides to energy customers online, by telephone and face-to-face. Also, the proposed remedy would explicitly provide for the cooperation of suppliers in providing Citizens Advice with information it might need from them.

6.352 As regards monitoring compliance with the proposed remedy, we note that this should be straightforward, as Citizens Advice and Ofgem could report to

the CMA if any supplier fails to comply with the orders, and Ofgem would be responsible for monitoring compliance with the licence conditions.

6.353 As regards the timescale for implementation of the proposed remedy, the CMA would start drafting and consulting on an order in the six-month period following publication of our final report. We would expect suppliers to be able to start providing the relevant information by April 2017. We would expect this to lead to increased engagement from customers on restricted meters from April 2017.

6.354 As regards the proposed recommendation to Citizens Advice to become a recognised provider of information and support for customers on restricted meters, we would expect Citizens Advice to be able to progress the implementation of this remedy immediately following publication of the CMA's final report.

Assessment of proportionality

6.355 In this section we set out our assessment of whether the proposed remedy would be a proportionate remedy.

- *Effective in achieving its legitimate aim*

6.356 For the reasons given above (see paragraph 6.348 to 6.354), our provisional view is that the proposed remedy would be effective in achieving its aim of reducing barriers to accessing and assessing information by customers on restricted meters and increasing such customers' awareness of their ability to switch. Accordingly, it would partly address two of the features giving rise to the Domestic Weak Customer Response AEC (and resulting detriment).

- *No more onerous than needed to achieve its aim*

6.357 We also consider that the remedy is no more onerous than required. In particular, as stated above, the information that suppliers would be required to give their customers on restricted meters is limited and straightforward, and could be provided in existing communications. We therefore consider that the cost imposed on suppliers would be minimal.

6.358 For the reasons given at paragraph 6.346, we consider that Citizens Advice is well placed to provide customers with information on the options available to them and provide support when assessing this information. We also consider that the recommendation in the proposed remedy in relation to information and support that Citizens Advice should provide (see paragraph 6.347) is no more than may be required by customers on restricted meters to

understand the options available to them and to make informed choices. We consider that without providing customers with access to such information, we cannot expect to promote engagement.

- *The least onerous if there is a choice between several effective measures*

6.359 As regards potential alternative remedies, our view is that there are no alternatives to the proposed remedy that would be both less onerous and effective in achieving the aims of the remedy. In particular, the remedy provides for ensuring that customers are aware of the options available to them (which will change as a result of the proposed remedy) and where they can get reliable information and advice. Any changes to the remedy that would require less of suppliers and/or Citizens Advice would, in our view, be seriously damaging to the aims of promoting customer awareness and ensuring customers have access to the information they need to make informed choices.

- *Does not produce disadvantages which are disproportionate to the aim*

6.360 In relation to potential adverse consequences arising from this proposed remedy, we have not identified any disadvantages to customers on restricted meters arising from being advised by their existing suppliers, in routine communications, of their rights to switch supplier and to single-rate tariffs and being provided with contact details for Citizens Advice.

Ofgem's statutory duties

6.361 As stated in Section 5, where the CMA is considering whether to take action for the purpose of modifying one or more of the conditions of a retail gas or electricity supplier's licence, in deciding whether such action would be reasonable and practicable, the CMA must 'have regard' to the relevant statutory functions of Ofgem.

6.362 Ofgem's statutory duties and functions, set out in the EA89 and the GA86, as amended by the EA10, have set competition as a secondary objective, with the principal objective being the interests of existing and future consumers taken as a whole, including decarbonisation, security of supply and the fulfilment by Ofgem of the objectives set out in Article 40(a) to (h) of the Gas Directive and Article 36(a) to (h) of the Electricity Directive.

6.363 Ofgem is generally required to carry out its functions in the manner it considers best calculated to further the principal objective. Before deciding to carry out its functions in a particular manner with a view to promoting

competition, Ofgem must consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests, having regard (among other things) to (i) the need to secure that, so far as economical to meet them, all reasonable demands for gas and electricity supply are met and can be financed; (ii) achieving sustainable development; and (iii) the interests of 'vulnerable' consumers.

- 6.364 In reaching our provisional decision to introduce new licence conditions on suppliers concerning these proposed remedies focused on customers on restricted meters we have, as part of our own application of the legal framework requiring us to decide upon proposed remedies that are effective and proportionate, taken into account Ofgem's statutory duties and objectives below.
- 6.365 In particular, we do not consider that any aspect of the aforementioned proposed remedies will have an adverse impact on suppliers' ability to meet all reasonable demands for gas and electricity supply, achieving sustainable development, security of supply or environmental concerns. We consider that our proposed remedies will directly engage Ofgem's principal objective of protecting the interests of existing and future consumers, including vulnerable consumers.
- 6.366 As noted above, the proposed remedies would enhance competition in the restricted meter segment as suppliers will be required to make available more tariffs to customers in the restricted meter segment. This could potentially exert downward pressure on the tariffs available to customers on restricted meters. The proposed remedies would also ensure that there are no barriers for customers to switch to cheaper single-rate electricity tariffs (as they will not be required to change the meter or incur in any replacement costs to avail of these tariffs), and that customers on restricted meters are informed about their tariff options by energy suppliers and Citizens Advice. Accordingly, as a result of the proposed remedies we would expect customers on restricted meters to benefit from cheaper single-rate tariffs.
- 6.367 Our provisional view is that both proposed remedies satisfy Ofgem's principal objective of protecting the interests of existing and future consumers wherever possible by promoting effective competition.

7. Retail supply to domestic customers: protecting customers who are less able to engage to exploit the benefits of competition

- 7.1 This section sets out our provisional decision on the introduction of a price cap remedy to address the detriment suffered by customers on prepayment meters. It is structured as follows:
- (a) First, we discuss the rationale for the proposed remedy and its scope, drawing on the analysis presented in the previous sections of this report;
 - (b) Then we set out the aim of the proposed remedy;
 - (c) Then we provide a summary of parties' views;
 - (d) Next, we discuss the design options that we have considered, including the structure and form of the cap, its stringency, duration and the way we propose to implement the proposed remedy (this assessment constitutes the bulk of this section, with further details provided in Appendix 7.1); and
 - (e) Finally, we set out our assessment of the effectiveness and proportionality of the proposed remedy.

Rationale for the remedy and proposed scope

- 7.2 We have provisionally identified a number of AECs affecting domestic retail energy markets – in particular, the Weak Customer Response AEC, the Prepayment AEC and the RMR AEC (the Domestic AECs).⁸⁷⁹ In Section 3, we set out our updated thinking and analysis concerning the features contributing to the Domestic AECs and the detriment arising from them, distinguishing between customers according to a variety of dimensions, including tariff type, meter type and payment method.
- 7.3 Our updated analysis of prices and bills suggests that the Domestic AECs have led to substantial levels of detriment for domestic customers, of around £1.7 billion per year over the last three and a half years, with a marked increase in detriment year on year. We have noted a considerable variation in the detriment suffered by customers of different suppliers and between different categories of customer of the Six Large Energy Firms. For dual fuel customers at Ofgem's medium Typical Domestic Consumption Value (TDCV), for example, detriment for prepayment customers was substantially

⁸⁷⁹ We also note the likely impact that our proposed remedies concerning the Gas settlement AEC and Electricity settlement AEC will have in increasing engagement by domestic (and microbusiness) customers.

higher over the period (equivalent to 15% of the bill) than that for standard credit customers (11% of the bill) and direct debit customers (10% of the bill).⁸⁸⁰

- 7.4 In Sections 5 and 6, we proposed a range of remedies designed to address aspects of the features contributing to the Domestic AECs directly, including measures to help create a framework for effective competition and a range of measures to help improve customer engagement. We noted in Section 4 that, while we believe such measures will be effective in addressing the features contributing to each of the Domestic AECs, they will take time to implement before they start to address the features we have identified and, in turn, reduce the detriment to domestic customers arising from them. For example, we would expect the Database remedy and the Ofgem-led Programme to start to improve customer engagement by 2018 and 2019 respectively.⁸⁸¹ In addition, the roll-out of smart meters will ultimately address aspects of the features contributing to the Prepayment AEC (eg the technical constraints on suppliers' ability to offer prepayment customers any number of tariffs) and help improve customer engagement,⁸⁸² but the roll-out is not due to be completed until the end of 2020.
- 7.5 The implication of this is that we expect the detriment arising from the Domestic AECs we have provisionally identified to persist for the next few years. Therefore, given the size of the detriment we have observed, we have considered the need to intervene to address domestic customer detriment directly in this transitional period, through a proposed price cap remedy.

Assessment of the case for a prepayment price cap

- 7.6 Given the interventionist nature of a price cap remedy, and the potential for adverse consequences, we have considered very carefully both the need for, and the appropriate scope of, a price cap remedy, and we have provisionally concluded that a price cap should apply to domestic customers on prepayment meters for a transitional period (2017 to the end of 2020). In reaching this provisional decision, we have given particular consideration to the following:
- (a) The Domestic AECs we have provisionally identified, the features contributing to them, the relative strength of those features as they apply to different categories of customer, and the extent to which, and when,

⁸⁸⁰ See Section 3.

⁸⁸¹ See Section 4.

⁸⁸² See also our discussion in paragraph 7.173.

our other proposed remedies concerning the Domestic AECs will address aspects of those features.

- (b) The scale of the detriment that we have observed, as well as the extent to which the detriment differs between different categories of customer and will be affected by our other proposed remedies.
- (c) The potential for adverse consequences from the introduction of a price cap,⁸⁸³ and how these might be expected to differ according to the scope, design and duration of the price cap remedy.
- (d) The practicability of implementing a cap on a sufficiently timely basis to address the detriment, in particular during the period while our other proposed remedies take effect.

7.7 In relation to the Domestic AECs, we have taken particular account of the strength of the features contributing to the Prepayment AEC and the Domestic Weak Customer Response AEC as it applies to prepayment customers.⁸⁸⁴ Our assessment of the need for a price cap across all SVT customers is set out in paragraphs 7.15 to 7.18.

7.8 Regarding the Prepayment AEC, prepayment customers have been able to access much lower gains from switching than other customers, even though they pay on average higher prices. We note that this has been due in part to the effect of technical restrictions arising from the dumb prepayment infrastructure, and that smart meters should not be subject to such restrictions. In that regard we have seen recent changes in the prepayment segments including an increase in the share of independent suppliers offering smart tariffs.⁸⁸⁵ However, we have yet to see significantly lower prices or, most importantly, evidence of a substantial reduction in detriment.

7.9 We believe that our proposed prepayment remedies⁸⁸⁶ and engagement remedies⁸⁸⁷ will help improve the conditions for competition in the prepayment segments, but these will take some time to implement and have an effect on detriment, and may not fully address the detriment arising from the Prepayment AEC until smart meters have been substantially rolled out (scheduled for the end of 2020).⁸⁸⁸

⁸⁸³ We discuss the interaction of the proposed price cap remedy with our other proposed remedies in Section 8.

⁸⁸⁴ See further paragraph 7.11 below.

⁸⁸⁵ See Section 3.

⁸⁸⁶ See Section 5.

⁸⁸⁷ See Section 6.

⁸⁸⁸ See Section 4 for further consideration of the timescales over which we expect our remedies to remedy the detriment.

- 7.10 In relation to the Domestic Weak Customer Response AEC, we note that in our survey prepayment customers were considerably less likely to have ever considered switching or to consider switching in the next three years than direct debit customers. We also note that lower engagement by prepayment customers will contribute to the features giving rise to the Prepayment AEC concerning softened incentives for suppliers to compete to acquire prepayment customers.
- 7.11 The level of detriment suffered by prepayment customers is particularly high. Over the period 1 January 2012 to 30 June 2015, detriment expressed as a proportion of the bill for prepayment customers of the Six Large Energy Firms at Ofgem's medium TDCV was higher than that for direct debit and standard credit customers for both dual fuel customers (15% for prepayment, 11% for standard credit, 10% for direct debit) and single fuel electricity customers (13% for prepayment customers, 11% for standard credit and 9% for direct debit). For single fuel gas customers, the levels of detriment were uniformly high for the three payment types (between 16% and 18%).⁸⁸⁹ Further, we note that, unlike other customers, where prepayment customers pay too high a price, part of the detriment is felt in curtailed consumption.
- 7.12 The detriment we have calculated for prepayment customers is also increasing, reaching £178 a year by 30 June 2015 for a dual fuel single rate meter prepayment customer consuming at Ofgem's TDCV, and £481 million a year for all prepayment customers.⁸⁹⁰
- 7.13 We have assessed the potential for adverse consequences arising from a price cap in more detail below, in the section on proportionality.⁸⁹¹ However, we note that in principle, a cap covering a relatively restricted proportion of consumers, such as prepayment customers⁸⁹² is likely to produce milder and more limited adverse consequences than a cap covering a broader group.⁸⁹³
- 7.14 The practicability of a price cap is also closely linked to its detailed design which we consider below. However, we consider that, in principle, the use of an easily identifiable criterion for qualification (such as being on a

⁸⁸⁹ See Section 3.

⁸⁹⁰ The analysis in Table 4 in Appendix 3.3 outlines total prepayment detriment of £486 million for 2015. This is the average detriment for 2015. The figure of £481 million above is the observed level of detriment at 30 June 2015 for customers of the Six Large Energy Firms.

⁸⁹¹ See paragraphs 7.221–7.268.

⁸⁹² 15% of gas customers and 16% of electricity customers have a prepayment meter.

⁸⁹³ We note that the larger the group of customers affected by a price cap, the greater the magnitude of any distorted incentive and that similarly a greater number of customers would be affected by any distorted incentives if the scope of the price cap were wider.

prepayment meter) will help ensure that the remedy is easily implementable within a short period of time. This is in contrast, for example, to potential approaches based on the use of data matching through the benefits system to try to target customers with particular demographic characteristics.⁸⁹⁴

Assessment of the case for a price cap across all SVT customers

- 7.15 While the detriment suffered by prepayment customers is particularly high, we note that other domestic customers will also suffer detriment during the transitional period, and have therefore given consideration to the application of a price cap to broader categories of customers, notably all SVT customers.
- 7.16 In the Remedies Notice we outlined a transitional ‘safeguard regulated tariff’ remedy for disengaged domestic customers. The Remedies Notice outlined that under this possible remedy, the maximum price level for default tariffs would be set by either the CMA or Ofgem – we refer to this possible remedy in this document as the SVT Price Cap Remedy. We noted the risks inherent in remedies which seek to control outcomes and how the scale of these risks relates to the form and scope of the safeguard tariff being contemplated. A number of respondents provided details of particular risks associated with the SVT Price Cap Remedy, with many respondents identifying a risk of distorting incentives and unintended consequences across the domestic and SME retail energy markets.⁸⁹⁵
- 7.17 Our provisional view is that the costs of attempting to address the detriment of all SVT customers through a price cap would likely be disproportionate. We believe that attempting to control outcomes for the substantial majority of customers (approximately 72% of electricity customers and 69% of gas customers of the Six Large Energy Firms were on the SVT as of 30 June 2015⁸⁹⁶) would – even during a transitional period – run excessive risks of undermining the competitive process, potentially resulting in worse outcomes for customers in the long run. This risk might occur through a combination of reducing the incentives of suppliers to compete and reducing the incentives of customers to engage.
- 7.18 Since, as noted in Section 3, a large part of the detriment we have observed in the form of high prices is likely due to inefficiency rather than excess profits, we believe the best, most sustainable approach to reducing this

⁸⁹⁴ We have considered the relationship between demographic characteristics and disengagement in Appendix 6.3.

⁸⁹⁵ See Appendix 7.1 for a summary of responses to the Remedies Notice.

⁸⁹⁶ See paragraph 6.247.

detriment in the long term is through fully competitive markets, in which more efficient suppliers gradually replace less efficient suppliers. Having considered very closely both the short-term benefits to customers and the longer-term risks that a broader cap may create, set against the features of the Domestic Weak Customer Response AEC, we have provisionally decided, on balance, not to propose an intervention to control prices across all customers on standard variable tariffs.

Summary of the provisional remedy decisions

- For the reasons set out below, we have provisionally decided to implement a transitional price cap on the maximum level of annual bills for domestic customers with prepayment meters, including prepayment restricted meters (the PPM Price Cap Remedy). The operation of this proposed remedy is described in paragraphs 7.78 to 7.148 below.
- We have provisionally decided not to implement a transitional safeguard regulated tariff for other domestic customers.

Aim of the remedy

- 7.19 The aim of the proposed price cap remedy (the PPM Price Cap Remedy) is to mitigate the residual detriment suffered by domestic customers on prepayment meters arising from the Prepayment AEC and the Domestic Weak Customer Response AEC during the transitional period. The transitional period is the period during which our other proposed remedies concerning the Prepayment AEC and the Domestic Weak Customer Response AEC are expected to take full effect, and before the substantial completion of the roll-out of smart meters by the end of 2020.
- 7.20 The price cap will be a transitional measure which will be closely linked to the national programme for the roll-out of SMETS 2 smart meters, reflecting our provisional view that the features that we have observed that give rise to the Prepayment AEC will be, to a significant extent, addressed once the vast majority of prepayment customers have a SMETS 2 smart meter and are able to benefit from suppliers being appropriately able and incentivised to compete for their business. We also believe, albeit over a longer period, that smart meters will help to improve customer engagement and help address the features contributing to the Domestic Weak Customer Response AEC and associated detriment.
- 7.21 In this way, the price cap will mitigate the full detriment while our other proposed remedies are implemented, and will mitigate the residual detriment

once the other proposed remedies have been introduced until the conclusion of the national programme for the roll-out of smart meters. In designing the remedy we have sought to help preserve suppliers' (both existing and new entrants') incentives to compete and mitigate the risk that suppliers are not able to earn adequate revenues under the cap.

Parties' views

7.22 We received responses in relation to both the SVT Price Cap Remedy and the PPM Price Cap Remedy. We have summarised the responses to each remedy separately below. A more detailed summary of parties' views is included in Appendix 7.1, Annex A (for the SVT Price Cap Remedy) and Annex B (for the PPM Price Cap Remedy).

Responses in respect of the SVT Price Cap Remedy

- 7.23 Responses in respect of the SVT Price Cap Remedy came from a wide range of parties including the Six Large Energy Firms, the Mid-tier Suppliers, smaller suppliers, consumer groups, individuals, academics, former regulators, PCWs, Ofgem and charities. Common themes raised by respondents were possible unintended consequences, proportionality, legality, scope, design, frequency of price cap reassessment, duration, possible implementation and transitional arrangements and structure of a price cap. Some respondents commented on the extent of their opposition to any cap.⁸⁹⁷ Other respondents were supportive of one or both proposals.⁸⁹⁸
- 7.24 Some respondents considered that any transitional safeguard regulated tariff may be likely to undermine innovation and/or developments in the market and have unintended consequences such as reduced consumer engagement.⁸⁹⁹
- 7.25 Other respondents agreed and considered that the 'safe haven' effect was likely to ensure a large number of customers remained on the safeguard tariff (either actively or passively), despite the presence of more competitive

⁸⁹⁷ Centrica, EDF Energy, E.ON, RWE, SP, SSE, Engie, Gazprom, Green Energy UK, [redacted], Drax, [redacted], Energy Action Scotland, Energy UK, Flow energy, [redacted], Haven Power, [redacted], Opus Energy, University of East Anglia, George Yarrow, Littlechild et al, Behavioural Insights Team, [redacted], CBI, Energy Action Scotland, First Utility, Spark Energy.

⁸⁹⁸ Federation of Small Businesses, Utility Warehouse, [redacted], Christians Against Poverty, [redacted], Ecotricity, Citizens Advice, Co-operative Energy, [redacted], Which?.

⁸⁹⁹ Centrica, Citizens Advice, [redacted], EDF Energy, Energy Action Scotland, Energy UK, E.ON, Flow Energy, Gazprom, Good Energy, Haven Power, ICOSS, Invesco Perpetual, Labrador, MoneySuperMarket, Ofgem, Spark Energy, SSE, Total Gas and Power, University of East Anglia, uSwitch, Utility Warehouse, [redacted].

offers.⁹⁰⁰ Ofgem said that there was a risk that the tariff could reduce incentives to engage and switch tariff or supplier.⁹⁰¹ Another respondent suggested that the safeguard tariff could act against the remedies that are designed to improve switching and engagement.⁹⁰²

- 7.26 Some respondents suggested there was a risk to quality of service and that the quality of service received by customers on the transitional safeguard regulated tariff could be reduced.⁹⁰³ Other respondents did not consider this to be the case.⁹⁰⁴ In addition it was noted that as the proportion of customers on a default tariff dwindled, any remaining customers on it would likely be the most disengaged – these customers were more likely to remain on that tariff even if service levels were poor.⁹⁰⁵ Ofgem agreed that a transitional safeguard regulated tariff could result in pressure on service provision but noted that it regulated aspects of service provision and had taken enforcement action in the past.
- 7.27 Some respondents drew attention to international examples of risks associated with price controls suggesting that these showed that price controls should be removed as they reduced price dispersion and weakened competition.⁹⁰⁶
- 7.28 Many respondents were concerned that in view of the many potential unintended consequences as discussed above, the proposed transitional safeguard regulated tariff was not a proportionate remedy. They asserted there was a lack of sufficiently robust evidence of harm, that the CMA had overstated the level of disengagement, the proposal would not be proportionate, and that the case for such radical intervention had not been made.⁹⁰⁷
- 7.29 Respondents referred to various pieces of EU policy, regulation and legislation (EU Consumer Rights Directive, Internal Energy Market Directives, Energy Liberalisation Directive, EU Third Package) and in particular that any transitional safeguard regulated tariff should not be

⁹⁰⁰ Centrica, EDF Energy, E.ON, Scottish Power, [9], Drax, Energy UK, Good Energy, Gocompare.com, University of East Anglia, MoneySuperMarket, Flow Energy.

⁹⁰¹ Ofgem.

⁹⁰² Which?

⁹⁰³ uSwitch, Total Gas and Power, Centrica, SSE.

⁹⁰⁴ E.ON, Scottish Power.

⁹⁰⁵ Centrica.

⁹⁰⁶ Centrica, Scottish Power, SSE.

⁹⁰⁷ Centrica, Scottish Power, SSE.

applied only to the Six Large Energy Firms as this would be discriminatory.⁹⁰⁸

- 7.30 Respondents were concerned at how any transitional safeguard regulated tariff would be scoped. One respondent said that the CMA had not provided a clear definition of those customers it believed were 'inactive'⁹⁰⁹ and that it was important not to equate SVT customers and inactive customers as many SVT customers were not properly considered inactive or disengaged.
- 7.31 One respondent said that any transitional safeguard regulated tariff should apply to all suppliers, including white labels. The instance of evergreen tariffs being significantly more expensive than fixed deals was most prevalent among large suppliers but was by no means restricted to them.⁹¹⁰ Many of the independent suppliers said that any transitional safeguard regulated tariff should be restricted to the Six Large Energy Firms since that was where the disengaged customers on SVTs were.⁹¹¹ Ofgem suggested that if 'sticky' domestic customers were targeted then it should be limited to the Six Large Energy Firms.
- 7.32 Two respondents commented on the complexity of cost recovery through tariffs, as the choice of tariff would introduce considerable complexity for those tasked with tariff design,⁹¹² and the need to determine for any transitional safeguard regulated tariff what proportion of fixed costs should be recovered through the unit rate and which through the standing charge.⁹¹³
- 7.33 The majority of the Six Large Energy Firms (all excluding SSE) outlined their preference for a cost-plus approach due to the reduced risk of unintended consequences as a result of this approach compared with a relative price cap. Other respondents were broadly in favour of the cost-plus approach while noting various difficulties that this might cause.⁹¹⁴
- 7.34 Some respondents also outlined the difficulties in identifying appropriate cost bases and benchmarks for a cost-plus approach. Respondents also had particular concerns around the challenges of cost determination (and therefore cost plus) for wholesale costs, non-energy costs, the impact on the wholesale market and ex post costs, as well as the increasing risk and

⁹⁰⁸ RWE, Scottish Power, SSE.

⁹⁰⁹ RWE.

⁹¹⁰ Citizens Advice.

⁹¹¹ Drax, Gazprom, Haven Power, Total Gas and Power, ICOSS, [REDACTED].

⁹¹² RWE

⁹¹³ RWE, SSE.

⁹¹⁴ [REDACTED], Energy Policy Group (University of Exeter), Haven Power, ICOSS, Total Gas and Power, University of East Anglia, [REDACTED], Drax.

increased costs of managing these positions.⁹¹⁵ Ofgem noted the intensive data requirements of a cost-plus model and that suppliers might challenge the assumptions and methodologies used. Ofgem suggested that some form of agreed indexation to a starting position could minimise such challenge.

- 7.35 Two respondents suggested that a relative approach should be set at a percentage of a supplier's most competitive tariff. This would reduce the gap between new and existing tariffs.⁹¹⁶ Another respondent said that the methodology risked linking the price of a default variable priced product with energy products that currently had very different characteristics, causing volatility of the price of a transitional safeguard regulated tariff.⁹¹⁷
- 7.36 One respondent suggested that reassessment would be needed sufficiently frequently to reflect any changes in underlying cost bases, as well as assumptions made around the wholesale energy hedging strategies.⁹¹⁸ Another respondent noted that the target group for this remedy was customers who had been on the SVT for some time and were used to prices moving infrequently, normally once or twice per year.⁹¹⁹ With regard to the safeguard regulated tariff another respondent advocated a clear rule that balanced avoidance of bill shock (if costs rose), delay to passing on benefits (if costs fell), the costs of administering price changes and the impact to customers from increased frequency of price changes.⁹²⁰
- 7.37 Seven respondents⁹²¹ recognised that a clear plan as to how any transitional safeguard regulated tariff would be phased out was required while one added that a regular review process, given the uncertainties about the impacts and effectiveness of this remedy in practice,⁹²² was also required.
- 7.38 Parties outlined various thoughts around transition arrangements, with the requirements being highly dependent on the type of safeguard tariff introduced. Some respondents⁹²³ described the workload surrounding the migration of millions of customers to new tariffs, the significant customer disruption, and communication issues.

⁹¹⁵ Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE.

⁹¹⁶ Ecotricity, Utility Warehouse.

⁹¹⁷ RWE.

⁹¹⁸ Centrica.

⁹¹⁹ EDF Energy.

⁹²⁰ E.ON.

⁹²¹ Centrica, Scottish Power, SSE, uSwitch, Which?, Haven Power, Ofgem.

⁹²² Centrica.

⁹²³ Centrica, SSE.

- 7.39 Respondents recognised that where the tariff may need constant monitoring and adjustment, this would best fall to Ofgem.⁹²⁴
- 7.40 One respondent said that a transitional safeguard regulated tariff should be based on the 'rising block' approach (first block is cheap, second is more expensive and third even more so). A variation could be vulnerable customers getting the first block free.⁹²⁵ Another respondent suggested that Ofgem should have power to regulate the tariffs of any supplier if it believed the differential between the most expensive and cheapest tariff was wider than a set rate.⁹²⁶

Responses in respect of the PPM Price Cap Remedy

- 7.41 Responses in respect of the PPM Price Cap Remedy came from a wide range of parties including the Six Large Energy Firms, the Mid-tier Suppliers, smaller suppliers, consumer groups and Ofgem. Common themes raised by respondents were proportionality, setting an appropriate level of the cap, quality of service impacts, headroom, information requirements, duration, frequency of price cap reassessment, scope, possible implementation and transitional arrangements, circumvention risks, and unintended consequences. Most respondents were suppliers that were strongly opposed to the safeguard price cap.⁹²⁷
- 7.42 Seven respondents said that they did not consider a price cap to be a justified or proportionate response to the harm identified.⁹²⁸ Centrica said that if the CMA did set prices relative to other prices, then it should be done with reference to other prepayment tariffs in the market (and not to direct debit or credit tariffs).⁹²⁹
- 7.43 Four respondents saw it as unlikely that a supplier would actively reduce the quality of service offered to customers on a regulated prepayment tariff but suggested other impacts.⁹³⁰ Two respondents expressed the view that it was unlikely that suppliers would reduce the level of service made available to prepayment customers unless the reference price was based on a similarly reduced level of customer service.⁹³¹ Two respondents suggested that there was a risk to quality of service towards levels that were of a minimum

⁹²⁴ ICOSS, Gazprom, Citizens Advice.

⁹²⁵ Energy Policy Group (University of Exeter).

⁹²⁶ Good Energy.

⁹²⁷ Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE, Good Energy, Utilita Energy.

⁹²⁸ Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE, First Utility.

⁹²⁹ Centrica.

⁹³⁰ Scottish Power, First Utility, SSE, E.ON.

⁹³¹ EDF Energy, Good Energy.

acceptable standard, as suppliers sought to protect squeezed margins. This could clearly be the case if the safeguard tariff, as an unintended consequence, failed to allow for efficient recovery of costs.⁹³²

- 7.44 One respondent suggested that suppliers would not have adequate incentives to minimise prices and hence it may not be appropriate to have any ‘headroom’ in the price cap.⁹³³ Another respondent was concerned that there was no method of calculating the headroom that would guarantee no serious adverse effects on the current healthy levels of competition.⁹³⁴ One respondent said that headroom on the safeguard cap should allow for a profit margin that was sufficient to ensure a price point that incentivised customers to engage with the markets, (although they also noted that even in this case there was likely to be a ‘safe haven’ effect as occurred in New South Wales).⁹³⁵
- 7.45 One respondent said that setting a cap with sufficient headroom would be vital and that headroom should be sufficient to give customers an incentive to engage in the market and switch tariff. The headroom would also need to provide sufficient scope for suppliers to manage the risk of changes in costs.⁹³⁶
- 7.46 Respondents gave a variety of views on what information would be required. One respondent suggested that the information required to set a cap would be deep knowledge of existing prepayment suppliers’ and prospective new entrants’ costs. For example, there would need to be a detailed understanding of full hedging requirements, and balancing costs including liquidity constraints. The respondent also said that if the cap was to reflect regional cost differences, detail on cost bases by region would also be required. They also stressed the importance of ensuring that such a calculation was not simply done at ‘average’ consumption as to do so would fail to take account of how different standing charge and unit rate configurations impacted low or high consuming customers, and how that might make any such cap too high or too low for all but ‘average’ customers. Taking this into account in each of the 14 different regions, for each of the various fuel and meter combinations, would be complex.⁹³⁷ Another respondent identified that the key information required would be prices charged for the reference tariffs, and the number of accounts, in total,

⁹³² Centrica, RWE.

⁹³³ Citizens Advice.

⁹³⁴ SSE.

⁹³⁵ Centrica.

⁹³⁶ EDF Energy.

⁹³⁷ Centrica.

associated with those reference tariffs. This data would need to be regularly updated to reflect pricing changes.⁹³⁸

- 7.47 One respondent said that if a price cap was introduced, it should lapse after a specified and reasonable period of time, and at the latest towards the end of the smart meter roll-out.⁹³⁹ Another respondent agreed saying that it should include a sunset clause, of 2020 at the latest, linked to the roll-out of smart meters, with a review in 2018.⁹⁴⁰ Another respondent agreed that there should be a sunset clause such that the price control lapses at a particular date (or when a well-defined milestone had been met) and also suggested the end of 2018 (linked to smart meter roll-out).⁹⁴¹
- 7.48 Views on the frequency of reassessment varied from three months to a year with most respondents considering six months or a year to be necessary. One respondent considered that the level of any cap would need to be reassessed at least annually to keep the prepayment safeguard tariff cap aligned to prevailing costs, but not much more frequently than annually.⁹⁴² One respondent highlighted the link between the period between reassessment of the price cap and the hedging strategy implicit in the cap. It said that longer periods would require more 'buffer' and would increase the need for mechanisms in order to pass through cost shocks.⁹⁴³
- 7.49 Views on scope were mixed. One respondent said that this remedy should apply to all SVT prepayment customers.⁹⁴⁴ Another respondent said that it was not proportionate for any prepayment customers.⁹⁴⁵ One respondent said that it was in favour of protecting vulnerable customers but that prepayment customers were an extremely poor proxy for these and the proposed remedy would have high costs of monitoring.⁹⁴⁶ One respondent said that it did not believe that customers on smart prepayment meters should be covered by the cap, and thus any customer switching from traditional to a smart prepayment meter should fall out of any cap regime.⁹⁴⁷
- 7.50 Seven respondents said that, if implemented, this remedy should apply to all suppliers.⁹⁴⁸ EDF Energy suggested that otherwise the customers of exempt

⁹³⁸ Citizens Advice.

⁹³⁹ Centrica.

⁹⁴⁰ E.ON.

⁹⁴¹ Scottish Power.

⁹⁴² RWE.

⁹⁴³ First Utility.

⁹⁴⁴ RWE.

⁹⁴⁵ EDF Energy.

⁹⁴⁶ SSE.

⁹⁴⁷ Good Energy.

⁹⁴⁸ RWE, Centrica, Scottish Power, EDF Energy, SSE, E.ON, Citizens Advice.

suppliers would not be not offered the same level of protection as those with non-exempt suppliers.⁹⁴⁹

- 7.51 Parties outlined various thoughts around transition arrangements, with the requirements being highly dependent on the type of safeguard tariff introduced. One respondent said that a transition period (unspecified) would be required to establish reference levels for the cap and determine the time frame to minimise tariff administration costs.⁹⁵⁰ One respondent said that it should be phased in over a period of time sufficient to allow suppliers time to rebalance, where necessary, their standard and non-standard prepayment tariffs.⁹⁵¹ One respondent noted that suppliers had bought some of their energy several years ahead and consequently suggested a glide path when implementing to avoid creating winners and losers. The respondent proposed that the cap would therefore initially be set at the SVT level and decrease linearly until it reached the target level.⁹⁵²
- 7.52 Five respondents did not believe suppliers would be able to circumvent tariff regulation by encouraging customers to switch onto less favourable unregulated tariffs as they considered that the existing Standards of Conduct licence conditions should provide sufficient protection.⁹⁵³ Two others considered this low risk for the same reason.⁹⁵⁴
- 7.53 One respondent noted that which party was best placed to set the cap would depend on the context in which it was set, with the CMA being well-placed for a one-off setting but Ofgem being better placed for subsequent updates.⁹⁵⁵ One respondent said that this could be implemented by the CMA or Ofgem.⁹⁵⁶ One respondent suggested that there may be a role for Ofgem in administering any price cap but that independent review would be necessary to ensure the cap was fair to all suppliers.⁹⁵⁷ Another respondent suggested that Ofgem was better placed to set a cap in consultation with suppliers.⁹⁵⁸
- 7.54 Some respondents identified a variety of unintended consequences including:

⁹⁴⁹ EDF Energy.

⁹⁵⁰ SSE.

⁹⁵¹ Scottish Power.

⁹⁵² First Utility.

⁹⁵³ Utilita, Citizens Advice, RWE, SSE, EDF Energy.

⁹⁵⁴ First Utility, Scottish Power.

⁹⁵⁵ Citizens Advice.

⁹⁵⁶ EDF Energy.

⁹⁵⁷ First Utility.

⁹⁵⁸ Good Energy.

- (a) A price cap is likely to distort competition in the rest of the market with companies being deterred from entering the prepayment segments because of the presence of price regulation.⁹⁵⁹
- (b) It could reduce switching as customers' potential savings were reduced and customers might be attracted to a tariff with regulated prices (believing that it was 'safe') rather than engaging in the market.⁹⁶⁰
- (c) If the headroom was set too low, new entrants and existing competitors would struggle to persuade customers to leave the protection of regulated prices, reducing the market for new entry and ultimately the amount of competitive deals available to prepayment customers.⁹⁶¹

7.55 We consider the above views expressed by parties in paragraphs 7.56 and following below.

Design considerations

- 7.56 As noted above, we considered the scope of customers to which it may be appropriate to apply a price cap remedy. Parties' views provided in response to the Remedies Notice and the Second Supplemental Remedies Notice,⁹⁶² in combination with our own assessment of the possible consequences of imposing a price cap, informed our assessment of scope. We considered that to apply a price cap to all customers on SVTs, ie to around 70% of domestic customers, would introduce a material risk of distorting incentives and could limit the effectiveness of our engagement remedies.
- 7.57 We have considered a range of options for the design of the PPM Price Cap Remedy. In this section we identify some of the options we have considered and the criteria that we have taken into account in evaluating them before setting out the design of our proposed remedy. We then set out our provisional view on the stringency of the price cap,⁹⁶³ presenting the results of our analysis of the impacts on prepayment customers and suppliers of the cap and present our provisional conclusions on sunset provisions and the way in which we propose to implement the cap.

⁹⁵⁹ Centrica, EDF Energy, RWE, Scottish Power, SSE, Good Energy, First Utility.

⁹⁶⁰ Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE, Good Energy, First Utility.

⁹⁶¹ Centrica, EDF Energy, RWE, Scottish Power, SSE, Good Energy.

⁹⁶² See Appendix 7.1 for further detail on parties' views on the possible unintended consequences and scope of the price cap.

⁹⁶³ Considering, in particular, the headroom we propose to incorporate into the price cap.

- 7.58 We have evaluated the effectiveness and proportionality of different options for the design of the proposed price cap remedy against several key design criteria, notably:
- (a) practicability (whether the cap is easy to implement on a timely basis, easy to calculate in an objective way and easy to comply with and monitor);
 - (b) minimal impacts on supplier incentives (whether the design minimises the scope for perverse incentives and allows competition);
 - (c) accuracy (whether the cap accurately reflects changes in competitive market conditions over time, and any changes in the costs that an efficient supplier would be expected to bear); and
 - (d) impacts on customers and suppliers (whether the cap reduces prices for prepayment customers while allowing efficient suppliers a reasonable opportunity to recover their costs, without leading to a reduction in quality).
- 7.59 The first three criteria are particularly relevant for considering the structure and form of the cap, while the fourth is largely a function of the stringency of the cap, including whether to introduce an element of headroom (explicit and/or implicit) in the level of the cap. Accordingly, we first explain our preferred design for the structure and form of the cap against the first three criteria, before considering impacts in a separate section on the stringency of the cap.
- 7.60 We present our overall assessment of the effectiveness and proportionality of this proposed remedy at the end of this section.⁹⁶⁴

The structure and form of the cap

- 7.61 We have considered a range of options for the structure and form of the price cap, including approaches based on bottom-up cost modelling, internal and external reference pricing and a hybrid reference price and cost index approach.

⁹⁶⁴ We note that the above criteria are wholly consistent with the criteria set out in our guidance regarding the assessment of effectiveness and proportionality as set out in paragraphs 7.188–7.268 below, and that a proportionate remedy must (a) be effective in achieving its legitimate aim; (b) be no more onerous than needed to achieve its aim; (c) be the least onerous if there is a choice between several effective measures; and (d) not produce disadvantages which are disproportionate to the aim.

Bottom-up cost approach

- 7.62 We gave some consideration to an approach based on bottom-up cost modelling, which would involve constructing a cap based on a detailed assessment of the costs incurred in the supply of energy to customers, an adjustment for efficiency and an allowance for an appropriate rate of return on capital. This is broadly the sort of approach that is typically used in the regulation of natural monopolies. However, we concluded that this approach did not meet our practicability criterion as it could not feasibly be implemented within the required timescales.

Internal reference pricing approach

- 7.63 Ovo Energy and RWE suggested to us variations of what we consider an ‘internal reference pricing’ or non-discrimination approach. Under RWE’s proposed approach⁹⁶⁵ suppliers would be obliged to offer their fixed-term contract offers to all payment methods with suppliers prevented from charging any differential between standard credit and prepayment prices. In this way there would be some form of constraint not on the overall level of a supplier’s prices, but on the difference between the prices that a supplier offered to different categories of customer.
- 7.64 Ovo Energy was supportive of a price cap but had concerns that such a measure might harm innovation to a greater extent than an alternate proposal that it favoured – a cost-reflective principle (CRP), which would consist in requiring that any differences in prices be justified in relation to differences in costs. Ovo Energy submitted that:
- the introduction of a CRP, coupled with clear guidelines and a framework for robust enforcement, would significantly reduce the current price difference between fixed and variable tariff offerings in line with the true costs associated with each. This would mean that a supplier’s ability to compete would be wholly dependent on how well they deliver efficiency savings and innovative products.⁹⁶⁶
- 7.65 We note that internal reference pricing approaches are generally easy to implement (since they tend to be based on principles defined ex ante). However, we have reviewed previous such non-discrimination regulations and believe that they are likely to produce negative outcomes for customers.

⁹⁶⁵ RWE.

⁹⁶⁶ Ovo Energy.

In particular, when Ofgem prohibited suppliers from offering out-of-area discounts for new customers, the effect was to increase prices for out-of-area customers and reduce the strength of competition.⁹⁶⁷ We expect therefore that, in the case of the PPM Price Cap Remedy, preventing discrimination in prices paid by prepayment and non-prepayment customers would result in an increase in prices paid by non-prepayment customers and reduce the scope for suppliers to target particular tariffs at one segment or another.

- 7.66 We have therefore provisionally decided not to pursue internal reference price approaches of this sort as they lead to excessive risks of perverse supplier incentives and harmful impacts on competition (ie failing our second criterion).

External and hybrid reference pricing approaches

- 7.67 We have given detailed consideration to two lead options for a PPM Price Cap Remedy, which in principle meet all of our design criteria. These are:
- (a) a hybrid reference price and cost index approach, which would involve setting an initial level of the prepayment cap based on our competitive benchmark analysis and then allowing the cap to change over time according to movements in exogenous cost indices; and
 - (b) an external reference price approach, which would involve setting a cap on prepayment tariffs based on non-SVT direct debit tariffs in the market plus an uplift reflecting our assessment of the costs associated with prepayment.
- 7.68 We discuss in detail in this section how the hybrid reference price approach could work. A detailed discussion of the external reference price approach is provided in Appendix 7.1.
- 7.69 We consider that the hybrid reference price and cost index approach is a viable option for setting the price cap. The detailed analysis that we have conducted of prices and bills has allowed us to calculate a competitive benchmark bill for prepayment customers as of 30 June 2015.⁹⁶⁸ Under this approach, the competitive benchmark bill would then change annually according to changes in exogenous cost indices relating to: wholesale costs; network costs; policy costs and inflation.

⁹⁶⁷ See [provisional findings report](#), paragraph 8.254.

⁹⁶⁸ See paragraphs 7.79–7.91.

- 7.70 The particular benefit of this approach is that it is easy to implement and, since suppliers are unable to shift the cost indices used to change the cap year on year, it mitigates the risk that suppliers seek to manipulate the level of the price cap. The challenge of this approach surrounds the definition of policy costs and how they change over time, which is discussed further below.
- 7.71 In contrast, while we believe that the external reference price approach could have been a viable and timely approach to setting the PPM Price Cap Remedy, we did, however, identify some significant weaknesses in this approach, which are not apparent in the hybrid approach.
- 7.72 We considered several variants of this external reference approach, which primarily concerned differences in the population of external reference tariffs (the 'reference basket'). In one variant, the reference basket was composed of non-SVT acquisition tariffs in the previous period, while in another the reference basket was composed of the stock of non-SVT tariffs paid by customers in the previous period. We found that the former was preferable against our 'accuracy' criterion (since acquisition tariffs more closely reflected changes in market conditions), while the latter was preferable in relation to the 'supplier incentives' criterion (since the reference basket drew on a broader range of tariffs and hence was more robust against manipulation).
- 7.73 However, under each of these variants, we identified several drawbacks associated with the external reference price approach. This included: the existence of perverse incentives and potential mechanisms for suppliers to game the cap (for example, through manipulation of the reference basket tariffs in order to drive up the level of the cap); potential accuracy concerns as a result of the lag between the date reference tariffs were brought onto the market and the implementation of the cap informed by these tariffs (for example, where prices achievable when reference basket tariffs were first brought onto the market are no longer achievable based on market conditions when the cap is effective); practicality in terms of the significant, regular data required by Ofgem to calculate updated caps; and potential changes in the nature of competition in the reference basket which may reduce the effectiveness of the cap (for example, a move to bundled or heavily discounted tariffs in the reference basket which would not be adjusted for in the price cap calculation and therefore may give rise to an ineffective cap) and added to the concerns around perverse incentives.
- 7.74 Overall, our provisional decision is that we should adopt the hybrid reference price and cost index approach, for the following principal reasons:

- (a) Practicability: our preferred approach is easier to implement than the external reference price approach. In particular, it is less burdensome for both Ofgem and suppliers, since there is no requirement for updated information on tariffs to be submitted on a periodic basis and the cost index information we have prescribed is readily available.
- (b) Supplier incentives: there appears to us to be minimal scope for perverse incentives under the preferred approach, since the indices we have identified are not manipulable by suppliers. In contrast, even under the more robust variant of the reference price approach (the ‘stock’ approach), there is some potential for the cap to be manipulated or inflated through changes in the nature of competition (eg suppliers might compete more by offering discounts and other benefits which would not be reflected in the cap, rather than reducing prices, which would be).
- (c) Accuracy: in relation to accuracy, the comparison of the two options is more balanced. The advantage of the reference basket approach is that new tariffs offered by suppliers should reflect expected changes in efficient costs, without each of the cost components needing to be specified. Against this, the more robust of the reference basket variants (the ‘stock’ approach) introduced an element of lag into these expectations, undermining accuracy. Our preferred approach will accommodate changes in wholesale and network costs relatively simply, but it is challenging to accommodate changes in policy costs with a high degree of accuracy.

7.75 As noted above, the particular challenge arising from our preferred option is how to accommodate policy costs, which are becoming⁹⁶⁹ an increasingly large component of the overall costs borne by suppliers. We considered options that would involve adjustments for observed changes in each component of policy costs – such as CfD costs, ROC prices and the costs of implementing the Energy Company Obligation – but judged that this introduced excessive complexity and uncertainty into the design of the cap.

7.76 We have provisionally concluded that the best way to accommodate policy costs within our preferred approach is to use current projections of the maximum allowed costs arising from such policies, as set out in the most recent projections from the Office for Budget Responsibility.⁹⁷⁰ We note that adopting this approach is relatively robust since the projections reflect latest

⁹⁶⁹ Ofgem’s analysis of the components of a typical customer’s bill estimates that environmental and social costs will have increased from £62 in the year to 31 December 2014 to £71 in the year to 31 March 2016. Source:

Ofgem, [Breakdown of an electricity bill over time](#).

⁹⁷⁰ Office for Budget Responsibility (July 2015), [Economic and fiscal outlook](#).

expectations for actual spend and consider that this approach has considerable merits in terms of simplicity.

- 7.77 In summary, we believe that our preferred design is the one that achieves the best balance against the above criteria, particularly given the need to implement the price cap remedy in the near future to maximise its effectiveness.

Proposed design

- 7.78 The proposed price cap would be based on our estimated benchmark for a competitive prepayment tariff as at 30 June 2015 (initial level of the cap – period 0), adjusted for movements in input costs since 30 June 2015 ('cost indexing'). The adjustments would explicitly allow for movements in whole-sale energy costs, network costs, policy costs and indirect costs due to inflation.

Initial level of the cap ('period 0')

- *Competitive benchmark*

- 7.79 For the purpose of calculating the initial level of the cap, we are proposing as a first step to estimate a relevant competitive benchmark tariff by following the same approach that we used in Section 3. As explained in Section 3, our competitive benchmark is a hypothetical construct based on the tariffs offered by Ovo Energy and First Utility. The benchmark includes all tariff types weighted by the respective number of accounts within each of Ovo Energy and First Utility adjusted for network costs and payment method cost differentials.⁹⁷¹ For the purposes of setting the initial level of the price cap we would use only results for 30 June 2015,⁹⁷² with these prices adjusted to add back in regional network costs and the additional costs to serve prepayment customers (see paragraphs 7.85 to 7.87).
- 7.80 The initial level of the cap would be defined separately for prepayment customers in each region for:
- (a) dual fuel, both Economy 7 and single rate meters;

⁹⁷¹ The benchmark we use for setting the price cap is based on prices for direct debit tariffs and we allow for an uplift to reflect the incremental costs of serving prepayment customers – see paragraphs 7.85–7.87 below.

⁹⁷² At 30 June 2015 the benchmark bills (net of network costs and cost-to-serve differential) at medium TDCV for dual fuel single rate meter customers; dual fuel Economy 7 meter customers; single fuel electricity single rate meter customers; single fuel electricity Economy 7 meter customers; and single fuel gas customers were £728, £670, £353, £315 and £402 respectively.

- (b) single fuel electricity, both Economy 7 and single rate meters; and
- (c) single fuel gas.

- 7.81 Based on the detriment analysis in Section 3, we have found that on 30 June 2015, for a medium typical consumption single rate meter customer paying by dual fuel, the competitive benchmark bill net of network costs and cost to serve differentials was £728, resulting in a difference between the competitive benchmark tariff and actual bills averaged across the Six Large Energy Firms of £178.⁹⁷³
- 7.82 This level of the cap would then be rolled forward to the period when the cap takes effect using cost indices, and changed on a yearly basis thereafter using the same cost indices.
- 7.83 We expect that, unless price changes for prepayment customers between 30 June 2015 and the beginning of the cap are substantially lower than changes in the relevant indices, the effect of the price cap would be an immediate and substantial reduction in average bills. This is discussed in more detail in the section below on impacts.
- 7.84 We have also considered whether it is appropriate to include an explicit allowance for headroom in the level of the price cap. We consider that there are two key bases for the inclusion of headroom: to facilitate competition and to mitigate the risk that the price cap does not allow for recovery of efficient costs. We note that in practice some ‘implicit’ headroom may be already included in the price cap we are proposing, due to choices made in the design of the benchmark tariff and costs index. In the discussion of each component below, we indicate where we believe that such implicit headroom has been built in. We then further consider the need for explicit headroom in paragraphs 7.165 to 7.170.

- *The prepayment uplift*

- 7.85 The benchmark tariff set out in Section 3 is based on tariffs available to customers on direct debit, and therefore reflects the costs to serve those particular customers.⁹⁷⁴ Since we will be using this benchmark to produce a price cap which will apply to prepayment customers, it is necessary to take into consideration the costs-to-serve differentials between these two payment methods.

⁹⁷³ The detriment analysis in Appendix 3.3 outlines average detriment across the period. These figures represent the detriment identified at 30 June 2015.

⁹⁷⁴ See paragraph 3.167.

- 7.86 In Appendix 3.6 we consider what a reasonable level of costs-to-serve differential between those customers on direct debit and those on prepayment should be. We have provisionally determined that a costs-to-serve differential of £54 (£22 electricity; £32 gas) is appropriate. We therefore use these values as an element of the proposed price cap.
- 7.87 We are proposing that these cost-to-serve differentials will be adjusted in line with CPI at each annual update of the price cap (see below).

Cost indexing

- 7.88 As of 30 June 2015, the competitive benchmark bill will be adjusted to include network costs and prepayment costs to serve and decomposed into five cost components (wholesale, network, policy, indirect costs and PPM uplift), to be used for subsequent indexing. The formulae below describes how the prepayment price cap (for example, for single fuel electricity, standard meter customers) would initially be determined on the basis of these components and then updated:

$$\begin{aligned} \text{Price cap (region } i, \text{ period } j, \text{ consumption } k) = & \\ & \text{Wholesale cost (period } j, \text{ consumption } k) \\ & + \text{Network cost (region } i, \text{ period } j, \text{ consumption } k) \\ & + \text{Policy cost (period } j, \text{ consumption } k) \\ & + \text{Indirect costs (period } j, \text{ consumption } k) \\ & + \text{PPM uplift (period } j) \end{aligned}$$

Where:

$$\begin{aligned} \text{Wholesale cost (period } j, \text{ consumption } k) = & \\ \text{Wholesale cost (period } 0, \text{ consumption } k) & \\ \times \text{Wholesale index (period } j) & \\ / \text{Wholesale index (period } 0) & \end{aligned}$$

$$\begin{aligned} \text{Network cost (region } i, \text{ period } j, \text{ consumption } k) = & \\ \text{Network cost (region } i, \text{ period } 0, \text{ consumption } k) & \\ \times \text{Network index (period } j) & \\ / \text{Network index (period } 0) & \end{aligned}$$

$$\begin{aligned} \text{Policy cost (period } j, \text{ consumption } k) = & \\ \text{Policy cost (period } 0, \text{ consumption } k) & \\ \times \text{Policy index (period } j) & \\ / \text{Policy index (period } 0) & \end{aligned}$$

$$\text{Indirect cost (period } j, \text{ consumption } k) =$$

Indirect cost (period 0, consumption k)
x CPI (period j) / CPI (period 0)

PPM uplift (period j) =
PPM uplift (period 0) x CPI (period j) / CPI (period 0)

7.89 The following would be specified in the final order and associated licence conditions:

(a) All costs in period 0 – our approach to determining these values is described below in paragraphs 7.92 to 7.101.

(b) All index values in period 0.

(c) The method of determining the value of each index value in period j j.

7.90 The calculation would also follow these principles for single fuel electricity Economy 7 meter customers, single fuel gas customers, dual fuel single rate meter customers and dual fuel Economy 7 meter customers, though the values would be different.

7.91 Table 7.1 summarises the frequency with which each component of the price cap would be indexed and the basis for updates.

Table 7.1: Frequency of updates

<i>Component</i>	<i>Frequency of updates</i>	<i>Geographical basis</i>	<i>Basis for update</i>
Wholesale	Annual	National	ICIS data
Network	Annual	Regional	Ofgem data
Policy	Annual	National	OBR
Indirect	Annual	National	CPI
PPM Uplift	Annual	National	CPI

Source: CMA.

- *Determining the costs in period 0*

7.92 As of 30 June 2015, the competitive benchmark⁹⁷⁵ bill would be decomposed into four cost components (wholesale, network, policy and indirect costs), to be used for subsequent indexing. The costs in period 0 for wholesale, policy and indirect costs would be determined according to the formulae below:

⁹⁷⁵ At 30 June 2015 the benchmark bills (net of network costs and cost-to-serve differential) at medium TDCV for dual fuel single rate meter customers; dual fuel Economy 7 meter customers; single fuel electricity single rate meter customers; single fuel electricity Economy 7 meter customers; and single fuel gas customers were £728, £670, £353, £315 and £402 respectively.

For electricity

Wholesale cost (period 0, consumption k)
= Benchmark (consumption k) x 56.6%

Policy cost (period 0, consumption k)
= Benchmark (consumption k) x 19.0%

Indirect cost (period 0, consumption k)
= Benchmark (consumption k) x 24.4%

For gas

Wholesale cost (period 0, consumption k)
= Benchmark (consumption k) x 66.4%

Policy cost (period 0, consumption k)
= Benchmark (consumption k) x 7.4%

Indirect cost (period 0, consumption k)
= Benchmark (consumption k) x 26.2%

- 7.93 The percentages shown above are taken from our analysis of the components of a typical domestic energy bill for financial year 2014. We have excluded network costs for this analysis as the benchmark to which these percentages are applied excludes network costs.⁹⁷⁶ This adjustment is shown in the table below.

Table 7.2: Breakdown of total bills and bills excluding network costs

	<i>Electricity</i>		<i>Gas</i>		<i>Dual fuel</i>	
	<i>% of total bill</i>	<i>% of bill excl. network</i>	<i>% of total bill</i>	<i>% of bill excl. network</i>	<i>% of total bill</i>	<i>% of bill excl. network</i>
<i>2014 values</i>						
Wholesale costs	42.2	56.6	50.8	66.4	44.3	59.0
Network costs	25.5	N/A	23.5	N/A	25.0	N/A
Policy costs	14.1	19.0	5.7	7.4	12.0	16.1
Indirect costs	18.2	24.4	20.0	26.2	18.7	24.9
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: CMA analysis.

- 7.94 Network costs in each region in period 0 would be specified in the final order, and associated licence conditions. To calculate these network costs for the purposes of our analyses to date we have used Ofgem Supply

⁹⁷⁶ The breakdown in this table does not breakdown separately the PPM uplift component outlined in paragraph 7.88.

Market Indicator information and instructions for compiling data on the network cost components per energy bill.

- 7.95 The level of disaggregation of the Ofgem data allowed us to extract the rates of the single components of transmission and distribution network charges for both electricity and gas.
- 7.96 Ofgem data was cross-checked with the annual 'Statement of charges' of UK transmission and distribution companies. Whenever discrepancies were found, we used these documents to either correct or supplement Ofgem data.
- 7.97 There are 13 gas distribution zones (known as Local Distribution Zones or LDZ) and 14 electricity distribution areas (PES regions). Since gas and electricity regions do not correspond exactly, the overlap of PES regions across LDZ had to be mapped.
- 7.98 After compiling single data sets on transmission and distribution network charges for each fuel, these were merged together by using a list of postcodes for which the PES region is known and the Xoserve mapping of postcodes to LDZ.
- 7.99 There are several gas exit points (relative to gas transmission) within each gas distribution area and each is differently priced. Consistently with the Ofgem methodology, we selected one gas exit point in each LDZ and computed the gas transmission charge at that point.
- 7.100 Our provisional assessment of network costs for period 0 is as shown in the table below.

Table 7.3: Provisional decision on period 0 network cost allowances

£

Single rate Gas	Period 0 network cost			Electricity	Period 0 network cost		
	High	Medium	Low		High	Medium	Low
East Anglia	200	142	95	East Anglia	172	118	80
East Midlands	183	130	87	East Midlands	172	116	76
London	223	158	106	London	160	110	75
Merseyside and North Wales	213	152	101	Merseyside and North Wales	241	164	110
West Midlands	203	144	96	West Midlands	178	121	80
North East	200	142	95	North East	186	132	93
North Scotland	172	122	81	North Scotland	217	151	105
North West	214	152	102	North West	185	127	86
South East	213	151	101	South East	189	130	87
South Scotland	172	122	81	South Scotland	182	125	85
South Wales	190	135	90	South Wales	200	136	90
South West	235	167	111	South West	222	151	101
Southern	227	161	107	Southern	186	125	83
Yorkshire	184	131	87	Yorkshire	175	123	87
Economy 7 Gas	Period 0 network cost			Electricity	Period 0 network cost		
	High	Medium	Low		High	Medium	Low
East Anglia	N/A	N/A	N/A	East Anglia	148	103	70
East Midlands	N/A	N/A	N/A	East Midlands	142	96	64
London	N/A	N/A	N/A	London	141	98	67
Merseyside and North Wales	N/A	N/A	N/A	Merseyside and North Wales	203	139	94
West Midlands	N/A	N/A	N/A	West Midlands	148	101	68
North East	N/A	N/A	N/A	North East	164	119	88
North Scotland	N/A	N/A	N/A	North Scotland	192	135	95
North West	N/A	N/A	N/A	North West	145	101	69
South East	N/A	N/A	N/A	South East	164	113	77
South Scotland	N/A	N/A	N/A	South Scotland	159	110	76
South Wales	N/A	N/A	N/A	South Wales	162	111	75
South West	N/A	N/A	N/A	South West	185	127	86
Southern	N/A	N/A	N/A	Southern	150	102	68
Yorkshire	N/A	N/A	N/A	Yorkshire	153	110	79

Source: CMA.

7.101 Note that the network costs are specified for high, medium and low consumption values. These different values will be used to calculate the level of the price cap at each different consumption level as described in paragraphs 7.138 to 7.142. We used the TDCVs that applied for the period January 2014 to August 2015 as the tariffs informing the benchmark were in the market in this period.⁹⁷⁷

- *The update process*

7.102 The level of the price cap will be updated every year on 1 April. All tariffs on offer to prepayment customers would have to comply with the price cap at all times.

7.103 We considered the possibility of updating the wholesale index more frequently so that it would track movements in wholesale costs more closely. However, for the reasons set out below, we provisionally considered that annual updates struck an appropriate balance between timeliness,

⁹⁷⁷ The single rate meter high, medium and low values, respectively, were for electricity 4,900 kWh, 3,200 kWh, 2,000 kWh and for gas 19,000 kWh, 13,500 kWh, 9,000 kWh.

practicality and regulatory burden, and are therefore an effective and more proportionate manner to achieve the aim of the proposed remedy.

- 7.104 We note that a downside of a price cap updated annually is the existence of a lag between the index date (ie the date on which the tariffs used to create the competitive benchmark are on offer) and the period over which the price cap applies. Consequently changes in input prices over this period would not be fully reflected in the level of the price cap.
- 7.105 We therefore considered the possibility of resetting the price cap every six months. We concluded that while this would reduce the risks associated with the lag, it would not eliminate these risks but would introduce other risks relating to wholesale costs. We considered using a six-month wholesale index to align with six-monthly updates though considered that this would introduce undue volatility into the level of the price cap. This is because, for example, six-monthly updates using a six-month wholesale cost index would introduce seasonal swings in the level of the price cap.
- 7.106 A requirement to update the price cap annually, compared with a higher update frequency, limits the need for ongoing reassessment, therefore simplifying implementation and monitoring requirements. It would also have the benefit of offering prepayment customers a level of certainty over their monthly energy costs,⁹⁷⁸ as well as increased transparency and understanding for customers and other stakeholders.
- 7.107 Another practical issue that we have considered in reaching a provisional view on the appropriate frequency for updating the price cap is the impact on the prepayment infrastructure. Price updates for prepayment tariffs are transmitted to a prepayment meter each time the customer tops up their key/card at a prepayment terminal. There is a limit to the number of messages that can be stored on the prepayment terminal and thus it is impractical to make frequent changes to a large number of tariffs. Frequent updates is likely to increase the cost of using the system and could result in messages getting backlogged. On balance, we reached a provisional view that annual updates are appropriate.

- *Wholesale energy costs*

- 7.108 The proposed remedy would involve the CMA (for setting the price cap in a final order), and subsequently Ofgem, constructing a wholesale energy cost index using information available from ICIS⁹⁷⁹ on market prices for standard

⁹⁷⁸ Monthly energy costs under the cap would still be dependent on consumption.

⁹⁷⁹ ICIS is a market information provider.

wholesale products – specifically using market prices for energy products traded for delivery in the day(s), month(s), quarter(s) and season(s) ahead. This index should measure movements since the end of June 2015 in the cost of delivering gas and electricity to domestic customers for a period of one year ahead.⁹⁸⁰ We use June 2015 as the base period for this index as this is the period for which we constructed the benchmark price.

7.109 The index for wholesale energy costs would be applied to the proposed benchmark price as described in paragraphs 7.88 and 7.92. We consider that this approach will be favourable to suppliers given the decline in wholesale gas and electricity prices since 2014.⁹⁸¹ This is because the proposed benchmark price is based on tariffs First Utility and Ovo Energy customers were on as at the end of June 2015, and such prices would have been set some time before June 2015 when wholesale energy prices were higher.⁹⁸²

7.110 The index would be a weighted average of the prices of the relevant future products (month(s), quarter(s) and season(s)).⁹⁸³ Each product's prices would be weighted by the length of the period that the product covers within the year (for example, the price of the season-ahead product determines one half of next year's cost).⁹⁸⁴ Additionally, there would need to be seasonal consumption weights for electricity (winter and summer)⁹⁸⁵ and quarterly consumption weights for gas. The specific formulation of the index would be specified in the final order such that the process of calculating the level of the price cap is a purely mechanical exercise.

- *Network costs*

7.111 The costs of transferring energy from the producer to the end user are referred to as network costs. Network costs refer to the cost of building, maintaining and operating the energy network and system infrastructure to deliver energy to the customer. These are split between the transmission companies (who take the energy from the producers and deliver it to the different areas of the country) and distribution companies (who arrange for

⁹⁸⁰ We previously found that indices for the cost of delivering energy over 12-, 18- and 24-month periods moved closely together. See provisional findings report, [Appendix 7.2](#), paragraph 27.

⁹⁸¹ The concept of implicit headroom is discussed in paragraph 7.84.

⁹⁸² [X]

⁹⁸³ We use the ICIS price assessments for each of the products.

⁹⁸⁴ For electricity, we construct this index for baseload and peak product prices separately, and then compute a weighted average electricity index (assuming that 70% of the electricity consumed is baseload, and 30% are peak products).

⁹⁸⁵ Winter and summer products are both six-month seasonal products. We use fixed seasonal consumption weights throughout the period. The weights are based on energy consumption figures between 2004 and 2014, as published by DECC. See [DECC's publication page](#).

the energy to be transported from the transmission end point to the final users).

7.112 The revenues that transmission and distribution companies can earn are regulated by Ofgem under the RIIO price framework.⁹⁸⁶ These are set for an eight-year period with an annual mechanism to update for factors such as actual company performance, RPI inflation and any additional investment requirements under various uncertainty conditions. In practice the total revenues move by relatively small amounts year on year.

7.113 Ofgem calculates and publishes the updated allowed revenues for transmission and distribution operators in December of each year to take effect from the following April.

7.114 The network cost index values for electricity would be arrived at by the following process:

(a) For England and Wales: taking the opening year revenue⁹⁸⁷ for National Grid Electricity Transmission (NGET) and dividing equally by the corresponding 12 England and Wales Distribution Network Operator (DNO) areas. To this is added the individual DNO area opening year revenue.

(b) So for England and Wales:

$$\begin{aligned} \text{Network index (region i, period j)} = \\ \text{NGET revenue (period j)} / 12 + \text{DNO revenue (region i, period j)} \end{aligned}$$

(c) The Network cost element of the price cap is calculated by region:

$$\begin{aligned} \text{Network cost (region i, period j)} = \\ \text{Network cost (region i, period 0)} \times \text{Network index (period j)} \\ / \text{Network index (period 0)} \end{aligned}$$

(d) For the Scottish Power distribution area the opening year transmission revenues for Scottish Power can be added to the opening year distribution revenues for Scottish Power to form the opening year total revenue base.

⁹⁸⁶ Further information on the network price controls can be found on the Ofgem website: [gas distribution](#) and [gas transmission](#); [electricity distribution](#) and [electricity transmission](#).

⁹⁸⁷ The opening year revenue is the total revenue allowed by Ofgem in the price control for year 0 for each transmission operator, for each DNO and for each GDN respectively. For the purposes of the indexation calculation we ignore the revenues of the system operators.

(e) The total update year revenue is the sum of the Scottish Power distribution revenue plus the Scottish Power Transmission revenue for the year in question.

(f) So for the Scottish Power distribution area:

$$\begin{aligned} &\text{Network index (SP area, period } j) \\ &= \text{SP transmission revenue (period } j) + \text{SP distribution revenue (period } j) \end{aligned}$$

(g) A similar process can be followed for Scottish Hydro Electric transmission area and the corresponding SSE distribution area.

(h) So for the SSE distribution area:

$$\begin{aligned} &\text{Network index (SSE area, period } j) \\ &= \text{SHETL}^{988} \text{ transmission revenue (period } j) \\ &+ \text{SSE distribution revenue (period } j) \end{aligned}$$

7.115 The network cost index values for gas would be determined using the same methodology as we applied to calculate the gas network cost allowances shown in Table 7.3. This approach allows us to calculate network cost index values for the 14 electricity distribution regions using the same mapping of LDZs to DNO areas as we used for the underlying cost allowances.

7.116 To arrive at the total network index values for each region, we will calculate the weighted values of the network element of the electricity index and the weighted value of the network element of the gas index weighted by the network values calculated in the opening period o position for that region. Combining these will give an overall index for dual fuel.

- *Policy costs*

7.117 We note that the costs of complying with various social and environmental schemes are recovered through electricity and gas bills. The level of the price cap would be updated to recognise changes in the costs of complying with these schemes.

7.118 We note that actual policy costs are uncertain as they depend on external factors, namely:

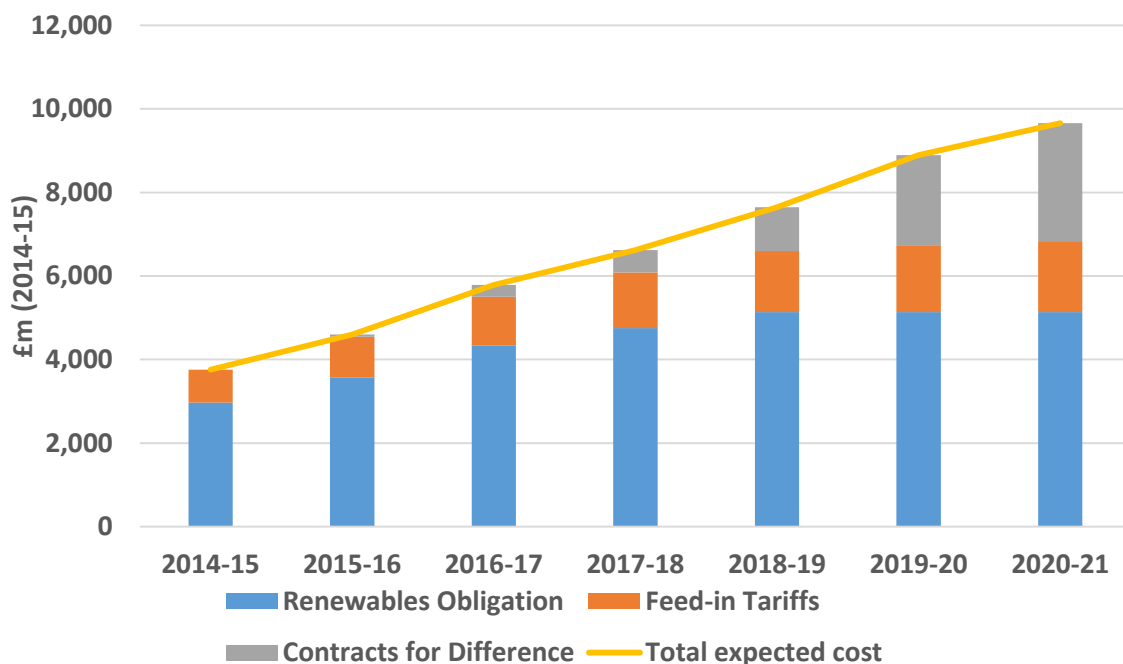
⁹⁸⁸ SHETL is Scottish Hydro Electric Transmission plc; SSE distribution revenue covers both Southern Electric Power Distribution plc and Scottish Hydro Electric Power Distribution plc.

- (a) the level of contracted generation;
- (b) the wholesale price of electricity; and
- (c) the amount of renewable electricity generated by qualifying generators.

7.119 Changes in these external factors since the levy control framework was introduced led to DECC updating, in July 2015,⁹⁸⁹ its projections of the aggregate cost of complying with these schemes. These updated figures of July 2015 aligned with the Office for Budget Responsibility's assessment of the projected costs of these schemes to 2020.

7.120 We have provisionally decided that these annual projections for the total actual outturn cost will be used as the index values for policy costs for the price cap applying to electricity tariffs. The breakdown of these values across the different schemes is shown in the chart below.

Figure 7.1: Projected increase in policy costs



Source: DECC, [Controlling the cost of renewable energy](#) (uplifted to 2014/15 prices by CMA).

7.121 The policy cost index values would be specified in the final order in real terms. Allowance would be made for CPI inflation as follows:

Policy index (period j, nominal) =

⁹⁸⁹ See DECC press release: [Controlling the cost of renewable energy](#).

$$\text{Policy index (period } j, \text{ real)} \times \text{CPI (period } j) / \text{CPI (period } 0)$$

7.122 The provisionally proposed policy index values, in real terms, for the electricity price cap would therefore be:

Table 7.4: Summary of provisionally proposed index values for policy costs (electricity)

	<i>£m, 2014/15 prices</i>						
	2014/15	2015/16	2016-17	2017/18	2018/19	2019/20	2020/21
Provisionally proposed policy index values	3,756	4,599	5,788	6,615	7,644	8,891	9,655

Source: CMA analysis.

7.123 To arrive at the total proposed policy index values, we will calculate the weighted values of the policy element of the electricity index and the weighted value of the policy element of the gas index weighted by the policy values calculated in the opening period t_0 position. Combining these will give an overall index for dual fuel.

7.124 In light of the uncertainty in the outturn costs, compared with the projections used in the index, we have considered whether it would be appropriate to have an ex post update such that the policy index values align with outturn policy costs. However, we have concluded that determining outturn values would duplicate the work already undertaken by the Office for Budget Responsibility as it has a duty to update annually projections of expenditure. Therefore we provisionally propose that the index values would be updated annually to reflect the Office for Budget Responsibility's latest projections for the annual cost of the renewables obligation, contracts for difference scheme and feed-in-tariffs scheme and that these updated values would supersede the index values shown above.⁹⁹⁰

7.125 We note also that in July 2015 DECC announced measures to limit the cost of certain policy costs.⁹⁹¹ We consider that these measures mitigate the risk that policy costs in future years will increase above the level published by DECC in July 2015.

7.126 We note that the only policy costs included within gas bills relate to the Energy Company Obligation (ECO) and the Warm Home Discount. The ECO scheme has been extended to March 2017 and DECC have estimated the annual cost at £1.35 billion.⁹⁹² It is not clear if the scheme will be extended beyond that point although DECC has suggested that 'The future

⁹⁹⁰ For the avoidance of doubt these changes to the index values would be purely prospective and there would be no retrospective change in the level of policy index values.

⁹⁹¹ DECC, [Controlling the cost of renewable energy](#).

⁹⁹² DECC, [Energy Company Obligation delivery costs](#), paragraph 9.

of the ECO scheme from 2017 onwards will be part of discussions around a new, better integrated policy for home energy efficiency'.⁹⁹³ We have provisionally assumed that these costs, which are already factored into bills, will continue over the period the cap is in effect at the same level in real terms.

7.127 We note that the Warm Home Discount has now been extended to 2020/21. We note that the total cost of this scheme in 2014/15 was £326 million⁹⁹⁴ and make the assumption that it will not increase in real terms to differentially impact energy bills (ie it sits outside of the projection shown but remains neutral in its' impact on bills).

7.128 The table below shows the provisionally proposed policy index values, in real terms, for the gas price cap.

Table 7.5: summary of provisionally proposed index values for policy costs (gas)

	<i>£m, 2014/15 prices</i>						
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Provisionally proposed policy index values	1	1	1	1	1	1	1

Source: CMA analysis.

7.129 To arrive at the total policy index values, we will calculate the weighted values of the policy element of the electricity index and the weighted value of the policy element of the gas index weighted by the policy values calculated in the opening period 0 position. Combining these will give an overall policy index for dual fuel.

- *Indirect costs*

7.130 The initial level of the price cap is based on our analysis of tariff prices and therefore includes an allowance for indirect costs. As discussed in Section 3, the calculation of the competitive benchmark is based on Ovo Energy and First Utility tariffs. We have assessed the sustainability of these suppliers and consider that this benchmark includes a level of implicit profit at the competitive level. This is included within the indirect cost element of the benchmark.

7.131 We expect that over time the indirect costs element of this benchmark will be subject to two opposing forces:

⁹⁹³ DECC blog announcing changes to green home improvement policies.

⁹⁹⁴ Ofgem, Warm Home Discount Annual Report 2014-15.

- (a) Inflation – costs are likely to increase over time in line with general inflation.
 - (b) Efficiency – we expect that suppliers will achieve ongoing efficiencies in their internal costs.
- 7.132 It is hard to know what the net impact of these forces will be over time though it is likely that the net impact will vary from time to time. To be prudent in setting the level of the price cap we have provisionally decided that the initial level of indirect costs will be subject to inflation in line with the CPI.
- 7.133 We consider that this will result in the indirect costs element of the price cap being less stringent⁹⁹⁵ over time. We consider that this is appropriate as we expect that over time our other proposed remedies, plus other developments in the market such as smart meter roll-out, will result in competition determining a price beneath the level of the cap. At the same time we note that periods further in the future are subject to greater uncertainty and therefore it is reasonable to allow greater headroom.

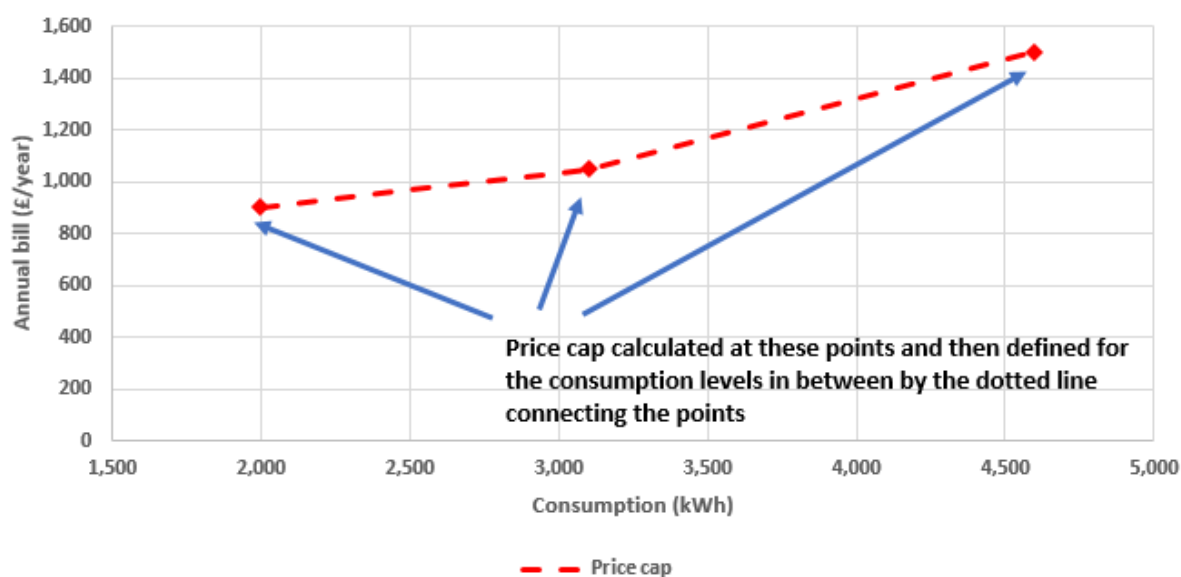
Application of the cap

- 7.134 The price cap for dual fuel tariffs would be based on the benchmark constructed from dual fuel tariff prices. Similarly the single fuel price caps would be constructed from the benchmarks constructed from single fuel tariff prices.
- 7.135 We note that it is possible that this approach could lead to a situation in which the dual fuel tariff is not equal to the sum of the single fuel price caps. This could create some incentive for customers to prefer dual fuel or single fuel tariffs. We consider that this approach is not inconsistent with prices in the markets whereby the lowest prices may sometimes come from a dual fuel offering and at other times two single fuel tariffs may offer a lower total price.
- 7.136 We considered an alternative construction in which the dual fuel tariff would be defined as the sum of the single fuel price caps. We consider that while this approach avoids creating incentives for suppliers to favour dual fuel or single fuel, it is less robust as the single benchmarks are constructed from a significantly smaller population.

⁹⁹⁵ ie building in more implicit headroom.

- 7.137 The price cap for each fuel would be defined in each of the 14 distribution network operator regions (see paragraph 7.97 for our approach to determining gas network costs on this regional basis). In total there would therefore be 70 price caps.⁹⁹⁶
- 7.138 The above calculation would be conducted for each of three different single rate meter consumption levels:⁹⁹⁷
- (a) The low TDCV (2,000 kWh for electricity, 8,000 kWh for gas).
 - (b) The medium TDCV of (3,100 kWh for electricity, 12,500 kWh for gas).
 - (c) The high TDCV of (4,600 kWh for electricity, 18,000 kWh for gas).
- 7.139 The price cap would be defined in terms of these three points and the straight lines connecting them. Tariffs subject to the price cap must result in lower annual bills than the price cap at all consumption levels as illustrated below:

Figure 7.2: Illustration of how the price cap is defined



Source: CMA.

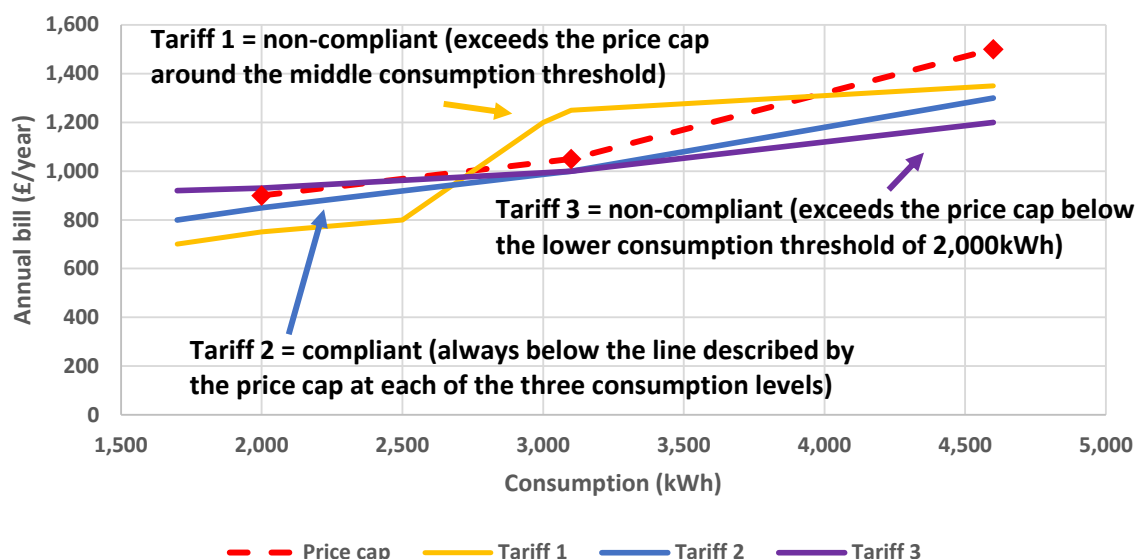
⁹⁹⁶ For each of 14 regions there would be a price cap for each of:

1. single fuel gas
2. single rate meter, single fuel electricity
3. single rate meter, dual fuel
4. economy 7 meter, single fuel electricity
5. economy 7 meter, dual fuel

⁹⁹⁷ The figures shown here are those that are prevailing at the time of writing. The TDCVs used for the benchmark analysis were those prevailing for the period January 2014 to August 2015 as the tariffs informing the benchmark were in the market in this period. Further information about [TDCVs](#) can be found on the Ofgem website.

- 7.140 The price cap for Economy 7 meters would be calculated using the profile class 2 TDCV, a 38:62 off-peak:peak split⁹⁹⁸ and the Economy 7 benchmark price.
- 7.141 Suppliers would be responsible for ensuring their own compliance ex ante. Ofgem would also check compliance ex post on a tariff-by-tariff basis and would have at its disposal the usual array of enforcement tools should it encounter instances of non-compliance. A tariff would be compliant if:
- (a) the annual cost at the high, medium and low consumption levels is less than the price cap (in the relevant region, for the relevant meter-tariff type); and
 - (b) the annual cost between these consumption levels is less than the price that would be on the straight line between the price cap levels at the consumption thresholds (see Figure 7.3).

Figure 7.3: Price cap compliance example



Source: CMA.

- 7.142 At any point while the PPM Price Cap Remedy is in force, all tariffs that are on offer to prepayment customers, or which prepayment customers are currently on, would need to be priced such that the projected annual bill is less than the cap for all levels of consumption. When the level of the price cap is reset, tariffs would need to be compliant with the new price cap. This could result in price reductions. We expect that as competition develops in

⁹⁹⁸ This split is in line with observed consumption patterns in the gains from switching data set and consistent with the split used in the benchmark analysis.

the prepayment segments it would be competition rather than the price cap which becomes the more stringent constraint on pricing.

- 7.143 We have considered whether there is a need for a bespoke derogation procedure such that the price cap could be temporarily disapplied. We consider that such a derogation mechanism is not required. If a party feels that the price cap is inappropriate, either in general or in respect of its application at a particular time, then it is able to challenge the CMA's final report. We consider that this provides sufficient scope for the PPM Price Cap Remedy to be challenged by interested parties.
- 7.144 We considered the possibility of specifying the price cap in terms of a standing charge and a unit rate. This could be done by firstly following the steps described above to construct a chart similar to the one shown in Figure 7.3. From that chart we could identify the two points which are joined by a straight line with the shallowest gradient. The resulting straight line could then be described in terms of a standing charge (by extending the line left until it cross the point of nil kWh) and a unit rate (by calculating the gradient).
- 7.145 We considered that this approach would have a benefit of relating the price cap to the usual terms that customers are familiar with. It would also be slightly easier to assess compliance as each domestic prepayment tariff on offer would need to have a standing charge and a unit rate less than those specified by the cap.
- 7.146 We also note, however, that this approach would significantly limit suppliers' flexibility to offer a variety of tariffs. This in turn could be expected to weaken competition for prepayment customers. On balance we concluded that it was sufficiently clear and simple to specify the price cap as illustrated in Figure 7.3 and that it was desirable to allow for flexibility in tariff design where possible.

- *Non-Economy 7 restricted meters*

- 7.147 Prepayment customers who have a restricted meter would be within scope of the prepayment price cap. The arrangements for Economy 7 meter customers are described above. The price cap that would apply to customers on non-Economy 7 restricted meters would be the single-rate price cap (regardless of the tariff that they are on). In particular, the single-rate price cap would, for a prepayment customer on a non-Economy 7 restricted meter, apply to their total consumption aggregated across all registers and meters.

- 7.148 We note that for customers on non-Economy 7 restricted meters their bills will depend on their patterns of usage across different times of day and/or meters which will not be known at the time a tariff is set. We therefore propose that suppliers would be required to make best efforts to ensure compliance in setting tariffs for such customers ex ante based on their knowledge of historical consumption patterns and that Ofgem would review compliance ex post based on the actual bills for these customers. In the event that the cap was found to have been breached for a particular set of customers, an annual rebate would be paid by the supplier to the customers concerned.

Stringency of cap and impacts

Assumptions and data

- 7.149 In order to estimate the impact of the provisionally proposed price cap on customers and suppliers at Ofgem's medium TDCV, we have used tariff data and customer numbers as at 30 June 2015 and compared these against the price cap calculated on this date under our preferred approach. A number of assumptions have been adopted in performing this comparison. These are discussed in Appendix 7.1.
- 7.150 In this analysis we do not distinguish between the impacts on prepayment customers with smart meters as distinct from those with dumb prepayment meters.

Impacts on customers

- 7.151 We have calculated the price cap across each fuel/meter combination as at 30 June 2015, in line with the methodology set out in paragraph 7.149. We consider separately the possible impact of unintended consequences in paragraphs 7.236 to 7.257.
- 7.152 The table below shows the impact of the proposed price cap across the different fuel/meter combinations, assuming £nil headroom. We have subsequently illustrated the level of the caps on a regional basis compared with the average prepayment bill and the cheapest prepayment tariff bill for the Six Large Energy Firms' and the Mid-tier Suppliers' customers based on actual customer tariffs at 30 June 2015. This is outlined in the charts below. Generally the cheapest prepayment tariff bill relates to a smart offering.

Table 7.6: Summary of estimated average customer savings (30 June 2015, medium TDCV), nil headroom

	<i>Minimum regional average saving</i>	<i>Maximum regional average saving</i>	<i>Average national saving</i>
Dual fuel, single rate meter	£149 (South West)	£205 (North Scotland)	£176
Dual fuel, Economy 7	£226 (South West & North East)	£277 (North Scotland)	£251
Single fuel electricity, single rate meter	£39 (South Scotland)	£67 (North Scotland)	£53
Single fuel electricity, Economy 7	£79 (East Anglia)	£108 (Midlands & North West)	£88
Single fuel gas, single rate meter	£83 (South West)	£132 (North Scotland)	£117

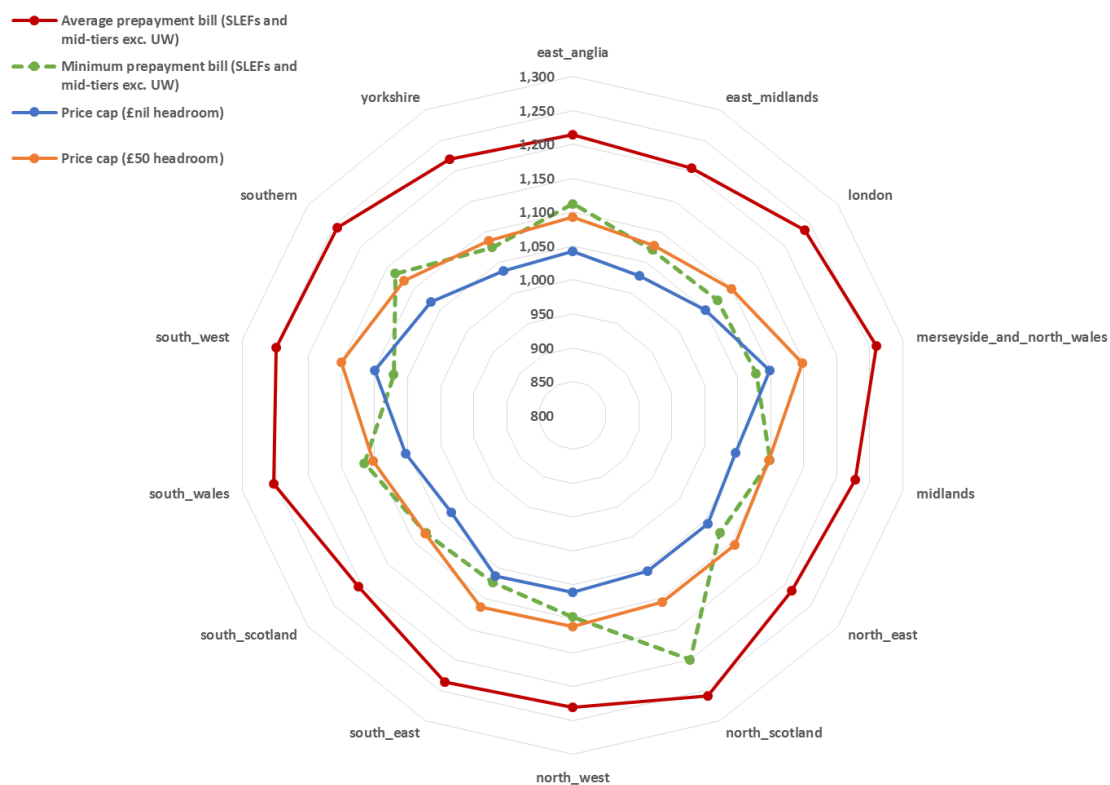
Source: CMA analysis.

7.153 We have illustrated the level of the caps on a regional basis compared with the average prepayment bill and cheapest prepayment tariff bill for the customers of the Six Large Energy Firms and the Mid-tier Suppliers, based on actual customer tariffs at 30 June 2015, for each of the fuel/meter combinations, below. These charts outline the impact of £nil and £50 dual fuel (ie £25 per fuel) headroom within the price cap. Generally this cheapest prepayment tariff bill relates to a smart offering.

7.154 Customer impacts outlined below are based on customers' standardised consumption at Ofgem's medium TDCV. We have estimated the impact of the price cap on actual prepayment customer bills as a reduction of approximately 13.1% and 8.2% based on headroom of £nil and £50 dual fuel (ie £25 per fuel).

- *Dual fuel, single rate meter customers*

Figure 7.4: Preferred design price cap model vs average prepayment bill (dual fuel, single rate meter, 30 June 2015, medium TDCV)

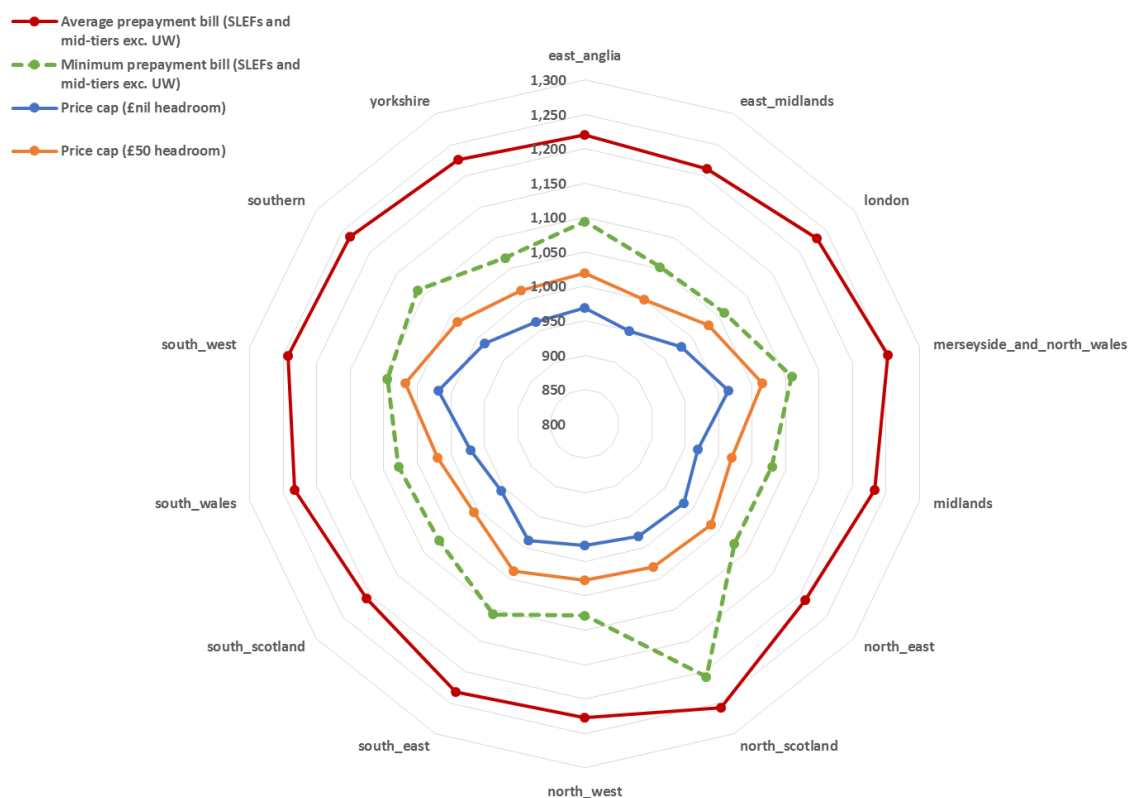


Source: CMA analysis.

7.155 On a national basis, the average bill across all dual fuel, single rate meter prepayment customers will reduce from £1,230 to £1,054 or £1,104, a reduction of £176 or £126 (14.3% or 10.2%) under a price cap with £nil and £50 dual fuel headroom respectively.

- *Dual fuel, Economy 7 customers*

Figure 7.5: Preferred design price cap model vs average prepayment bill (dual fuel, Economy 7, 30 June 2015, medium TDCV)

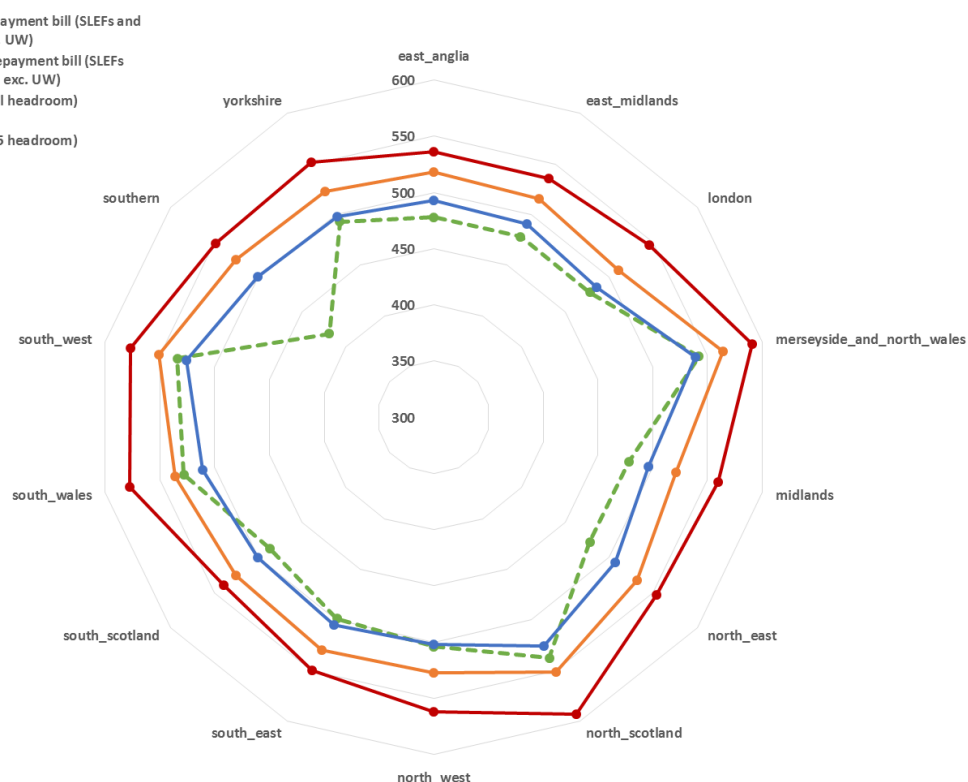


Source: CMA analysis.

7.156 On a national basis, the average bill across all dual fuel, Economy 7 meter prepayment customers will reduce from £1,224 to £973 or £1,023, a reduction of £251 or £201 (20.5% or 16.4%) under a price cap with £nil and £50 dual fuel headroom respectively.

- *Single fuel electricity, single rate meter customers*

Figure 7.6: Preferred design price cap model vs average prepayment bill (single fuel electricity, single rate meter, 30 June 2015, medium TDCV)

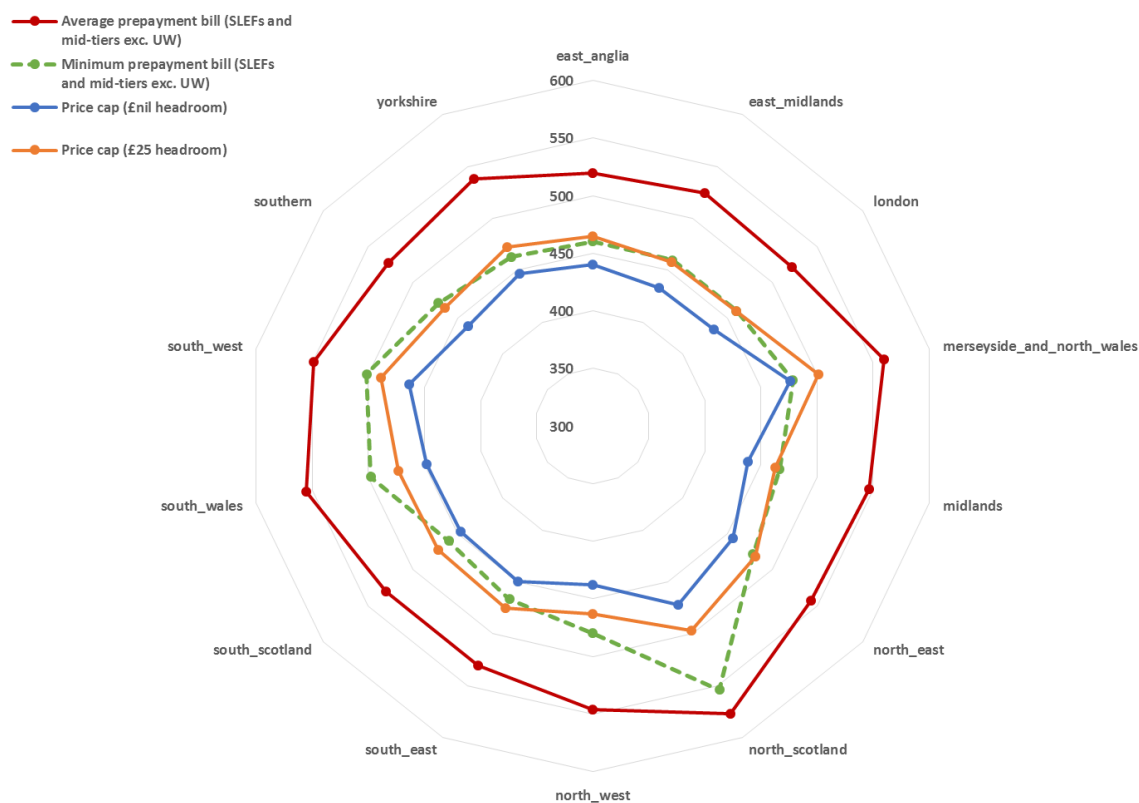


Source: CMA analysis.

7.157 On a national basis, the average bill across all single fuel electricity, single rate meter prepayment customers will reduce from £556 to £503 or £528, a reduction of £53 or £28 (9.5% or 5.0%) under a price cap with £nil and £50 dual fuel (ie £25 single fuel) headroom respectively.

- *Single fuel electricity, Economy 7 customers*

Figure 7.7: Preferred design price cap model vs average prepayment bill (single fuel electricity, Economy 7 meter, 30 June 2015, medium TDCV)

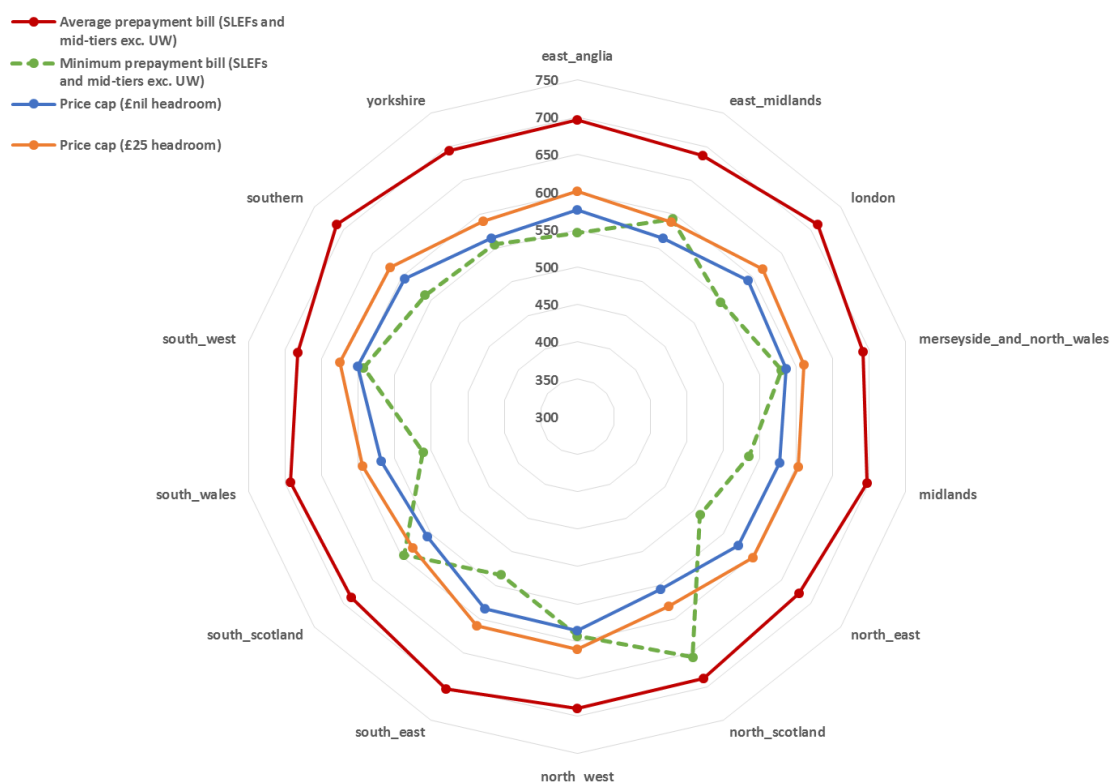


Source: CMA analysis.

7.158 On a national basis, the average bill across all single fuel electricity, Economy 7 meter prepayment customers will reduce from £534 to £446 or £471, a reduction of £88 or £63 (16.5% or 11.8%) under a price cap with £nil and £50 dual fuel (ie £25 single fuel) headroom respectively.

- *Single fuel gas, single rate meter customers*

Figure 7.8: Preferred design price cap model vs average prepayment bill (single fuel gas, single rate meter, 30 June 2015, medium TDCV)



Source: CMA analysis.

7.159 On a national basis, the average bill across all single fuel gas, single rate meter prepayment customers will reduce from £696 to £578 or £603, a reduction of £117 or 92 (16.9% or 13.3%) under a price cap with £nil and £50 dual fuel (ie £25 single fuel) headroom respectively.

- *Summary by fuel/meter type*

7.160 The table below summarises the average estimated savings for customers under the provisionally proposed price cap for each fuel/meter combinations across all regions under a price cap with £nil and £50 dual fuel (ie £25 per fuel) explicit headroom respectively at medium TDCV.

Table 7.7: Summary of estimated average customer savings at medium TDCV (30 June 2015, medium TDCV), £nil and £50 dual fuel (ie £25 per fuel) explicit headroom

	Average customer savings (£) – £nil headroom	% annual bill reduction – £nil headroom	Average customer savings (£) – £50 headroom	% annual bill reduction – £50 headroom
Dual fuel, single rate meter	£176	14.3%	£126	10.2%
Dual fuel, Economy 7	£251	20.5%	£201	16.4%
Single fuel electricity, single rate meter	£53	9.5%	£28	5.0%
Single fuel electricity, Economy 7	£88	16.5%	£63	11.8%
Single fuel gas, single rate meter	£117	16.9%	£92	13.3%

Source: CMA analysis.

Impacts on suppliers

- 7.161 The application of the price cap with £nil headroom would reduce suppliers' revenue in line with the level of detriment observed. This amount would reduce dependent upon the level of headroom applied. We have observed detriment attributable to the prepayment customers of the Six Large Energy Firms by 30 June 2015 of £481 million.⁹⁹⁹ This would translate into a reduction in the annual revenues of the Six Large Energy Firms under the price cap of £481 million and £303 million with £nil and £50 headroom respectively. This revenue reduction will be apportioned across the Six Large Energy Firms based on their share of the detriment outlined in Section 3.
- 7.162 In financial year 2014 earnings before interest and tax (EBIT) generated by the Six Large Energy Firms from their domestic supply was £1,193 million. For illustration, a revenue reduction of £481 million and £303 million would represent a reduction in the domestic supply EBIT of the Six Large Energy Firms of 40.3% and 25.4% respectively.
- 7.163 The price cap will also apply to Mid-tier Suppliers and smaller suppliers and will therefore result in revenue reductions outside of the Six Large Energy Firms. [REDACTED]¹⁰⁰⁰ [REDACTED].
- 7.164 [REDACTED] In this regard the proposed price cap would not treat the prepayment customer base of the Mid-tier Suppliers and the independent suppliers any differently from the prepayment customer bases of the Six Large Energy Firms. However, in customer bill terms, the reductions that would be felt in the revenues of the Six Large Energy Firms, the Mid-tier Suppliers and other suppliers would be smaller than the detriment levels which we have observed. We thus expect, based on our current analysis, that any revenue

⁹⁹⁹ The gains from switching data set which informed this analysis included a variety of exclusions (for example, due to incomplete tariff data). As such the actual level of detriment and the impact of the price cap on supplier revenue may be in excess of the amounts stated in this analysis.

¹⁰⁰⁰ [REDACTED]

reduction would still result in per customer revenues in excess of efficient prices, and so all suppliers should be able to supply at a profit in the prepayment segments.

Headroom

- 7.165 As noted above, we have considered whether to include explicit headroom within the provisionally proposed price cap. We consider that there are two bases for including headroom:
- (a) to facilitate competition; and
 - (b) to mitigate the risk that the price cap does not allow for recovery of efficient costs.
- 7.166 We have provisionally decided to include headroom of £25 per fuel (ie £50 headroom in the dual fuel cap). This headroom reduces the amount of detriment addressed by the PPM Price Cap Remedy and also mitigates risks in a number of respects. For example, it reduces the likelihood that changes in external costs over the year that a price cap is set for will result in the price cap being below the level of efficient costs. There is therefore a trade-off between the effectiveness and proportionality of the price cap according to the level of explicit headroom.
- 7.167 In determining the appropriateness of including explicit headroom, we have also considered the amount of implicit headroom that the proposed price-cap already includes within its design. We have provided for some implicit headroom to be incorporated into the level of the cap through our approach to indexation of indirect costs and the prepayment uplift as we do not factor in any efficiency gains even though it is reasonable to expect that there will be such gains.
- 7.168 Our provisional assessment that £50 is a suitable level of explicit headroom was informed by our analysis of the impacts on both suppliers¹⁰⁰¹ and customers.¹⁰⁰² This analysis looked at the impact of different levels of headroom¹⁰⁰³ and allowed us to consider how the resulting price cap would compare with average and minimum prepayment tariff prices in the market.
- 7.169 We note that allowing for no explicit headroom results in a price cap which is lower than the minimum prepayment tariff in many regions for several of the different meter-fuel type combinations. Allowing for £25 per fuel results in a

¹⁰⁰¹ See paragraphs 7.161.

¹⁰⁰² See paragraphs 7.160.

¹⁰⁰³ See Figures 7.4–7.8.

price cap which is more generally in line with the minimum prepayment tariff prices in the market in many regions. This gives us some comfort that allowing for £25 of explicit headroom per fuel produces a sustainable level of the price cap and thereby mitigates to some extent the likelihood and potential severity of some of the unintended consequences we have identified.¹⁰⁰⁴

- 7.170 In particular we consider that setting the price cap at a sustainable level reduces the likelihood that suppliers seek to limit their exposure to the market or that they feel it necessary to try to reduce the quality of service in order to save costs. We also consider that the inclusion of explicit headroom limits the extent to which the introduction of a price cap increases the perception of regulatory risk.¹⁰⁰⁵ We note that a price cap is still an interventionist remedy and this could itself contribute to an increased perception of regulatory risk though we consider that by including sufficient headroom to produce a sustainable level of price cap we minimise the scope for regulatory risk.

Sunset provision and mid-term review

- 7.171 We have also considered the need for a sunset clause to ensure the duration of the price cap is both certain to the industry, and to ensure it is a proportionate remedy. Respondents to the Remedies Notice expressed a strong preference to ensure that any price cap was transitional and had a clearly defined sunset clause. There were also differing views on whether the exit should be linked to the roll-out of smart meters. We have carefully considered these concerns in the scoping and design of the price cap.
- 7.172 Specifically, the PPM Price Cap Remedy is intended to be transitional as we expect that, as the national programme for the roll-out of smart meters reaches substantial completion and our other proposed remedies take effect over time to allow and incentivise suppliers to compete more effectively for new prepayment customers and prepayment customers' engagement levels increase, prepayment customers are unlikely to continue to suffer detriment of the same magnitude that we have observed arising from the Prepayment AEC and the Domestic Weak Customer Response AEC.
- 7.173 In particular, it is our view that widespread adoption of smart meters will eliminate the technical constraints on suppliers' ability to offer prepayment customers any number of tariffs, including tariffs that are equivalent to those

¹⁰⁰⁴ See paragraphs 7.236–7.257 for consideration of potential unintended consequences.

¹⁰⁰⁵ See paragraphs 7.249–7.251.

on offer to customers on direct debit.¹⁰⁰⁶ It will also make it possible to switch customers remotely (at little or no cost) to a smart credit meter. It follows that, following substantial completion of the roll-out of smart meters, the tariffs on offer to prepayment customers should be constrained by those that are on offer to customers on direct debit (or other low-priced tariffs in the markets). We also expect prepayment customers to be engaging more frequently, and more effectively, as our proposed remedies concerning the Domestic Weak Customer Response AEC take effect.

- 7.174 In addition to the need for the proposed price cap therefore falling away by the end of 2020 (assuming roll-out of smart meters is substantially complete), the changed complexion of competition in the prepayment segments at that time will mitigate any potential adverse impact that might have otherwise resulted from the termination of the PPM Price Cap Remedy (such as prepayment customers experiencing bill shock as they move from a capped tariff to an uncapped tariff that may be higher).
- 7.175 Further, there will be no inherent difference in the cost to serve prepayment customers relative to direct debit customers once the roll-out of smart meters has been substantially completed as all such customers will be using the same metering infrastructure.¹⁰⁰⁷ This in turn should contribute to strengthen suppliers' incentives to compete to acquire prepayment customers.
- 7.176 We note that there are initial indications that competition for smart prepayment customers may be developing. In particular, we note that E.ON has announced that it plans to roll out its smart pay-as-you-go offering in 2016, having piloted it in 2015, which suggests that the options available to smart prepayment customers may become more attractive in future. We consider that this development – if implemented – would be positive, but the scale of the detriment we have observed from the Prepayment AEC and the Domestic Weak Customer Response AEC still warrants intervention.

¹⁰⁰⁶ As described in Section 3, dumb prepayment meters have a limited number of tariff slots which restrict the number of tariffs that can be offered. We understand that there is no such restriction applying to smart meters. Prepayment meter customers can already request a smart meter but may view any associated cost as a marginal cost caused by the switch (or, at least, a perception of a cost). This switching cost could therefore deter customers seeking out the most competitive prices when these are only available to customers with a smart meter. Smart meters can work in prepayment or credit mode. The smart meter roll-out will result in all customers having a smart meter such that there is no incremental cost in switching to another tariff.

¹⁰⁰⁷ As described in paragraph 7.11 current prepayment meter tariff prices are above the level we would expect if there were effective competition in the prepayment segments. While the increased costs to serve associated with prepayment meters are a contributing factor to higher prepayment tariffs, we have observed that they are not currently driving prepayment meter tariff prices.

- 7.177 For the above reasons, we propose to include a sunset provision for the price cap that is linked to the roll-out of smart meters being substantially completed.
- 7.178 Our current expectation based on discussions with DECC is that widespread adoption of smart meters will occur no later than on 31 December 2020 in accordance with the government's stated timetable for the roll-out.¹⁰⁰⁸ We expect that by this date the supply of energy to domestic prepayment customers will have evolved significantly, partly as a result of our other proposed remedies concerning promoting customers' engagement and partly as a result of the improved functionality of smart meters such that we do not expect that these customers will still suffer to some extent from the Domestic Weak Customer Response AEC or Prepayment AEC or associated detriment.
- 7.179 This approach to terminating the PPM Price Cap Remedy provides certainty to suppliers, customers and other key stakeholders including government, Ofgem, consumer bodies and investors in the energy sector. We believe this is particularly important in facilitating suppliers' longer-term decisions such as deciding to innovate. This certainty is also beneficial for customers as it makes the workings of these segments of the domestic retail energy markets more transparent and avoids potential perverse incentives where, for example, termination of the price cap based on an alternative ending mechanism may have been contingent on customer behaviour (see further paragraph 7.181).
- 7.180 We note that there is some inherent uncertainty over exactly when the roll-out of smart meters in the domestic retail energy markets will be completed, and so it is possible that the Prepayment AEC, and the Domestic Weak Customer Response AEC, will persist in substantial form beyond 31 December 2020. Accordingly, while we would propose to incorporate a sunset provision into the PPM Price Cap Remedy that is linked to the successful completion of the roll-out of smart meters, we also propose to conduct a focused mid-term review in January 2019¹⁰⁰⁹ of the progress that has been made concerning the roll-out of SMETS 2 smart meters.¹⁰¹⁰ In the event that the roll-out of SMETS 2 smart meters was materially ahead of schedule, we would consider whether to terminate the price cap early (ie an

¹⁰⁰⁸ See DECC, [Smart Metering Implementation Programme](#).

¹⁰⁰⁹ January 2019 is suggested as the date for this mid-term review as the approximate midpoint between the potential commencement of the PPM Price Cap Remedy in April 2017 and the termination of the remedy in December 2020.

¹⁰¹⁰ We believe it is the installation of SMETS 2 meters which is relevant to our assessment of the ongoing need for a price cap as these have features such as interoperability which are necessary to realise the full benefits of smart metering.

early termination provision would be included). In the event that, at the date of the mid-term review, the roll-out of SMETS 2 smart meters does not appear likely to be completed by 31 December 2020, we would consider whether to encourage Ofgem to review the situation and take whatever action it considers appropriate (including whether to introduce a similarly structured price cap in the prepayment segments as from the start of 2021). We believe that this approach is more proportionate than extending the PPM Price Cap Remedy for a further specified period. While this creates some uncertainty about the possibility of a price cap being in place beyond 2020, this uncertainty is narrowed to the issue of the extent of roll-out.

- 7.181 We have considered alternative options for terminating the PPM Price Cap Remedy with several such options making termination contingent in some way on the installation of SMETS 2 smart meters on a customer-by-customer basis, given the link between the roll-out of smart meters and the Prepayment AEC (and, to a lesser extent, the Domestic Weak Customer Response AEC) (see paragraph 7.172). However, we also consider that having a sunset provision that led to the PPM Price Cap Remedy falling away at different times for different customers (ie depending on whether a particular customer has a smart prepayment or not) would create uncertainty for customers and suppliers and may also create perverse incentives for customers. For example, if a customer ceased to be in scope of the price cap once they have a smart meter, then customers whose annual bills are still at the price cap level may seek to avoid having a smart meter installed (eg if they benefited, or perceived that they benefited from a lower capped price).¹⁰¹¹

Implementation, monitoring and enforcement

- 7.182 We have considered how the PPM Price Cap Remedy would be implemented, monitored and enforced.

¹⁰¹¹ We note that a potential solution to this problem would be not to extend the cap to those customers who refuse a smart meter when offered one by their supplier. However, we consider that it would be very onerous to monitor compliance with such price cap. We also considered whether to oblige suppliers to offer smart meters to their prepayment customers. However, we are minded not to pursue such remedy.

The means of implementing the remedy

- 7.183 The operation and implications of the remedy need to be clear to the persons to whom the remedy is directed as well as to other interested parties, ie to affected suppliers and to Ofgem.¹⁰¹²
- 7.184 We are proposing to implement the proposed remedy by way of an order on suppliers. In addition, and for the purposes set out below, we believe it is appropriate to modify, by way of an order, the gas and electricity supply standard licence conditions, with a view to introducing an obligation to comply with the proposed PPM Price Cap remedy.
- 7.185 As regards enforcement, the CMA would be able to directly enforce against the order. Ofgem, as energy regulator, would have a duty to monitor suppliers' compliance with the licence condition and the power to sanction any contravention of a standard licence condition (including by imposing penalties up to 10% of the contravening supplier's turnover).¹⁰¹³ We would expect that resolution of any non-compliance may involve suppliers issuing a rebate to customers who had previously paid tariffs which were in excess of the price cap. The suitable course of action will, however, be a matter for Ofgem to decide, based on the relevant facts and circumstances.
- 7.186 In our proposed remedy, Ofgem would have an additional role in determining the updated level of the price cap, as set out in the relevant suppliers' licence conditions. This would involve Ofgem collecting information relating to each of the cost indices¹⁰¹⁴ and using these to calculate the updated price cap level in line with methodology specified in the licence. This process would be mechanical and objective.

Timescale for the implementation of the PPM Price Cap Remedy

- 7.187 Subsequent to publication of the final order, we expect that suppliers will need a period of up to three months to make any practical changes such as updating prices and inform their customers. We therefore expect that a price cap remedy could be implemented with effect from April 2017 and, as noted above, updated annually on 1 April.

¹⁰¹² As regards affected customers, we believe that only the key implications of the remedy must be clear to them but it would be a matter for suppliers and Ofgem to determine how to inform these customers appropriately. In practice, while the proposed remedy will have practical benefits for customers, it will not require any direct involvement from customers.

¹⁰¹³ See paragraph 7.196.

¹⁰¹⁴ This information would come from the Office for Budget Responsibility, ICIS Heren and Ofgem's own price control team.

Assessment of effectiveness

7.188 While we provisionally consider that the proposed remedies set out in Sections 5 and 6 will be effective in addressing the features contributing to each of the Domestic Weak Customer Response AEC and the Prepayment AEC, they will take time to implement before they start to address the features we have identified and, in turn, reduce the detriment to domestic customers arising from them. As a result, we expect the detriment arising from the Domestic Weak Customer Response AEC and the Prepayment AEC to persist in substantial form for the next few years, ie until the completion of the roll-out of smart meters. As a result, given the size of the detriment we have observed, we have considered the need to intervene to address domestic customer detriment directly in this transitional period, through the proposed PPM Price Cap Remedy.

7.189 Our provisional view is that, for the reasons set out in this section and summarised below, the PPM Price Cap Remedy would be effective in achieving this aim. In summary we believe that the PPM Price Cap Remedy would be effective as the design specifies an initial level which is derived from the level of detriment we observe¹⁰¹⁵ and the indexing mechanism has been designed to result in the price cap remaining at a level which is both sustainable and which mitigates the detriment.¹⁰¹⁶

7.190 We expect that the principal benefit of this remedy will be the reduction in customer bills. The size of this impact relative to each supplier's revenue varies significantly across suppliers as prepayment customers make up a larger proportion of the customer base for some suppliers than others. We estimate that the PPM Price Cap Remedy could reduce customer bills as shown in table below:

Table 7.8: Summary of estimated average customer savings at medium TDCV, £50 dual fuel (ie £25 per fuel) explicit headroom

	<i>Average customer savings (£) – £50 headroom</i>	<i>% annual bill reduction – £50 headroom</i>
Dual fuel, single rate meter	£126	10.2%
Dual fuel, Economy 7	£201	16.4%
Single fuel electricity, single rate meter	£28	5.0%
Single fuel electricity, Economy 7	£63	11.8%
Single fuel gas, single rate meter	£92	13.3%

Source: CMA analysis.

¹⁰¹⁵ See paragraphs 7.79–7.87.

¹⁰¹⁶ See paragraphs 7.102–7.133.

- 7.191 We consider that these savings are appropriate as prevailing prepayment tariff prices on 30 June 2015 appear to be of the order of £178¹⁰¹⁷ more expensive than the benchmark direct debit dual fuel single rate meter tariff prices, allowing for a cost-to-serve differential. In customer bill terms, these reductions are smaller than the detriment levels which we have observed. We thus expect that any supplier revenue reduction would still result in per customer revenues in excess of efficient cost.
- 7.192 In assessing the effectiveness of the proposed remedy we have in particular considered the following factors:
- (a) the extent to which the proposed remedy is capable of effective implementation, monitoring and enforcement;
 - (b) the timescale over which the PPM Price Cap Remedy is likely to have an effect;
 - (c) compliance with existing laws and regulations; and
 - (d) its interaction with our other proposed remedies.

Implementation, monitoring and enforcement

- 7.193 For the reasons set out in paragraphs 7.183 to 7.186, we propose to implement the price cap by way of an order on suppliers and associated licence conditions changes that will facilitate monitoring, enforcement and updating of the price cap. We consider that implementing the price cap by way of an order and associated licence conditions changes would provide a higher degree of certainty over the timing of implementation, in particular given that the initial price cap would be set on the basis of analysis that has already been conducted by the CMA (set out in Section 3).
- 7.194 In this regard, we have noted above that we consider that the proposed remedy is capable of being in force from April 2017. The price cap would be determined upon publication of a final order by the CMA, three months ahead of the date the price cap would come into effect in order to give suppliers sufficient time to assess compliance of their tariff offers and make changes as necessary. Each supplier would have to assess compliance of its prepayment tariffs with the PPM Price Cap Remedy as described in paragraph 7.141. A tariff would be compliant if the structure of charges is such that for any consumption level between the low and high TDCVs

¹⁰¹⁷ See paragraph 7.12.

specified by Ofgem at the start of each price cap year the projected customer bill is no more than the level specified in the price cap.

- 7.195 In this way suppliers would be able to take steps to ensure they are compliant from the outset and can remain compliant throughout the relevant period.
- 7.196 Similarly, the process for updating the level of the cap (in line with the movement of the exogenous indices) would be simple, with the update being observed and introduced into the price cap by Ofgem following a mechanical and objective process. We expect that Ofgem, as sector regulator, would monitor compliance with the relevant licence conditions on an ex post basis by reviewing tariffs on offer. The information needed to assess compliance in this way would be the publically available information about the standing charge and unit rate of each domestic prepayment tariff.
- 7.197 The method for assessing compliance would be entirely objective as the projected level of the customer bill could be readily calculated and compared to the price cap at all consumption levels. We therefore consider that it would be practical for Ofgem (and the CMA) to monitor compliance with this remedy.
- 7.198 As noted above, enforcement of the order and/or the licence conditions could be led by the CMA or Ofgem as appropriate.

Timescale for the PPM Price Cap Remedy

- 7.199 In evaluating the effectiveness of the proposed remedy, we have considered the timescale over which the Domestic Weak Customer Response AEC and the prepayment AEC would be expected to endure, and the timescale over which the proposed remedy would be likely to take effect. As noted, we believe that this consideration is of particular importance for this proposed remedy as the price cap would only be in place as a transitional measure pending development of effective competition for prepayment customers. We expect that this will develop over the period to the end of 2020, once the roll-out of smart meters has been substantially completed.
- 7.200 We have described in Section 4 the timescale over which we expect the remedies addressing the Domestic Weak Customer Response AEC and the Prepayment AEC to be effective. As noted in paragraph 7.58 above, given the magnitude of the detriment being suffered by prepayment customers from the Prepayment AEC and the Domestic Weak Customer AEC, which will take time to be addressed by our proposed remedies and the roll-out of smart meters, timely implementation is a key criterion for the price cap. We

consider that there is a trade-off between implementing a remedy which can be effective in the short term versus taking a longer period of time to develop a remedy which may more precisely track costs. We note that these considerations apply not only to the initial implementation of the remedy but also to ongoing updates.

- 7.201 As noted above, our expectation is that the PPM Price Cap Remedy could be in force and be effective from April 2017.^{1018,1019} As a result, it will be effective in achieving its aim of mitigating the detriment arising from the Domestic Weak Customer Response AEC and Prepayment AEC in the short term.

Compliance and consistency of the PPM Price Cap Remedy with existing laws and regulations

- 7.202 As part of our assessment of the effectiveness of the PPM Price Cap Remedy and the approach we have taken to some of the detailed design components, we have taken into account the need for the PPM Price Cap Remedy to comply with relevant laws and regulations. A particular focus of our assessment of this aspect has been the interaction of the PPM Price Cap Remedy with existing standard licence conditions and relevant EU legislation (in particular Directive 2009/72/EC¹⁰²⁰ concerning electricity supply (the 'Electricity Directive'), and Directive 2009/73/EC¹⁰²¹ concerning gas supply (the 'Gas Directive') (collectively, the 'Energy Directives'), and case law.
- 7.203 Our assessment of effectiveness of the proposed PPM Price Cap Remedy has assessed compliance with the requirement concerning the charges for different payment methods included in SLCs 22B.7 (a) and SLC 27.2A, ie suppliers must ensure that any differences in charges between payment methods are cost reflective.¹⁰²² We understand that SLC 27.2A prohibits suppliers from applying a tariff to prepayment customers that means they

¹⁰¹⁸ As described in paragraph 7.187.

¹⁰¹⁹ Suppliers may reduce their prices in anticipation of the price cap so as to avoid a negative public perception of their prices being excessive. In such circumstances the price cap remedy may be considered to be effective prior to its implementation rather than simply not being effective at all. We note that the distinction between effective prior to implementation and ineffective is hard to draw as there may not be a clear indication of the motivation for lowering prices so it may be argued that any such price decrease was caused by something other than the price cap remedy.

¹⁰²⁰ Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC (which contained a similar provision to Article 3(2)).

¹⁰²¹ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC (which contained a similar provision to Article 3(2)).

¹⁰²² This requirement is underpinned by the Energy Directives (Annex I 1(d)).

are charged more than non-prepayment customers (after allowing for differences in costs) on the same tariff, but does not prevent suppliers from applying a lower payment differential.¹⁰²³ Therefore, to the extent that the proposed PPM Price Cap Remedy imposes a maximum annual bill that suppliers can charge to prepayment domestic customers, we consider that the proposed PPM Price Cap Remedy would not lead to suppliers being in breach of SLCs 22B.7 (a), SLC 27.2A and the Energy Directives.

7.204 In addition, we have considered compliance of the proposed PPM Price Cap Remedy with (i) Article 3(2) of the Energy Directives; and (ii) the judgment of the Court of Justice delivered on 20 April 2010 in the *Federutility* case (the ‘Federutility Judgment’).¹⁰²⁴

7.205 Article 3(2) of the Energy Directives allows EU member states to price regulate through the imposition of public service obligations on companies operating in the electricity and gas sectors, and broadly sets out the requirements that the public service obligations must fulfil to be compatible with EU law. The Federutility Judgment sets out additional criteria that a national retail price regulation measure under Article 3(2) of the Energy Directives must satisfy, including the following conditions:¹⁰²⁵

- (a) the public service obligation must be adopted in the general economic interest;
- (b) the public service obligation had to be necessary to achieve the objective in the general economic interest; and
- (c) the public service obligation must be clearly defined, transparent, non-discriminatory, verifiable, and must guarantee equal access for EU gas companies to consumers.

Adopted in the general economic interest

7.206 We note that services of a general economic interest capture a wide range of services.¹⁰²⁶ The domestic retail supply of gas and electricity, in particular,

¹⁰²³ Ofgem’s open letter dated 20 May 2014 and Ofgem’s guidance dated 17 December 2009. We understand that this interpretation of SLC 27.2A is consistent with the Energy Directives.

¹⁰²⁴ Case C-265/08, *Federutility and others v Autorità per l’energia elettrica e il gas*, [2010] ECR I-3377. As part of our assessment, we have also considered the Court of Justice judgment delivered on 10 September 2015 in the *Commission v Poland* case, Case C-36/14, which broadly upheld the Federutility Judgment.

¹⁰²⁵ While the Federutility Judgment focused on Article 3(2) of Directive 2003/55 concerning gas, this Article is identical to Article 3(2) of the Gas Directive, and almost identical to Article 3(2) of the Electricity Directive. Accordingly, the Federutility criteria applies to Article 3(2) of both directives.

¹⁰²⁶ Subject to EU legislation, EU member states are generally free to determine those services which they consider to be of the general economic interest, Communication from the Commission ‘Services of general interest in Europe’ (OJ 2001 C 17, p. 4), paragraph 22.

have each been identified as being in the general economic interest by EU case law,¹⁰²⁷ legislation¹⁰²⁸ and guidance from the European Commission.¹⁰²⁹ We also note that the Energy Directives¹⁰³⁰ impose an obligation on member states to ensure that customers are supplied with gas and electricity at reasonable prices.

- 7.207 In this regard, we note that the ultimate aim of the PPM Price Cap Remedy is to ensure that the prices for the retail supply of gas and electricity to domestic prepayment customers in Great Britain are affordable (or, in other words, maintained at a reasonable level). The PPM Price Cap Remedy is designed to do so by mitigating the residual harm to domestic prepayment customers that we provisionally consider arises and will continue to arise from the Prepayment AEC and the Domestic Weak Customer Response AEC while our proposed remedies concerning the prepayment framework, and concerning domestic customer engagement more generally, take effect, and until the roll-out of smart meters has been substantially completed. In particular, we envisage that the PPM Price Cap Remedy would reduce the prices being paid by prepayment customers and equilibrate the highest of them¹⁰³¹ with a cost-adjusted benchmark level based on competitively priced acquisition tariffs in the rest of the domestic markets (see paragraph 7.79).
- 7.208 Accordingly, we consider that the aim of the PPM Price Cap Remedy, of ensuring reasonable prices in relation to the supply of gas and electricity to PPM customers, is consistent with the Energy Directives and being adopted in the general economic interest.

Necessary to achieve the objective in the general economic interest

- 7.209 In addition to being adopted in the general economic interest, we have considered whether the PPM Price Cap Remedy would go no further than necessary to achieve the objective in the general economic interest. Save as noted below, we consider that our usual proportionality assessment, following the criteria set out in the CMA's guidelines for market investigations,¹⁰³² is consistent with this general requirement (see paragraphs 7.221 to 7.268

¹⁰²⁷ The ECJ has held a large and varied group of services to be of general economic interest in utilities industries, including the supply of gas (eg Case C- 159/94 *Commission v France* [1997] ECR I- 5815), and electricity (eg Case C- 393/92 *Municipality of Almelo and Others* [1994] ECR I- 1477).

¹⁰²⁸ Article 3(2) of the Energy Directives, including a reference to Article 106 of the Treaty.

¹⁰²⁹ For example, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions '[A Quality Framework for Services of General Interest in Europe](#)', 20 December 2011.

¹⁰³⁰ Recitals 45 and 50 and Article 3(2) of the Electricity Directive, and recital 43 of the Gas Directive.

¹⁰³¹ We consider that our other proposed remedies should enable competition to take place below the level of the price cap.

¹⁰³² [CC3](#).

below). In addition, we have had particular regard to ensuring the PPM Price Cap Remedy would be limited in time, and subject to a mid-term review.

- 7.210 As part of our assessment of the effectiveness of the proposed remedy, which takes into account the need to apply a sunset clause to the PPM Price Cap Remedy, we have considered how long the Prepayment AEC (and the resulting detriment) could be expected to persist and, accordingly, how long prepayment customers will need to be prepayment by the PPM Price Cap Remedy (see paragraphs 7.171 to 7.181 above).
- 7.211 We consider that smart meters, and our other proposed remedies concerning the Prepayment AEC and domestic customer engagement, are expected to change the competitive dynamic in the prepayment segments, and more broadly across the domestic retail energy markets, and the way that customers and suppliers interact so the PPM Price Cap Remedy would no longer be required once smart meter roll-out has been concluded by the end of 2020 (by which time our other proposed remedies would also be taking or have taken effect) (see paragraphs 7.171 to 7.181 above). Accordingly, we propose that our provisional remedy would expire upon substantial completion of smart meter roll-out.
- 7.212 As noted above, we note that there is some inherent uncertainty over exactly when the roll-out of smart meters in the domestic retail energy markets will be completed, and so it is possible that smart meter roll-out could be substantially completed ahead of 31 December 2020. It is also possible that the Prepayment AEC, and the Domestic Weak Customer Response AEC will persist beyond 31 December 2020. Accordingly, while we would propose to incorporate a sunset provision into the PPM Price Cap Remedy that is linked to the successful completion of the roll-out of smart meters, we also propose to conduct a focused mid-term review in January 2019¹⁰³³ of the progress that has been made concerning the roll-out of SMETS 2 smart meters.
- 7.213 We note that we do not at this point propose to recommend Ofgem to implement a new price cap beyond the 31 December 2020 sunset date.

¹⁰³³ January 2019 is suggested as the date for this mid-term review as the approximate midpoint between the potential commencement of the PPM Price Cap Remedy in April 2017 and the termination of the remedy in December 2020.

Must be clearly defined, transparent, non-discriminatory, verifiable, and guarantee equal access

- 7.214 We consider that these considerations are broadly consistent with our usual effectiveness and proportionality assessment when deciding upon any given remedy.
- 7.215 Our assessment of effectiveness of the PPM Price Cap Remedy (see paragraphs 7.193 to 7.198 above) has taken into account the need to be capable of implementation, monitoring and enforcement, which all require that the PPM Price Cap Remedy is clearly defined, transparent, and with a verifiable scope.
- 7.216 Our proposed design of the PPM Price Cap Remedy takes into account the requirement to be non-discriminatory and guaranteeing equal access. In this context, we have considered the likely impact of the PPM Price Cap Remedy on suppliers and note, in this regard, that the PPM Price Cap Remedy would treat all suppliers' prepayment customer bases in the same way, and would not lead to companies with similar customer bases being treated differently.

Interaction with other remedies

- 7.217 We are also proposing other remedies to address, in part, the Prepayment AEC and Domestic Weak Customer Response AEC, and associated detriment. Our provisional view is that while such measures will be effective in addressing the features contributing to each of the Domestic Weak Customer Response AEC and the Prepayment AEC, they will take time to implement before they start to address the features we have identified and, in turn, reduce the detriment to domestic customers arising from them. As a result, we expect the detriment arising from the Domestic Weak Customer Response AEC and the Prepayment AEC to persist in substantial form for the next few years. Given the size of the detriment we have observed, we have therefore considered the need to intervene to address domestic customer detriment directly in this transitional period, through the proposed PPM Price Cap Remedy.
- 7.218 As noted in Section 8, we believe that our proposed remedies concerning the Domestic Weak Customer AEC and associated detriment can materially, over the long term, improve engagement and overcome many aspects of the features that we have provisionally identified.
- 7.219 We recognise that a price cap remedy is likely to reduce the potential benefits of competition and has the potential, therefore, to dampen the

effectiveness of our other proposed remedies. We consider these and other possible unintended consequences further in paragraphs 7.236 to 7.257.

- 7.220 However, in the short term, we do not expect our other proposed remedies to take effect, and so we do not expect our proposed price cap to have any material adverse effect on the effectiveness of our other proposed remedies during the initial period prior to their implementation and when they become effective, when the significant detriment for prepayment customers will be largely otherwise unaddressed. As a result, prepayment customers are therefore unlikely to realise the benefits of competition even if the price cap were not introduced. The ongoing magnitude of the detriment for prepayment customers was a substantial factor in determining our provisional decision to impose the price cap remedy.

Assessment of proportionality

- 7.221 We assess the proportionality of our proposed remedies in line with the criteria set out in our guidance¹⁰³⁴ which states that a proportionate remedy is one that:¹⁰³⁵

- (a) is effective in achieving its legitimate aim;
- (b) is no more onerous than needed to achieve its aim;
- (c) is the least onerous if there is a choice between several effective measures; and
- (d) does not produce disadvantages which are disproportionate to the aim.

Effective in achieving its aim

- 7.222 As described in the effectiveness section¹⁰³⁶ we believe that the PPM Price Cap Remedy is likely to be effective in achieving its aim of limiting the prices paid by prepayment customers in the short to medium term while other remedies to the Prepayment AEC and Domestic Weak Customer Response AEC are taking effect, so mitigating the detriment resulting from those AECs during the transitional period (ie until the end of 2020).
- 7.223 We have also considered other potential impacts on suppliers. We anticipate that suppliers will face some costs associated with implementing the

¹⁰³⁴ CC3.

¹⁰³⁵ CC3, paragraph 344.

¹⁰³⁶ See paragraphs 7.188–7.220.

remedy.¹⁰³⁷ We do not expect these costs to be large as we expect that they will relate only to monitoring compliance and updating tariff prices as necessary to remain compliant.

- 7.224 We note the risk that the level of the price cap may be set too low to allow for recovery of efficient costs. To the extent this risk materialises it would reduce revenues by more than the excess which we have observed relative to prices offered on direct debit. Thus we have sought to mitigate this risk, and our approach to doing so is described in paragraphs 7.165 to 7.170.
- 7.225 We have also considered potential second order effects such as the risk of the PPM Price Cap Remedy distorting incentives. Our assessment of these risks is set out in paragraphs 7.236 to 7.257. In summary we are aware of a number of possible distorting effects and have taken steps to mitigate these risks where possible. We consider that the residual risks are sufficiently small in terms of likelihood and impact as to not result in the PPM Price Cap Remedy producing disadvantages which are disproportionate to the aim.

No more onerous than needed

- 7.226 We consider that the price cap is the only effective way to deal with the harm to customers which is expected to persist until effective competition develops, supported by our other proposed remedies and the smart meter roll-out.
- 7.227 We consider that the PPM Price Cap Remedy is no more onerous than needed to achieve its aim. We considered too whether it is possible to limit the prices paid by domestic prepayment customers without imposing a price cap. In particular we looked at the possibility of using principles-based regulation to mandate the approach suppliers must take when setting prices for domestic prepayment customers, for example by imposing a cost reflectivity requirement. We note that there is already a cost-reflectivity obligation relating to differences in the price charged for different payment methods with the same tariff.¹⁰³⁸
- 7.228 Our experience of reviewing cost differentials¹⁰³⁹ suggests that suppliers do not have sufficiently reliable cost information to allow for robust enforcement of such a cost-reflectivity requirement such that this would not be a practical

¹⁰³⁷ See paragraphs 7.258–7.260 for further detail.

¹⁰³⁸ This obligation is imposed by SLC 27.2A of the supply licence which was introduced to reflect requirements in European Union (EU) Directives – Annex A(d) of Directive 2003/54/EC concerning common rules for the internal market in electricity and of Directive 2003/55/EC concerning common rules for the internal market in natural gas.

¹⁰³⁹ Appendix 3.6, paragraph 35.

solution. We considered that a cost-reflectivity obligation is also not sufficient to achieve the aims of the PPM Price Cap Remedy since it does not protect customers from the Prepayment AEC should a supplier's high prices reflect inefficient costs. We also believe there is significant scope for such a requirement to be gamed for example by manipulating internal cost allocation.

- 7.229 We have considered whether there are less onerous ways to achieve the aim of limiting prices and do not believe that there are. In particular we considered variations on the proposed design. These alternative design options are described in paragraphs 7.62 to 7.74. We believe that the PPM Price Cap Remedy is a more effective and proportionate remedy compared to the alternative price cap design concerning the external reference price design, based on our assessment against the key criteria of practicability, supplier incentives and accuracy discussed in paragraph 7.74. In a nutshell, we believe that the proposed remedy is less onerous than the alternative price cap design due to the simpler calculation methodology; annual, rather than six monthly, update approach; and the reduced requirement for significant volumes of data to be provided and reviewed by suppliers and Ofgem respectively.
- 7.230 We have identified two specific respects in which the PPM Price Cap Remedy may be onerous:
- (a) Specifying a maximum level for prices which does not allow reasonable opportunities for the recovery of efficient costs.
 - (b) Imposing costs associated with complying with the price cap, for example costs relating to monitoring and compliance.
- 7.231 We have sought to mitigate the risk that the price cap is set below the level of efficient costs by designing the price cap to take competitive prices in the market¹⁰⁴⁰ as a starting point and then updating in line with indices tracking the key components of a customer's bill. Additionally the existence of headroom mitigates the risk that the level of the cap will be below efficient costs.
- 7.232 We note that building in headroom to mitigate the risk of the cap being too low increases the risk of the cap being too high. However, our initial

¹⁰⁴⁰ The benchmark is based on the prices offered by Ovo Energy and First Utility. We consider that these tariffs are competitive.

modelling suggests that dual fuel single rate customers would benefit from a reduction of £149 to £205¹⁰⁴¹ a year at Ofgem's medium TDCV.

- 7.233 Thus we consider that the PPM Price Cap Remedy is no more onerous than necessary to achieve its legitimate aim.

Is the least onerous if there is a choice between several effective measures

- 7.234 We have considered multiple alternative design options, including an external reference price approach which involves setting a cap on prepayment tariffs based on direct debit tariffs in the market, plus an uplift reflecting our assessment of the costs associated with serving prepayment customers. Our consideration of these alternative options is set out in paragraphs 7.62 to 7.74. In our view, the PPM Price Cap Remedy involving a hybrid reference price and cost index approach is the design that achieves the best balance between practicability, minimising the scope for gaming, accuracy, and our key criterion of being capable of implementation in the near future (in order to maximise its effectiveness). Accordingly, our provisional view is that, of the multiple alternative design options we have considered, our preferred design option would be the most effective at meeting its aim.

- 7.235 We also considered whether to set out a price cap in terms of a standing charge and unit rates. While we note some benefits of this approach, we provisionally concluded that this approach would constrain suppliers' flexibility to offer a variety of tariffs, which in turn could be expected to weaken competition for domestic prepayment customers (see paragraph 7.144).

Does not produce disproportionate disadvantages

- 7.236 To assess whether the PPM Price Cap Remedy produces disadvantages which are disproportionate to the aim we have considered the potential impact of the PPM Price Cap Remedy on suppliers and customers. Our assessment of these impacts is detailed above in paragraphs 7.151 to 7.164.

¹⁰⁴¹ This range represents the potential saving for each dual fuel, domestic, single rate, PPM customer at Ofgem's medium TDCV. The saving for each customer will depend on whether they are a dual fuel or single fuel customer, which region of the country they are in, whether they have a single rate or Economy 7 meter and their actual level of energy consumption.

- 7.237 We have considered the possible unintended consequences of the PPM Price Cap Remedy. In particular we have considered possible unintended impacts on the behaviour of customers and suppliers as described below.

Possibility of reduced customer engagement

- 7.238 A possible unintended consequence we have identified is that the existence of a price cap would reduce customer engagement. The risk is that some customers may feel they benefit sufficiently from the price cap such that there is no need to investigate alternative tariffs in the market. We note that the level of the price cap provides the opportunity for customers to benefit from switching to a cheaper supplier, thus mitigating the risk that customers do not engage in the market. However, we have not been able to reliably quantify the likelihood of customers not engaging as a result of the price cap.
- 7.239 Therefore we considered the possible consequences of widespread disengagement among affected customers, ie prepayment customers. Such widespread disengagement may inhibit strong competition from developing in the prepayment segments. We expect that the direct disincentivising effect would be limited to prepayment customers over the life of the PPM Price Cap Remedy. We note that currently there appears to be limited competition in the markets for non-smart prepayment customers and thus the marginal impact of any disincentivisation resulting from the PPM Price Cap Remedy, relative to the current status quo, may be relatively small.
- 7.240 We note that in the counterfactual scenario competition in the prepayment segments may intensify such that the marginal impact of a price cap would be more significant. However, based on the evidence of detriment available to us and our assessment of the counterfactual we believe it is appropriate to implement a price cap remedy.
- 7.241 Beyond the life of the PPM Price Cap Remedy levels of engagement among prepayment customers may remain low if customers have ‘lost the habit’ of engaging in the market, though we consider that the implementation of our engagement remedies and the introduction of fully functional smart meters is likely to increase, potentially significantly, the levels of engagement, particularly if these attract tariffs below the cap.

Reduced competition for prepayment customers

- 7.242 Another possible unintended consequence may be that suppliers do not attempt to compete in the prepayment segments at all as they instead seek to minimise risk by structuring tariffs to align as closely as possible with the price cap. We consider that it is possible that suppliers would offer tariffs

akin to the SVT where the price changes every year in line with the price cap. We expect that suppliers would be hesitant to offer fixed-term tariffs of more than one year in duration as a means of mitigating the risk that they under-recover costs should the price cap be lowered during the fixed-term tariff period. In this way it seems possible that the price cap may act to reduce the strength of competition in the prepayment segments and average prices could therefore rise.

- 7.243 However, against the current counterfactual of limited effective competition in the prepayment segments (as evidenced by the substantial detriment we have provisionally found), in the short term we would expect that the price cap would be effective at lowering prices. In the medium term it is possible that prices in such a scenario may be higher than they would be in the counterfactual. That is, prices, when subject to the price cap, **may** be higher than they would have been if the other proposed remedies concerning the Prepayment AEC and the Domestic Weak Customer Response AEC were introduced but the PPM Price Cap Remedy was not. However, given the timetable for the possible implementation of the other proposed remedies as compared with the implementation and expected removal of the PPM Price Cap Remedy, we do not think that there is a significant risk of prices being inflated in the medium term.

Risk that suppliers attempt to game the cap

- 7.244 We have considered the risk that suppliers attempt to game the cap. We consider that suppliers will not have the ability to game the price cap as the level of the price cap is determined solely with reference to parameters which the suppliers are unable to influence.¹⁰⁴²

Risk of suppliers exiting the market

- 7.245 There is a risk that under-recovery of costs, or the fear of costs not being recovered, leads some suppliers to seek to exit the prepayment segments. Condition 22 of the supply licence requires that suppliers provide an offer to supply to any customers that request one (which must include an offer to pay by prepayment meter¹⁰⁴³). Thus the only way for a supplier with more than 50,000 domestic customers to completely exit the prepayment segments would be to entirely cease licensed activity and relinquish its

¹⁰⁴² We note that some of the suppliers are vertically integrated and are part of a corporate group that also owns and operates energy network infrastructure. We note that the RIIO price control regulations stipulate the revenue that these network businesses are allowed to earn and therefore the suppliers are not able to influence this aspect of the price cap even when part of a vertically integrated corporate group.

¹⁰⁴³ When a supplier has more than 50,000 domestic customers. See SLC 27.1 and 27.2.

supply licence. We consider that the incentives against doing so are strong enough that likelihood of this outcome is low.

- 7.246 We note that suppliers could attempt to effectively exit the market while retaining their licence and remaining compliant. For example, suppliers could avoid taking on new customers by only offering prepayment meter tariffs with onerous conditions such that customers would not choose these tariffs. Suppliers could also seek to sell their existing stock of prepayment customers.¹⁰⁴⁴ We note that existing regulations relating to Standards of Conduct¹⁰⁴⁵ limit the extent to which suppliers can treat existing prepayment customers poorly. A number of respondents to the Second Supplemental Remedies Notice suggested that these regulations would be effective in this regard.
- 7.247 Our expectation is that while the price cap will initially reduce prices, the new level of prices will still be at such a level that profitable competition is possible beneath the level of the cap. Thus we do not expect that suppliers would have significant incentive to exit the market. We also note the scope for a final order to be reviewed on the basis of a material change in circumstance.

Reduced quality of service

- 7.248 We have considered the possibility that the existence of a price cap could reduce the quality of service received by affected customers. We do not consider that this is a significant risk as suppliers noted in their response to the Second Supplemental Remedies Notice that the Standards of Conduct,¹⁰⁴⁶ which suppliers are obliged to deliver, mitigate this risk. One supplier noted that the pressure of competition and need to increase or maintain market share would also mitigate this risk. Other suppliers suggested that there was a risk that a price cap could result in reduced quality of service but did not provide persuasive arguments to support this view.

¹⁰⁴⁴ We have not considered in detail the structure of any such disposal beyond identifying that it would likely be possible to create a new licensed subsidiary which administers all prepayment meter contracts with customers and to then sell this business in its entirety.

¹⁰⁴⁵ Specifically SLCs 7B and 25C of the gas and electricity supply licences specify the standards of conduct to which suppliers must adhere. These conditions require that suppliers treat customers fairly.

¹⁰⁴⁶ See Appendix 7.1, Annex B, paragraph 20.

Increased perception of regulatory risk

- 7.249 There is a risk that investors perceive increased regulatory risk in the sector as a result of a price cap being implemented. This perception of greater regulatory risk could result in investors seeking higher rates of return¹⁰⁴⁷ which in turn would increase costs for suppliers and ultimately the prices paid by customers.
- 7.250 To the extent that investors currently benefit from a weaker level of competition and the consequential elevated prices, the current level of perceived risk in the sector may be lower than it would be if there were robust competition. Thus we do not believe that we should act with the aim of ensuring there is no increased perception of risk.
- 7.251 We are, however, mindful of the need to act in a rational manner and to avoid increasing the risk, or perceived risk, in the domestic retail energy markets unduly. Accordingly we have sought to mitigate the risk of a number of adverse scenarios (such as the risk of cost under-recovery). Further, we consider that the limited scope of the PPM Price Cap Remedy, the rationale for its introduction, the inclusion of headroom, the objective nature of the application of the cap, the clearly defined termination date and the limited duration, all act to moderate the extent of any increased perception of risk.

Risk of reduced innovation

- 7.252 There is a risk that suppliers cease, or reduce their level of, innovation in response to the lower profits available from prepayment customers. Should this happen then it is possible that non-prepayment customers and prepayment customers will suffer negative unintended consequences of the PPM Price Cap Remedy during the time it is in place, and beyond the point at which the PPM Price Cap Remedy is removed.
- 7.253 Pursuant to our proposed remedy to remove aspects of the simpler choices components of the RMR rules,¹⁰⁴⁸ suppliers will have a lot more scope to innovate in their tariff construction. Since only 15% of gas customers and 16% of electricity customers have a prepayment meter there is still significant incentive for suppliers to innovate in order to win new non-

¹⁰⁴⁷ We note that one investor (Invesco Perpetual) responded to the Remedies Notice indicating that increased regulatory uncertainty would likely increase its perception of risk in the sector and, therefore, companies' costs of capital.

¹⁰⁴⁸ See paragraph 11.9 for further detail.

prepayment customers. Thus we do not consider there to be a high likelihood of reduced innovation.

Risk that the price cap becomes permanent

- 7.254 Some respondents¹⁰⁴⁹ noted the risk that a price cap may become permanent due to the potential negative consequences of removing the cap and possible political pressure to retain the cap. If the PPM Price Cap Remedy were to stay in force indefinitely then it could potentially act to limit the development of competition for prepayment customers with an associated detrimental impact on customers.
- 7.255 We consider that the risk of political pressure being applied to retain the PPM Price Cap Remedy is effectively mitigated by the governance structure by which certain decisions of the CMA are made. Specifically, the CMA's decisions are made by an independent group of members of the CMA's panel. They are not accountable to ministers for their decisions, nor are they required to have particular regard to ministerial preferences.
- 7.256 We note that due to the positive impacts that we believe the PPM Price Cap Remedy is capable of delivering, the removal of these positive impacts at the end of the remedy may be perceived negatively. We believe that this risk is mitigated by the fact that the removal of PPM Price Cap Remedy would be expected to coincide with the substantive conclusion of the widespread installation of smart meters. This would have two relevant effects:
- (a) The removal of the PPM Price Cap Remedy would be objectively determined and its removal could be anticipated by affected customers and suppliers.
 - (b) The removal of the PPM Price Cap Remedy would coincide with an expected increase in ease with which prepayment customers may engage in the market and switch tariffs. Accordingly we expect that once the PPM Price Cap Remedy is removed, competition for prepayment customers would strengthen further such that the net result of the removal of the PPM Price Cap Remedy would be positive.
- 7.257 We note that one possible outcome of the mid-term review is that the CMA may decide to encourage Ofgem to review the roll-out of smart meters and take whatever action it considers appropriate (such as introducing a new price cap) from the start of 2021. However, we would only expect encouragement of a further price cap to result in the event that the roll-out of

¹⁰⁴⁹ See Appendix 7.1, Annex A, paragraph 19.

smart meters was materially behind schedule at the time of the mid-term review. In light of the above we do not consider that there is a significant risk of the PPM Price Cap Remedy becoming a permanent feature of the market.

Costs and benefits of implementing the price cap

- 7.258 We have considered the possibility of calculating the net present value for customers of the PPM Price Cap Remedy. We consider that while we have a reasonable estimate of the potential benefit for customers in the short term we lack precision in our estimate of the costs for suppliers. Further, the benefits in the quantum of the medium-term benefits is uncertain as it depends on the extent to which competition develops over this time frame.
- 7.259 We expect that each supplier would face the costs of collecting and reporting its tariff data to Ofgem and of maintaining a monitoring function to ensure its prices remain compliant. We note too that Ofgem will incur costs in updating the price cap and monitoring compliance. We note that Ofgem's 2014/15 Annual Report and Accounts shows that the total cost of the smarter grids and governance division (ie the part of Ofgem responsible for price controls) was £19.7 million in 2014/15 (and £19.0 million in 2013/14).¹⁰⁵⁰ We note too that the Water Industry Commission for Scotland (WICS) spent £0.9 million in 2014/15 (and £1.0 million in 2013/14)¹⁰⁵¹ on 'determination of prices and monitoring of performance' and that this covered the period in which WICS determined the price control for 2015–2021. Given the scale of Ofgem involvement anticipated in administering the PPM Price Cap Remedy we expect that the incremental cost for Ofgem would be closer to the costs we note WICS incurred.
- 7.260 We estimate that annual savings for customers, assuming medium TDCV for all prepayment customers and headroom of £25 per fuel, could be of the order of £303 million. We expect that the monitoring and compliance costs imposed on suppliers by this remedy will therefore not be material relative to the expected benefits for customers.

Relevant customer benefits

- 7.261 We have considered whether the Prepayment AEC gives rise to any relevant customer benefits¹⁰⁵² which may be lost as a result of the implementation of the PPM Price Cap Remedy. However, we do not believe that any such relevant customer benefits arise. We considered the possibility that other

¹⁰⁵⁰ See Ofgem [Annual Report and Accounts 2014-15](#), note 2.

¹⁰⁵¹ See [WICS resource accounts 2014-15](#), note 3.

¹⁰⁵² Section 134 (7)–(8) of the 2002 Act.

customers benefit from lower prices that suppliers are only able to offer because of the excess prices being charged to prepayment customers. If prepayment customers were subsidising other customers, suppliers would be able to offer other (non-prepayment meter) tariffs which were not profitable. We provisionally concluded that, while this is possible in principle, there is no evidence that this takes place, as suppliers have told us that they typically price tariffs to be profitable over the period for which they retain the customer. Further we have not seen any evidence that there is a waterbed effect in relation to prepayment customers.

Consideration of Ofgem's statutory duties

- 7.262 Where the CMA is considering whether to modify one or more of the conditions of a retail gas or electricity supplier's licence, in deciding whether such action would be reasonable and practicable, the CMA must 'have regard' to the relevant statutory functions of Ofgem.¹⁰⁵³
- 7.263 Accordingly, in reaching our provisional decision to introduce a new standard licence condition to implement the PPM Price Cap Remedy, we have, as part of our own application of the legal framework requiring us to decide upon proposed remedies that are effective and proportionate,¹⁰⁵⁴ taken into account Ofgem's statutory duties and objectives.
- 7.264 In particular, we do not consider that any aspect of the PPM Price Cap Remedy will have an adverse impact on suppliers' ability to meet all reasonable demands for gas and electricity supply (so far as it remains economical to do so), achieving sustainable development, security of supply or environmental concerns. In this regard, the PPM Price Cap Remedy will only impact the 'efficiency' limb of the Trilemma considerations built into Ofgem's statutory duties and functions (also known as the 'affordability' limb), insofar as the ultimate aim of the PPM Price Cap Remedy is to ensure that the prices for the retail supply of gas and electricity to domestic prepayment customers in Great Britain are affordable (or, in other words, maintained at a reasonable level).
- 7.265 The PPM Price Cap Remedy is designed to do so by mitigating the residual harm to domestic prepayment customers that we provisionally consider arises and will continue to arise from the Prepayment AEC and the Domestic Weak Customer Response AEC while our proposed remedies concerning the prepayment framework and concerning domestic customer engagement

¹⁰⁵³ Section 168 of the Act and paragraph 347 of [CC3](#).

¹⁰⁵⁴ [CC3](#), pp71–73.

more generally, take effect, and until the roll-out of smart meters has been substantially completed. In particular, we envisage that the PPM Price Cap Remedy would reduce the prices being paid by prepayment customers and equilibrate the highest of them¹⁰⁵⁵ with a cost-adjusted benchmark level based on competitively priced acquisition tariffs in the rest of the domestic markets (see paragraphs (7.79 to 7.87)).

- 7.266 In having regard to Ofgem's principal objective, we have also considered the potential impact that each aspect of the PPM Price Cap Remedy may have on protecting the interests of existing and future consumers, including vulnerable consumers. A remedy of this type has the benefit of providing direct protection to existing and future prepayment customers, many of whom are, and are likely to be, on low incomes or otherwise vulnerable, and who are suffering substantial harm, at least, from the Prepayment AEC, and also the Domestic Weak Customer Response AEC, and will continue to do so up until, at least, the roll-out of smart meters has been substantially completed (see paragraphs 7.171 to 7.181 above)(notwithstanding the implementation of our other proposed remedies concerning the Prepayment AEC and the Domestic Weak Customer Response AEC).
- 7.267 We note that we have considered the potential unintended adverse consequences the PPM Price Cap Remedy may have on certain aspects of competition in the prepayment segments, and retail domestic markets more broadly, and whether it may dampen the effectiveness of our other proposed remedies concerning the Prepayment AEC or the Domestic Weak Customer Response AEC. For the reasons given in paragraphs 7.236 to 7.261 above, we believe that the PPM Price Cap Remedy will not unnecessarily cut across the beneficial effects that competition has the potential to bring to customers. We expect that our proposed engagement, and other prepayment, remedies will introduce sufficiently strong competition for prepayment customers, such that competition will determine the prices paid by prepayment customers rather than the price cap. In this context, the design of the price cap incorporates a degree of implicit and explicit headroom to allow efficient suppliers to offer profitable tariffs below the level of the cap as outlined in paragraph 7.84 above. The PPM Price Cap Remedy has been carefully designed so as to appropriately target those customers who are clearly identifiable, are significantly harmed (by the combined effects of Prepayment AEC and the Domestic Weak Customer Response AEC), and for whom competition has been least effective to date, and has the furthest to improve to address the detriment we have observed

¹⁰⁵⁵ We consider that our other proposed remedies should enable competition to take place below the level of the price cap.

from the Prepayment AEC and the Domestic Weak Customer Response AEC.

- 7.268 Accordingly, in the paragraphs above we have balanced the potential unintended adverse consequences against the substantial benefit we consider the PPM Price Cap Remedy will bring to prepayment customers, and have provisionally decided to implement the PPM Price Cap Remedy. In doing so, we have had regard to Ofgem's statutory duties and objectives, in particular, its principal objective of protecting the interests of existing and future consumers, wherever possible by promoting effective competition.

8. Effectiveness and proportionality of our proposed package of remedies

- 8.1 Based on the assessment in Sections 4 to 7 above, we have proposed a number of measures to be included within a package of remedies that will be effective in addressing the Domestic AECs (and/or associated detriment) that we have provisionally identified.¹⁰⁵⁶
- 8.2 In our assessment of the effectiveness of this proposed package of remedies, we have considered below:
- (a) how the proposed package of remedies addresses the provisional AECs and/or associated customer detriment (paragraphs 8.3 to 8.53);
 - (b) other aspects of the effectiveness of our proposed package of remedies (paragraphs 8.54 to 8.100);
 - (c) relevant customer benefits (paragraphs 8.102 to 8.105); and
 - (d) the proportionality of our proposed package of remedies (paragraphs 8.106 to 8.148).

How the package of remedies addresses the provisional AECs and the resulting customer detriment

- 8.3 As set out in Section 4, we have provisionally identified five AECs affecting the domestic retail energy markets – the Domestic Weak Customer Response AEC, the Prepayment AEC, and three AECs relating to the regulatory framework, namely, the systems of electricity and gas settlement (the Settlement AECs)¹⁰⁵⁷ and aspects of the ‘simpler choices’ component of the RMR reforms (the RMR AEC). We estimate that the detriment arising from these AECs is very substantial – at around £1.7 billion per year over the last three and a half years for the Domestic AECs,¹⁰⁵⁸ with a marked increase in detriment year on year over the period.
- 8.4 We have discussed the aim of each element of the proposed package of remedies addressing the Domestic AECs in Sections 4 to 7. In this subsection, we draw upon those sections and summarise how the elements of the proposed remedies package work together to address those features

¹⁰⁵⁶ In addition, we have also proposed remedies aimed at addressing the Settlement AECs which concern the domestic (and SME) retail energy markets; the effectiveness and proportionality of the proposed remedies concerning the Settlement AECs are assessed in Section 5.

¹⁰⁵⁷ The Settlement AECs concern the SME retail energy markets as well as the domestic retail energy markets.

¹⁰⁵⁸ The Domestic Weak Customer Response AEC, the Prepayment AEC and the RMR AEC.

of the domestic retail energy markets that give rise to each of the provisional AECs and/or associated detriment.

- 8.5 We have provisionally found a number of features of the markets for the domestic retail supply of gas and electricity in Great Britain relating specifically to the prepayment segments that give rise to the Prepayment AEC and/or associated detriment.¹⁰⁵⁹ These features are:
- (a) technical constraints that limit the ability of all suppliers, and in particular new entrants, to innovate by offering tariff structures that meet demand from prepayment customers who do not have a smart meter (the technical constraints feature); and
 - (b) softened incentives for all suppliers, and in particular new entrants, to compete to acquire prepayment customers due to:
 - (i) actual and perceived higher costs to engage with, and acquire, prepayment customers compared with other customers; and
 - (ii) a low prospect of successfully completing the switch of indebted customers, who represent about 15% of prepayment customers.
- 8.6 We have provisionally found that the simpler choices component of Ofgem's RMR rules (including the ban on complex tariffs, the maximum limit on the number of tariffs that suppliers will be able to offer at any point in time, the simplification of cash discounts, and the ban on certain bundled products) is a feature of the markets for the domestic retail supply of electricity and gas that gives rise to the RMR AEC by reducing retail suppliers' ability to innovate in designing tariff structures, and by softening competition between PCWs.
- 8.7 In addition, we have provisionally found that a combination of features in the markets for the domestic retail supply of gas and electricity give rise to the Domestic Weak Customer Response AEC which, in turn, gives suppliers a position of unilateral market power concerning their inactive customer base which they are able to exploit through their pricing policies or otherwise.
- 8.8 These features are: customers' limited awareness of and interest in their ability to switch energy supplier, actual and perceived barriers to accessing and assessing information, and actual and/or perceived barriers to switching. We have noted that these features are heightened in respect of domestic customers on restricted meters due to factors affecting these particular

¹⁰⁵⁹ See the [Addendum](#).

customers.¹⁰⁶⁰ We have also observed that the overall weight of evidence supports a provisional finding that disengagement and weak customer response is a more significant problem among prepayment customers compared with domestic customers on direct debit.¹⁰⁶¹

- 8.9 As noted in Section 4, our proposed remedies package concerning the Domestic AECs is based on the principles of: creating a framework for effective competition; helping customers to engage; and protecting customers who are less able to engage to exploit the benefits of competition. The component parts of the remedies package concerning each of these principles are set out in turn below. Our provisional view is that the proposed remedy package will be effective in addressing each of the Domestic AECs and/or associated detriment.

Creating a framework for effective competition

Remedies to address constraints on competition for prepayment customers

- 8.10 For the reasons set out in Section 3, we believe that, in addition to the RMR AEC, there are features of the domestic retail energy markets that give rise to two distinct, but related, AECs concerning prepayment meter customers: one on the demand side (the Domestic Weak Customer Response AEC), and one principally concerning the supply side (the Prepayment AEC).
- 8.11 As regards the Prepayment AEC, we propose to recommend a number of actions are taken by Ofgem, possibly with the acceptance of undertakings from the Six Large Energy Firms, which we provisionally consider will be effective in addressing aspects of the features giving rise to the Prepayment AEC. Further details are set out in Section 5.
- 8.12 In relation to the technical constraints feature imposed by the dumb prepayment infrastructure, we are proposing a range of remedies that will make better use of the available tariff slots, so as to reduce the impact of the dumb prepayment meter technical constraints on the ability of suppliers, and in particular new entrants, to innovate by offering tariff structures that meet demand from prepayment meter customers who do not have a smart meter.
- 8.13 These proposed remedies include recommendations to Ofgem that it take responsibility for the efficient allocation of gas tariff pages. Moreover, we are proposing to seek undertakings from the Six Large Energy Firms (and, absent such undertakings, recommend that Ofgem change gas suppliers'

¹⁰⁶⁰ See paragraphs 3.136.

¹⁰⁶¹ See paragraph 3.112.

standard licence conditions) so as to (i) set up a cap on the number of gas tariff pages that a supplier can hold; (ii) set up an obligation for suppliers to provide relevant information for Ofgem to monitor the allocation of the gas tariff codes; and (iii) enable Ofgem to mandate the transfer of unused gas tariff codes to another supplier.

- 8.14 To further mitigate the impact of tariff codes on competition for customers on dumb prepayment meters, we recommend that Ofgem changes SLC 22B.7(b) to allow suppliers to set prices to prepayment customers with no obligation to apply the regional cost variations that are applied to other payment methods within the same core tariff. As a result, suppliers would be able to make better and more efficient use of the tariff codes that have been allocated. We also recommend that Ofgem deprioritises potential enforcement action against suppliers in relation to this licence condition pending the change. This will allow suppliers to make better use of their limited tariff codes.
- 8.15 The aspect of the feature of softened incentives for all suppliers (and in particular new entrants) to compete to acquire prepayment customers arising from a low prospect of successfully completing the switch of indebted customers, will be partly addressed by our proposed recommendation to Ofgem to take appropriate steps to ensure that certain changes to the Debt Assignment Protocol are implemented by the end of 2016. This proposed remedy mainly involves removing some of the barriers that prepayment customers without a debt face when attempting to switch to a credit meter.
- 8.16 In light of the above, we consider that the proposed remedies specific to the prepayment segments are complementary, and will be effective in addressing part of the Prepayment AEC and associated detriment by increasing both suppliers' ability, and their incentives, to compete for customers in the prepayment segments.

Withdrawal of the simpler choices component of the RMR rules

- 8.17 Our proposed package of remedies includes remedies that will be effective in addressing the RMR AEC and associated detriment. Further details are set out in Section 5.
- 8.18 The proposed remedy takes the form of a recommendation to Ofgem to remove a number of standard licence conditions relating to the simpler choices component of the RMR rules (including the ban on complex tariffs, the four-tariff rule, the ban on certain discounts, and the ban on certain

bundled products).¹⁰⁶² Our proposed recommendation will enhance competition and innovation between retail energy suppliers in the retention and acquisition of domestic customers and, accordingly, will address not only the RMR AEC, but will also in part enhance suppliers' ability to compete for new customers (including prepayment customers), thus also addressing part of the Prepayment AEC. Increased choice for domestic customers may also raise customers' interest in switching, and thereby address part of one of the features giving rise to the Domestic Weak Customer Response AEC.

- 8.19 In addition, our proposed recommendation will facilitate competition between PCWs by allowing them to negotiate exclusive tariffs with domestic energy suppliers and to offer discounts funded by the commissions they receive from suppliers. As the incentive on the part of suppliers to negotiate exclusive deals with PCWs can also potentially be undermined by the current Whole of the Market Requirement included in Ofgem's Confidence Code,¹⁰⁶³ our proposed recommendation to Ofgem also provides for the removal of the Whole of the Market Requirement, and the introduction of a requirement for accredited PCWs to be transparent over the market coverage they provide to domestic customers.¹⁰⁶⁴ We have noted that PCWs play a key role in removing barriers for domestic customers to access and assess information and, accordingly, in facilitating customer engagement. Therefore, our proposed remedy would also address part of one of the features giving rise to the Domestic Weak Customer Response AEC.
- 8.20 In order to mitigate any potential unintended consequences arising from a potentially significant increase in the number of tariffs on offer, we also propose, as part of the recommendation to Ofgem, to introduce an additional Standard of Conduct into retail suppliers' standard licence conditions that would require suppliers to have regard in the design of tariffs to the ease with which customers can compare 'value for money' with other tariffs they offer.¹⁰⁶⁵ We have noted in Section 6, with encouragement, Ofgem's broader intentions to move to more principles-based regulation concerning the retail energy markets, and Ofgem's recent enforcement action against the existing Standards of Conduct.

Helping customers engage to exploit the benefits of competition

- 8.21 Our proposed package of remedies concerning domestic customer engagement involves proposed remedies that are targeted at addressing

¹⁰⁶² See paragraphs 5.358–5.443 for further details.

¹⁰⁶³ Involving a requirement on PCWs to display the whole of the market.

¹⁰⁶⁴ See paragraphs 6.108–6.129.

¹⁰⁶⁵ See paragraphs 6.82–6.103.

one or more aspects of the features giving rise to the Domestic Weak Customer Response AEC and associated detriment. Since the Domestic Weak Customer Response AEC affects all domestic customers, including prepayment customers, the proposed remedies can be expected, once they become effective, to also enhance suppliers' incentives to compete for prepayment customers. There will therefore be a strong interaction between the proposed remedies concerning the Domestic Weak Customer Response AEC and the Prepayment AEC.

- 8.22 However, our provisional view is that while the proposed supply- and demand-side measures will be effective in addressing the features contributing to each of the Domestic Weak Customer Response AEC and the Prepayment AEC, they will take time to implement before they start to address the features we have identified and, in turn, reduce the detriment to domestic customers arising from them. As a result, we expect that the substantial detriment arising, in particular, from the Domestic Weak Customer Response AEC and the Prepayment AEC, is likely to remain for the next few years. Given the size of the detriment we have observed, we have provisionally concluded that there is a need for a remedy to reduce the detriment directly during this transitional period, through the introduction of a price cap for customers on prepayment meters.
- 8.23 We discuss each of the proposed remedies concerning domestic customer engagement in turn below, and how they interact to address the features of the Domestic Weak Customer Response AEC and/or associated detriment, before discussing their interaction with the proposed price cap for prepayment customers. We have discussed the rationale for each engagement remedy comprising the proposed package in Section 6.
- 8.24 We have considered first how the proposed package of remedies addresses those features of the markets that give rise to weak customer response by limiting customers' awareness of and interest in their ability to switch energy supplier, create actual and/or perceived barriers for certain customers to access and assess information relating to gas and electricity retail supply, and create actual and/or perceived barriers to switching. We consider the synergies between the various measures and the coherence of the package of remedies later in this section (see paragraphs 8.85 to 8.100).

Customers' limited awareness of and interest in their ability to switch energy supplier

- 8.25 We have provisionally found that customers' limited awareness of and interest in their ability to switch energy supplier arises from two fundamental characteristics of the domestic retail energy markets, namely the

homogenous nature of gas and electricity (which fundamentally affects the potential for customer engagement in the markets), and the role of traditional meters and bills, which gives rise to a disparity between actual and estimated consumption that can be confusing and unhelpful to customers understanding the relationship between the energy they consume and the amount they ultimately pay.

- 8.26 These fundamental characteristics may particularly affect certain categories of customer (eg those who are elderly, live in social and rented housing or have relatively low levels of income or education) who we observe are less likely to have considered engaging than others.¹⁰⁶⁶
- 8.27 The proposed package of remedies will address, in part, this aspect of the Domestic Weak Customer Response AEC by increasing both customers' awareness of, and their interest in, their ability to switch energy supplier. We consider below the contribution made by each element of the proposed package of remedies to addressing this aspect.
- 8.28 First, we are proposing a programme, led by Ofgem (the Ofgem-led programme), to identify, test (through randomised controlled trials (RCTs), where appropriate) and implement (for example, through appropriate changes to gas and electricity suppliers' standard licence conditions) measures to provide domestic customers with different or additional information with the aim of promoting engagement in the domestic retail energy markets.¹⁰⁶⁷ We propose to seek to enhance the effective implementation of the Ofgem-led programme by inviting suppliers to offer undertakings to participate in the Ofgem-led programme or, failing that, to require suppliers to participate.
- 8.29 We have identified a shortlist of measures to be developed through the Ofgem-led programme, which includes testing (i) changes to the information in domestic bills and how this is presented including a market-wide cheapest tariff message; (ii) changes to the specific messaging that domestic customers receive in bills once they move, or are moved, on to an SVT and/or other default tariffs; and (iii) changes to the name of default tariffs. We propose to recommend that, in order to be as effective as possible, these measures be tested through use of RCTs. We would expect effective trials to lead to more effective engagement measures, which in turn would increase awareness and interest in switching on the part of domestic customers.

¹⁰⁶⁶ See the [provisional findings report](#), paragraph 8.301.

¹⁰⁶⁷ See paragraphs 6.12–6.74.

- 8.30 Second, we are proposing the creation of a database (the Database remedy) of certain domestic customers¹⁰⁶⁸ who have been on a supplier's SVT (or any other default tariff) for three or more years (the Disengaged Domestic Customers), to whom rival suppliers would have limited access and, subject to strict use restrictions, could then contact the Disengaged Domestic Customers that have not opted out.¹⁰⁶⁹ We have noted in Section 6 that this proposed remedy is modelled on the French competition authority's successful application for an interim order requiring Engie (formerly GDF Suez) to disclose details of its customers on regulated gas tariffs to other suppliers. Although a number of Disengaged Domestic Customers may choose to 'opt out' of the proposed disclosure, we consider based on the opt-out rate for the similar measure implemented in France, that many customers would not and suppliers would therefore be able to contact a large proportion of Disengaged Domestic Customers to prompt them to engage.
- 8.31 By giving rival suppliers access to certain customer information, we believe that they will be able to prompt such customers to engage through targeted marketing, thereby increasing such customers' awareness of, and possibly also their interest in, their ability to switch supplier.
- 8.32 Third, we are proposing specific measures targeted at customers on restricted meters,¹⁰⁷⁰ for whom we have observed that their awareness of their ability to switch is particularly limited.¹⁰⁷¹ We are proposing to order suppliers to remind their domestic electricity customers on restricted meters, in their regular communications with them, that they have the option to switch supplier or to switch to a single-rate tariff without having to change their meter or incur replacement costs. We are also proposing to recommend to Citizens Advice that it becomes a recognised provider of information and support to domestic electricity customers on restricted meters, and to order suppliers to provide their customers on restricted meters with contact details for Citizens Advice, and to provide Citizens Advice with information it may reasonably require concerning customers on restricted meters. These measures will directly increase the awareness of customers on restricted meters of their ability to switch.

¹⁰⁶⁸ Excluding customers who opt out.

¹⁰⁶⁹ See paragraphs 6.225–6.292.

¹⁰⁷⁰ See paragraphs 6.317–6.367.

¹⁰⁷¹ See paragraph 3.147(a).

Actual and perceived barriers to accessing and assessing information relating to energy supply

- 8.33 We have provisionally found that certain customers face actual and perceived barriers to accessing and assessing information arising, in particular, from the complex information provided in bills and the structure of tariffs which combine to inhibit the value-for-money assessment of available options (particularly for customers with low levels of education or income, the elderly and/or those without internet access, and a lack of confidence in, and access to, PCWs by certain customers, including the less well-educated and the less well-off).
- 8.34 The proposed package of remedies will address, in part, this aspect of the Domestic Weak Customer Response AEC by improving domestic customers' own ability to access and assess the information needed to make a value-for-money assessment (as regards the value for money of their existing tariff, and as compared to those offered by other suppliers). It will also improve domestic customers' use of PCWs and other TPIs to access and assess the information needed for such assessments.
- 8.35 First, the Ofgem-led programme, by measuring the effect on engagement of a range of different changes to bills, cheapest tariff messaging, and names for the SVT, can be expected, once successful trials have been concluded, to lead to clearer, and less complex, information being provided to customers, thereby (in addition to enhancing their awareness of and interest in their ability to switch) improving their access to and ability to assess information to help them decide whether to switch. In particular, we would expect the Ofgem-led programme to be capable of targeting particular customer groups, such as those on prepayment meters.
- 8.36 Second, the Database remedy will further facilitate such customers' access to information that enables them to conduct a value-for-money assessment. Since suppliers will be able to contact other suppliers' Disengaged Domestic Customers and market directly to them (by post), they will be able to design targeted marketing campaigns to encourage such customers to consider switching.
- 8.37 Third, we are proposing to increase the ability and incentives of PCWs to engage with domestic customers by, as noted above, removing the Whole of the Market Requirement on PCWs, and also by recommending to DECC that certain changes are made to the specification of Midata phase 2.¹⁰⁷² Such

¹⁰⁷² See paragraphs 6.094–6.222.

changes would increase supplier participation in Midata (thus ensuring that all customers' data is available for a price comparison), would expand the scope of data included (thus broadening the categories of customer that can receive a price comparison service), and give PCWs the ability to seek customer consent to have access, at a later point in time, or on an ongoing basis, to the customer's updated Midata. In combination, we would expect such proposed remedies, among other things, to allow PCWs to provide enhanced price comparison services to customers.

- 8.38 Finally, and as noted in Sections 5 and 6, we note that the proposed remedy concerning the removal of aspects of the simpler choices component of the RMR rules, is likely to lead to increased tariff complexity. However, for the reasons noted in Sections 5 and 6, when combined with the proposed removal of the Whole of the Market Requirement, and the introduction of a new Standard of Conduct, we do not consider that greater confusion will result. We therefore do not consider that the effectiveness of the proposed remedies targeting actual and perceived barriers to accessing and assessing information will be undermined.

Actual and/or perceived barriers to switching

- 8.39 We have provisionally found that customers face actual and/or perceived barriers to switching, such as where they have uncertified meters or experience erroneous transfers, which impact customers' ability to switch as well as their perception of switching. In addition, as noted in Section 3, we have observed that certain suppliers require customers on restricted meters to replace their restricted meter (the cost of which may or may not be covered by the supplier).¹⁰⁷³ We consider that this increases the actual and perceived barriers to switching faced by such customers, in particular, by adding to the number of factors that a customer needs to take into account in a value-for-money assessment.
- 8.40 The proposed package of remedies will address, in part, this aspect of the Domestic Weak Customer Response AEC by improving PCWs' access to customer meter information, and thereby help reduce the number of erroneous transfers. It will also remove the actual and/or perceived barriers to switching faced by customers of certain suppliers on restricted meters who are required to replace their meter (the cost of which may or may not be covered by the supplier), when switching to that supplier.

¹⁰⁷³ See paragraph 3.138.

- 8.41 First, we propose to order Gemserv and Xoserve, as managers of the ECOES and SCOGES databases, respectively, to provide access to PCWs to the databases on reasonable terms and subject to reasonable access terms.¹⁰⁷⁴ By accessing such databases, PCWs will be able to access more accurate metering information concerning domestic customers (rather than relying on customer information or information from GB Group), which would result in a reduction in the number of erroneous transfers.
- 8.42 Second, we propose to order electricity suppliers with more than 50,000 domestic customers to make all their single-rate electricity tariffs available to all (existing and new) domestic electricity customers on restricted meters without making such tariffs available conditional upon the replacement of their existing meter.¹⁰⁷⁵ By prohibiting suppliers from forcing customers to change meter, our view is that this proposed remedy will address this aspect of the feature giving rise to the Domestic Weak Customer Response AEC as regards customers on restricted meters.
- 8.43 This proposed remedy is also specifically designed to work in conjunction with the proposed informational remedy noted above concerning customers on restricted meters.¹⁰⁷⁶ The effectiveness of both proposed remedies would be increased as customers on restricted meters are provided with more information about their alternative tariff options, have more sources of information available to them (with greater focus by Citizens Advice), and would not be limited to other tariffs available for their specific restricted meter, since suppliers would be prohibited from forcing a customer to switch meter if they wished to switch to one of their unrestricted meter tariffs.

Impact on suppliers' unilateral market power

- 8.44 We believe that our proposed engagement remedies can materially improve engagement and overcome many aspects of the features that we have provisionally identified as giving rise to the Domestic Weak Customer Response AEC and associated detriment. In particular, we believe that our proposed remedies, together with the substantial completion of the national programme for the roll-out of smart meters¹⁰⁷⁷, will address the Domestic Weak Customer Response AEC and associated detriment (in particular as regards direct debit customers, who face reduced barriers to switching and to accessing and assessing information as compared to customers on

¹⁰⁷⁴ See paragraphs 6.149–6.187.

¹⁰⁷⁵ See paragraphs 6.321–6.341.

¹⁰⁷⁶ See paragraphs 6.342–6.360.

¹⁰⁷⁷ See paragraph 4.80.

restricted meters and prepayment customers¹⁰⁷⁸). Accordingly, suppliers would no longer have unilateral market power over their inactive customer base.

- 8.45 We noted in Section 4 that our proposed engagement remedies will take some time, however, to implement and become effective (some longer than others) (see further paragraphs 8.59 to 8.80 below). The roll-out of smart meters is not expected to be substantially completed until the end of 2020. In this regard, it has not been possible for us to quantitatively assess how the detriment we have provisionally found will be addressed by the different elements of the proposed package, nor by reference to any gradual diminishment to suppliers' unilateral power. By their nature, we expect our proposed remedies to be gradual in their implementation, and mutually reinforcing in their effect, and so we would anticipate that the Domestic Weak Customer Response AEC and associated detriment would be addressed increasingly effectively over the medium term (with the roll-out of smart meters supporting this position).

Protecting customers less able to engage to exploit the benefits of competition

- 8.46 In relation to the Domestic AECs, we have taken particular account of the strength of the features contributing to the Prepayment AEC and the Domestic Weak Customer Response AEC as it applies to prepayment customers.
- 8.47 We have, in particular, noted that the proposed remedies affecting prepayment customers, notably all of the proposed remedies designed to address aspects of the features contributing to all of the Domestic AECs, will take time to implement before they start to address the features we have identified and, in turn, reduce the detriment arising from them.
- 8.48 Accordingly, we expect the detriment arising from the Domestic AECs to persist in substantial form over, at least, the short term (ie for the next few years). Given the size of the detriment we have observed, of around £1.7 billion a year over the last three and a half years, with a marked increase in detriment year on year, and in particular in light of the detriment concerning prepayment customers of almost £500 million in 2015,¹⁰⁷⁹ we have provisionally decided to impose a price cap remedy on suppliers to prepayment customers.

¹⁰⁷⁸ See paragraphs 3.112 & 3.136.

¹⁰⁷⁹ See paragraphs 4.94 & 4.115.

- 8.49 More particularly, we propose to require suppliers to ensure that the annual bills paid by prepayment customers (assuming a predetermined consumption level) do not exceed a specified benchmark reference level, for a period until the end of 2020.
- 8.50 Given the interventionist nature of a price cap remedy, and the potential for adverse consequences, particularly risks for the emergence of a long-term competitive outcome, we have considered very carefully in Section 7 both the need for, and the appropriate scope of, a price cap remedy. In particular, since other domestic customers are also suffering significant detriment, and will continue to do so while our other proposed remedies take effect, we have also considered whether a transitional safeguard tariff would be appropriate concerning a broader customer base such as all SVT customers. However, we have provisionally concluded that such a price cap would likely be disproportionate.
- 8.51 We have, in particular, considered the interaction of our proposed price cap with the other proposed remedies concerning the Domestic AECs that we propose to introduce. We recognise that a price cap remedy is likely to reduce the potential benefits of competition and has the potential, therefore, to dampen the effectiveness of our other proposed remedies.
- 8.52 However, in the short term, as noted above, we do not expect our other proposed remedies to take effect, and so we do not expect our proposed price cap to have a material adverse effect on competition during this initial period, when the significant detriment for prepayment customers will be largely otherwise unaddressed. The ongoing magnitude of the detriment for prepayment customers was a substantial factor in determining our provisional decision to impose the price cap remedy.
- 8.53 Further, we have sought to design the price cap to ensure that there are benefits available to customers who engage once it is in place and our other proposed remedies have started to take effect. For instance, the scope of the price cap concerns only prepayment customers. We do not consider it likely that non-prepayment customers will be affected by the price cap, and they will be able to benefit fully from the other proposed remedies as soon as they are implemented. Moreover, absent the price cap, we do not expect that these other remedies would be fully effective as regards prepayment customers until the roll-out of smart meters has been substantially completed, due to the continuation of the Prepayment AEC until that conclusion and the evidence that the Domestic Weak Customer Response AEC is a more significant problem among prepayment customers compared

with domestic customers on direct debit.¹⁰⁸⁰ Accordingly, by limiting the duration of the proposed price cap and linking it to the roll-out of smart meters, we do not believe the effectiveness of the other proposed remedies will be dampened from the perspective of prepayment customers.

Other aspects of the effectiveness of our proposed package of remedies

- 8.54 Our assessment of the effectiveness of our remedy package has focused on the following factors:
- (a) the means by which the remedies would be implemented, monitored and enforced;
 - (b) the timescale over which the remedy measures will take effect;
 - (c) the consistency of the package of remedies with existing and likely future laws and regulations; and
 - (d) its coherence as a remedies package.

Implementation, monitoring and enforcement

- 8.55 In developing each of the proposed remedy measures, we have considered how each remedy measure could best be implemented, monitored and enforced in Sections 5, 6 and 7, and our provisional decision as regards each proposed remedy is set out in Section 11.
- 8.56 We note that our proposed package of remedies contains a large number of recommendations compared with some other market investigations. We consider that this is appropriate to the particular facts and circumstances of this investigation, as the ongoing regulatory role of Ofgem means that it is best placed to integrate many of the further actions necessary to address the various aspects of the Domestic AECs and associated detriment with its other interventions in the domestic retail energy markets.¹⁰⁸¹ We will consult Ofgem about the final remedies, but it will ultimately be a matter for Ofgem to decide whether and how to implement our recommendations and over what timescale.
- 8.57 We also propose to recommend that Ofgem removes or amends certain conditions in suppliers' standard licences, having provisionally concluded that an order on Ofgem to do so would be unnecessary in circumstances where our recommendation to remove or amend will be accompanied with a

¹⁰⁸⁰ See paragraph 3.112.

¹⁰⁸¹ See [CC3](#), paragraph 390.

recommendation that Ofgem deprioritises potential enforcement action concerning such licence conditions.¹⁰⁸²

- 8.58 We therefore provisionally conclude that each of the measures is capable of effective implementation, monitoring and enforcement.

The timescale over which our remedies would have effect

- 8.59 In evaluating the effectiveness of the proposed remedies aimed at addressing the Domestic AECs, we have considered the timescales over which these remedies would be likely to be implemented, would be likely to take effect in addressing the relevant aspects of the AECs and, ultimately, their impact on detriment.
- 8.60 In making our assessment, we have considered how they would work in combination with other remedies in the proposed package. We consider that the impact and effect of the proposed remedies will be greater as a part of a package.
- 8.61 The time taken to implement remedies following a CMA investigation will depend, in part, on whether the CMA is taking action itself or recommending action be taken by others.
- 8.62 Where the CMA is taking action itself, the implementation of remedies following a CMA investigation typically involves two stages. In the first stage, the CMA makes an order or accepts undertakings.¹⁰⁸³ The CMA must make a final order within six months of the date of publication of the market investigation report.¹⁰⁸⁴

Remedies to create a framework for effective competition

- *Redistributing gas prepayment tariff codes*

- 8.63 We would expect Ofgem to take responsibility for the efficient allocation of gas tariff pages immediately following publication of the CMA's final report. Where undertakings are not being negotiated with the CMA, we would expect Ofgem to commence a consultation on the proposed cap on the number of gas tariff pages that any supplier can hold, plus other obligations

¹⁰⁸² See paragraphs 5.224 & 5.421.

¹⁰⁸³ Suppliers are invited to offer undertakings concerning participation in the Ofgem-led programme and concerning the proposed remedy concerning gas tariff pages.

¹⁰⁸⁴ The CMA may extend this six-month period by up to a further four months if it considers there are special reasons why a final order cannot be made within the statutory deadline. Section 138A of the 2002 Act. These time limits do not apply to any further implementation required after final undertakings have been accepted or a final order made.

on information provision and compliance with directions. We would expect such consultation to conclude by the end of 2016, following which, we estimate that, Ofgem would require a further three months to make the relevant amendments and redistribute the gas tariff pages. As a result, we expect this proposed remedy will be in effect from mid 2017. However, we consider that this could be achieved significantly earlier if final undertakings are agreed with the CMA.

- *Softening SLC 22B.7(b)*

- 8.64 We consider that the relevant changes to SLC 22B.7(b) could be in place by the start of 2017. However, in order for our proposed remedy to take effect as soon as possible, we are also recommending that Ofgem deprioritises potential enforcement action against any supplier that sets prices to prepayment customers on the basis of grouping regional cost variations.

- *Debt assignment protocol*

- 8.65 As regards implementing the further changes we have identified concerning the Debt Assignment Protocol, we would expect Ofgem to integrate these changes into its ongoing work programme concerning the Debt Assignment Protocol.

- *Withdrawing the simpler choices component of the RMR rules*

- 8.66 Similarly to the softening of SLC 22B.7(b), we expect that Ofgem's consultation on the removal of the relevant standard licence conditions would conclude by the end of 2016. Ofgem could then implement and enforce the revised standard licence conditions from the beginning of 2017 with suppliers permitted to provide a wider range of tariffs. However, in order for our proposed remedy to take effect as soon as possible, we are also proposing to recommend that Ofgem deprioritises potential enforcement action against any supplier that operates in breach of the licence conditions being removed. We note the interaction of this proposed remedy with the proposed introduction of a new Standard of Conduct and the removal of the Whole of the Market Requirement from the Confidence Code. These are discussed in paragraphs 8.70 and 8.71 below.

Remedies to help customers engage

- *Ofgem programme to promote customer engagement*

8.67 We would expect Ofgem to begin developing initial plans for the programme immediately following the CMA's final report concerning the shortlist of measures that we propose to recommend are the focus of RCTs. In particular, we would expect Ofgem to progress such plans simultaneously with other developments concerning suppliers' participation in the Ofgem-led programme. For instance, if the CMA decides in the final report to pursue undertakings with suppliers, we would expect Ofgem to be able to progress its plans in conjunction with the CMA's negotiations with suppliers. Progress could similarly be made if the CMA is preparing a final order or Ofgem is introducing a new licence condition. We would expect that the first trials could start by mid 2017, by which time the CMA would have concluded the process of drafting and consulting on any final undertakings or order (or Ofgem would have concluded a consultation on any new licence condition) requiring suppliers to participate in the programme.

8.68 Ofgem could conduct evaluations of the trials from late 2017 onwards, and where trials proved successful, any interventions could be implemented from late 2018 onwards. Subsequently we would expect Ofgem to monitor the effectiveness of the interventions and continue to update the programme on an ongoing basis.

8.69 We would therefore expect the remedy to start having an effect in addressing aspects of the features identified in the provisional findings report, including the actual and perceived barriers in accessing and assessing information, from the beginning of 2019.

- *Greater use of principles – addition to standards of conduct*

8.70 As with the other proposed recommendations concerning changes to suppliers' licence conditions, we would expect Ofgem's consultation on the new standard of conduct to conclude by the end of 2016, such that it could implement and enforce the revised standard of conduct from 2017 onwards. As explained in Section 6, we consider that the effectiveness of the remedy critically depends on Ofgem maintaining its monitoring and enforcement activity concerning all Standards of Conduct.

- *Enhancing the ability and incentives of TPLs to prompt engagement*

8.71 We consider that the proposed changes to the Confidence Code could be implemented simultaneously with our proposed recommendations

concerning suppliers' licence conditions. In this regard, Ofgem would consult on the proposed removal of the Whole of the Market Requirement from the Confidence Code immediately after we publish our final report, with this process expected to conclude by the end of 2016. The change could then be implemented by the beginning of 2017.

8.72 The CMA would draft and consult on an order requiring Gemserv and Xoserve to provide PCWs with access to data in the six-month period following publication of the final report, with this process expected to conclude by the end of 2016. Gemserv and Xoserve could then be expected to provide access to PCWs from the beginning of 2017 onwards.

8.73 As regards the recommendation to DECC to make changes to the Midata programme, we envisage that DECC would consult on the proposed changes immediately following publication of our final report, with a view to introducing the requisite changes in its ongoing legislative programme for inclusion in the next energy sector or omnibus bill.

8.74 We would therefore expect this package of remedies aimed at promoting the role of PCWs in addressing actual and perceived barriers in accessing and assessing information and promoting competition among PCWs and, in turn, suppliers to take effect during 2017.

- *Prompts for customers – customer database remedy*

8.75 Following publication of our final report, the CMA would start drafting and consulting on an order requiring suppliers to send an opt-out letter (the Opt-out Letter) to their domestic customers who have been on the SVT or other default tariff for three or more years (Disengaged Domestic Customers). During this period, we would also expect Ofgem to begin developing the database and associated access agreements, and following publication of the CMA's final order, we would require suppliers to send the Opt-out Letter to all Disengaged Domestic Customers by mid 2017.

8.76 We would require suppliers to pass certain details of the Disengaged Domestic Customers who have not opted out to Ofgem by the end of 2017 at the latest. We would therefore expect rival suppliers to start accessing the database, and contacting the relevant Disengaged Domestic Customers by the end of 2017. The database would then be updated every six months from the beginning of 2018 onwards.

- *Customers on restricted meters*

- 8.77 As regards the suppliers making all their single-rate tariffs available to any domestic customers on any type of restricted meter without making switching conditional on a restricted meter being replaced, and the provision of certain information to such customers, the CMA would start drafting and consulting on an order in the six-month period following publication of our final report. We would expect suppliers to be able to make the necessary adjustments to their billing systems within three months of the date of a CMA order, and therefore to start offering all customers on restricted meter tariffs the ability to switch to their single-rate unrestricted meter tariffs, and providing the relevant information, by April 2017. We would expect this to lead to increased engagement from customers on restricted meters from April 2017.
- 8.78 As regards becoming a recognised provider of information and support for customers on restricted meters, we would expect Citizens Advice to be able to progress the implementation of this remedy immediately following publication of the CMA's final report.

Price cap

- 8.79 As regards the price cap, we expect that once the final order is published specifying the level of the price cap, suppliers will need a period of time to notify their customers of any price changes required in order to comply with the price cap and to implement these changes. We therefore anticipate that the price cap could be in force and effective from April 2017.

Provisional conclusion on timescale for remedies to address the Domestic AECs

- 8.80 We have provisionally concluded that we could reasonably expect all elements of the proposed remedy package to be in place within around 12 to 18 months of publication of our final report. We have also provisionally concluded that the proposed remedies will have a significant beneficial impact on competition within two to three years of publication of our final report and that this effect will continue to grow, as competition and innovation between suppliers is enhanced in their offerings of products to domestic customers, and domestic customers become more aware of the potential benefits of shopping around and of the tools available to help them to do so.

Consistency of our proposed remedies with existing and future laws and regulations

- 8.81 As part of our consideration of the design of each of the remedies in our proposed package, we have considered whether these remedies would be inconsistent with other relevant laws and regulations applicable to the domestic retail energy markets. A particular focus of our assessment of this aspect of remedy design has been the interaction of our proposed remedies with EU legislation; data protection legislation; legislation concerning privacy and electronic communications; general consumer protection legislation; existing standard licence conditions; and future legislative programmes.
- 8.82 In this regard, compliance with EU legislation (in particular, the Energy Directives¹⁰⁸⁵) has been a relevant design consideration of the proposed removal of the simpler choices component of the RMR rules, the proposed removal of SLC 22B.7(b) to partly address the Prepayment AEC and the proposed price cap. Compliance with data protection legislation (in particular, the Data Protection Act 1998, the Privacy and Electronic Communications Regulations 2003 and the forthcoming General Data Protection Regulation¹⁰⁸⁶) has been a relevant design consideration of our proposed Database remedy and, to a lesser degree, the proposed remedies to give PCWs access to the ECOES and SCOGES databases. Compliance with general consumer legislation and existing standard licence conditions (and in particular, the Standards of Conduct) has been a relevant design consideration of our proposed removal of aspects of the simpler choices component of the RMR rules. DECC's proposed legislative programme for Midata phase 2 has been a relevant aspect of our proposed remedy to give PCWs access to Midata. As regards the proposed price cap, we have had particular regard to the Energy Directives and the judgment of the Court of Justice delivered on 20 April 2010 in the *Federutility* case (the *Federutility Judgment*).¹⁰⁸⁷
- 8.83 As regards forthcoming regulatory developments, we have, where relevant, taken these into account in our design of individual remedies, such as Ofgem's ongoing work concerning the Debt Assignment Protocol. Where our proposed remedies involve amendments to suppliers' licences, we have also had regard to Ofgem's statutory duties and objectives concerning each individual remedy.

¹⁰⁸⁵ Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity and Directive 2009/73/EC of 13 July 2009 concerning common rules for the internal market in natural gas.

¹⁰⁸⁶ European Commission, [Proposal for a General Data Protection Regulation](#).

¹⁰⁸⁷ Case C-265/08, *Federutility and others v Autoita per l'energia elettrica e il gas*, (2010) ECR I-3377. As part of our assessment we have also considered the Court of Justice judgment delivered on 10 September 2015 in the *Commission v Poland* case, Case C-36/14, which broadly upheld the *Federutility Judgment*.

- 8.84 In light of the above, we have provisionally concluded that our proposed package of remedies, and the elements within it, are consistent with current and expected laws and regulations applicable to the domestic retail energy markets.

Coherence of our remedies as a package

- 8.85 We have considered the extent to which the proposed remedy measures contained within our proposed package of remedies are likely to be mutually reinforcing.
- 8.86 We have identified in Section 4 a number of important synergies between the different elements of the package of remedies.
- 8.87 Each of the proposed remedies, concerning the Prepayment AEC, the RMR AEC and the Domestic Weak Customer Response AEC addresses, in a different and complementary way, various aspects of the features giving rise to the Domestic AECs and the detriment arising from them.
- 8.88 First, the remedies that we are proposing that concern only the Prepayment AEC (namely, the amendment of SLC 22B.7(b), the redistribution of gas tariff pages, and amendments to the Debt Assignment Protocol) are mutually reinforcing in addressing aspects of the features we have provisionally identified concerning the technical constraints of the prepayment system and softened incentives for suppliers to compete to acquire new prepayment customers.
- 8.89 However, despite such supply-side remedies, we do not believe they will, by themselves, be effective at addressing the full extent of the Prepayment AEC, nor the substantial detriment that we have observed being suffered by prepayment customers.¹⁰⁸⁸ In this regard, as set out in Section 4, there are substantial synergies between the proposed remedies targeted exclusively at the Prepayment AEC, and the other proposed remedies concerning the Domestic Weak Customer Response AEC, which also impact prepayment customers, and combines with and contributes to the features of the Prepayment AEC and the RMR AEC.
- 8.90 Second, our proposed remedies concerning the Domestic Weak Customer Response AEC all have the synergy of simultaneously addressing different components of the features we have provisionally identified.¹⁰⁸⁹ In addition to facilitating engagement by some of the most disengaged domestic

¹⁰⁸⁸ See Section 4.

¹⁰⁸⁹ See paragraphs 8.3–8.53.

customers (such as those who have been on a SVT for three or more years), the remedies are also expected to improve engagement levels across the domestic retail energy markets as a whole. This includes customers on restricted meters, who we have observed are subject to heightened features giving rise to weak customer response.

- 8.91 This also includes prepayment customers, who we have observed are paying particularly high prices compared with the rest of the markets and are suffering more significantly from weak customer response than domestic customers on direct debit tariffs.¹⁰⁹⁰
- 8.92 More specifically, as regards the domestic engagement remedies, we believe there are certain aspects which will mutually reinforce once such remedies start to become effective.
- 8.93 The Ofgem-led programme is potentially wide-ranging in scope (beyond the initial shortlist of measures that we have identified as being particularly suitable for RCTs). Some of our other proposed remedies involve new communications with certain domestic customers (eg the Opt-out Letters concerning the Database remedy), and may also be suitable candidates for inclusion in the Ofgem-led programme after prioritisation of our shortlist of measures.
- 8.94 The proposed remedies that enhance PCWs' ability and incentives to engage domestic customers will also work synergistically with the proposed remedies concerning customers on restricted meters. Such customers' awareness of and interest in their ability to switch is expected to increase simultaneously with a reduction in the actual and/or perceived barriers to switching that they face. At the same time, PCWs will have better access to accurate meter numbers (through the ECOES and SCOGES databases), stronger incentives to negotiate individual deals with suppliers (which could, for instance, focus on particular customer groups such as prepayment customers, or encouraging customers on restricted meters to switch to single-rate tariffs), and in due course will have access to more comprehensive customer data through an enhanced Midata programme.
- 8.95 However, while we believe that the remedies that we have proposed to help create a framework for effective competition and improve customer engagement will be effective in addressing the features contributing to each of the Domestic AECs, they will take time to implement before they start to address the features we have identified and, in turn, reduce the detriment to

¹⁰⁹⁰ See paragraph 3.112.

domestic customers arising from them. For example, we would expect the Database remedy and the Ofgem-led programme to start to improve customer engagement by 2018 and 2019, respectively. Such remedies will, inevitably, take some time to become fully effective. There will therefore be continuing residual detriment for prepayment customers who, we have provisionally found, are suffering substantial harm from the Prepayment AEC and the Domestic Weak Customer Response AEC. For prepayment customers, the persisting features of the Prepayment AEC will not be addressed until the roll-out of smart meters is substantially complete (expected by the end of 2020).

- 8.96 For prepayment meter customers, therefore, we believe it is necessary to propose to introduce a price cap for a limited period of time.
- 8.97 We have considered the interaction of such a price cap with our other proposed remedies, in particular, the broader remedies targeting the Domestic Weak Customer Response AEC and those concerning exclusively the Prepayment AEC.
- 8.98 However, we expect such interaction to be limited in the interim period pending our proposed engagement remedies becoming effective.¹⁰⁹¹ We note that the removal and reduction of certain technical and regulatory constraints on suppliers offering tariffs to prepayment customers (in particular, concerning gas tariff codes and the removal of the four-tariff rule), and the enhanced ability and incentives for PCWs to engage with domestic customers, are all remedies that could become effective early in 2017. Such remedies have the capacity to and, indeed, it is our expectation that they will, increase suppliers' ability and incentives to engage prepayment customers, and increase some prepayment customers' ability to access and assess information to help them decide whether to switch. However, the effectiveness of such remedies will be limited as regards prepayment customers, on the one hand, because certain technical constraints concerning the dumb prepayment infrastructure will persist (there will continue to be a limited total of gas and electricity tariff pages), and on the other, because prepayment customers are less likely to use a PCW for searching when switching, have confidence in using a PCW and have access to the internet, than direct debit customers.¹⁰⁹²
- 8.99 In any event, we have sought to design the price cap to ensure that there are benefits available to customers who engage once it is in place and our

¹⁰⁹¹ See Section 7.

¹⁰⁹² See paragraphs 3.102 & 3.103.

other proposed remedies have started to take effect. These design considerations are set out in Section 7.

- 8.100 We have therefore provisionally concluded that this represents a coherent package of remedies, whose elements are mutually reinforcing and support the statutory duties and objectives of Ofgem, where relevant.

Provisional conclusion on effectiveness of the proposed remedy package

- 8.101 In light of the above, we have provisionally concluded that the proposed package of remedies represents an effective solution to the Domestic AECs that we have provisionally identified.¹⁰⁹³

Relevant customer benefits

- 8.102 In deciding the question of remedies, the CMA may ‘have regard to the effect of any action on any relevant customer benefits (RCBs) of the feature or features of the market concerned’.¹⁰⁹⁴ RCBs are defined in the 2002 Act and are limited to benefits to relevant customers in the form of:

- (a) lower prices, higher quality or greater choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or
- (b) greater innovation in relation to such goods or services.

- 8.103 The 2002 Act provides that a benefit is only an RCB if the CMA believes that:

- (a) the benefit has accrued as a result (whether wholly or partly) of the feature or features concerned or may be expected to accrue within a reasonable period of time as a result (whether wholly or partly) of that feature or those features; and
- (b) the benefit was, or is, unlikely to accrue without the feature or features concerned.

- 8.104 In the Remedies Notice, Supplemental Remedies Notice and the Second Supplemental Remedies Notice we invited parties to inform us of any RCBs to which we should have regard. We have considered any RCBs raised under each individual remedy assessment (including those we are minded

¹⁰⁹³ As noted above, the assessment of the effectiveness and proportionality of the proposed remedies concerning the Settlement AECs is addressed in Section 5.

¹⁰⁹⁴ Section 134(7) of the 2002 Act.

not to proceed with), whether specifically under a separate consideration of RCBs, or in the context of the design of the remedy and a consideration of its possible unintended adverse consequences.

- 8.105 We have provisionally concluded that there are no RCBs that might be lost as a result of introducing our proposed package of remedies. Consequentially, we see no need to modify our proposed remedy package to take account of RCBs.

Proportionality of our proposed package of remedies

- 8.106 In this section, we have summarised our assessment of whether our proposed package of remedies would be proportionate to address the Prepayment AEC, the RMR AEC and the Domestic Weak Customer Response AEC that we have provisionally found and/or the associated detriments. We have done this by considering whether the proposed package of remedies:

- (a) is effective in achieving its aim;
- (b) is no more onerous than necessary to achieve its aim;
- (c) is the least onerous if there is a choice; and
- (d) does not produce adverse effects which are disproportionate to the aim.

Effective in achieving its aim

- 8.107 For the reasons set out in Sections 4, 5, 6 and 7, we have provisionally concluded that our proposed package of remedies would be effective in its legitimate aim of remedying the Prepayment AEC, the RMR AEC and the Domestic Weak Customer Response AEC that we have provisionally identified and/or the associated detriments.

No more onerous than necessary to achieve its aim

- 8.108 In assessing whether the proposed package of remedies is no more onerous than necessary, we have considered:
- (a) whether each measure within the proposed package of remedies is required to remedy the Domestic AECs that we have provisionally found; and
 - (b) whether the design of each remedy measure within the proposed package of remedies is no more onerous than it needs to be.

Is each element of the proposed package of remedies necessary?

- 8.109 We have considered whether it would be possible to achieve a sufficiently comprehensive solution to the Domestic AECs that we have provisionally identified without implementing all of the measures in our proposed package of remedies.
- 8.110 Based on our assessment in Sections 4, 5, 6 and 7 of how the elements of the proposed remedy package contribute to remedying the Domestic AECs, we took the view that each measure makes a material contribution to the effectiveness of the proposed remedy package, such that its overall impact would be weakened if any single measure were removed from the package. The contribution to the overall impact of the package varies between remedies but each has an important role to play in addressing the Domestic AECs that justifies its inclusion in the package, and they are mutually reinforcing (see paragraphs 8.3 to 8.53 and 8.85 to 8.100).
- 8.111 While the measures work together to address the Domestic AECs, we have nonetheless considered some elements to be of particular importance to make a significant contribution to remedying the Domestic AECs even in the absence of the other remedies.
- 8.112 For instance, the proposed removal of the simpler choices component of the RMR rules is of particular importance in enhancing competition and innovation between suppliers in their offerings to domestic customers and, accordingly, will make a significant contribution to addressing the RMR AEC and associated detriment.
- 8.113 The Ofgem-led programme (involving RCTs, where appropriate) and the Database remedy are of particular importance in prompting domestic customers to engage in the markets and, accordingly, will make a significant contribution to addressing the Domestic Weak Customer Response AEC and associated detriment. These two remedies in particular work together by seeking to (a) improve the correspondence that customers receive where their suppliers' incentives are not fully aligned (especially in terms of highlighting the alternative options available to customers), and (b) give those rival suppliers (which have an incentive to engage customers) the ability to market directly to the most disengaged customers.
- 8.114 The price cap remedy is of particular importance to protect prepayment customers against the residual harm that, in our provisional view, arises and will continue to arise from the Prepayment AEC and the Domestic Weak Customer Response AEC while our other proposed remedies aimed at

addressing these AECs take effect, and until the roll-out of smart meters has been substantially completed (expected by the end of 2020).

- 8.115 We consider that the complementary effect of the various elements of the remedies package is an important aspect of the effectiveness of the package as a whole. Accordingly, we have provisionally concluded that it is necessary to include each of the measures in our proposed package of remedies in order to achieve a sufficiently comprehensive solution to the Domestic AECs we have provisionally identified.

Is the design of each remedy measure within the proposed package of remedies no more onerous than it needs to be?

- 8.116 Our consideration of the design and implementation of each of the measures is set out in Sections 5, 6 and 7.
- 8.117 In reaching our provisional decisions on remedy design, we have sought to avoid imposing costs and restrictions on parties that go beyond what is needed to achieve an effective remedy.
- 8.118 We have also sought to strike a similar balance in terms of remedy implementation. For example, we propose to seek undertakings where possible to achieve certain of our proposed remedies where we consider it may be effective and appropriate do so.
- 8.119 As regards the price cap, we have considered whether it may be possible to limit the prices paid by prepayment customers without imposing a price cap, for example, through using principles based regulation concerning a cost-reflectivity requirement. We have also taken into account the potential for the price cap to be more onerous than necessary in its design. In this regard, we have specifically taken into account the potential for the price cap to be set at a level that does not allow reasonable opportunity for suppliers to recover efficient costs, and as regards implementation costs. We have sought to mitigate these risks by taking competitive prices from outside the prepayment segments, adjusted to reflect cost differentials, and then updating such prices in line with indices tracking key components of a customer's bill. Additionally, the existence of both implicit and explicit headroom mitigates the risk that the level of the cap will be below efficient costs.
- 8.120 By following the above approach, we have sought to ensure that no measure within the proposed package of remedies is more onerous than it needs to be, in order to address the Domestic AECs.

- 8.121 In light of the above, we have therefore provisionally concluded that our proposed package of remedies is no more onerous than necessary in order to remedy the Domestic AECs and resulting customer detriment.

Least onerous if there is a choice

- 8.122 If the CMA is choosing between two remedy measures which appear to be equally effective, it should choose the remedy measure that imposes the least cost or is least restrictive.
- 8.123 We have not been able to identify an alternative package of remedies that would be both as effective, and less onerous, in addressing the Domestic AECs and associated detriment as the package we have provisionally identified. However, when deciding on the measures to be included in our proposed package of remedies, we have considered some other possible ways of addressing the Domestic AECs and/or customer detriment. These include measures that we have proposed for consideration, and some other measures that have been proposed by parties in response to the Remedies Notice, Supplemental Remedies Notice and Second Supplemental Remedies Notice.
- 8.124 Our detailed assessment of these alternative measures is set out in Sections 5 and 6. We have concluded that a number of measures should not be pursued as part any proposed package.
- 8.125 As regards the efficient allocation of gas tariff pages, we are minded not to proceed with centralising the management of gas (and potentially electricity) tariff pages, which we consider will be more complex, time-consuming and costly than the alternative remedy we propose through seeking undertakings from certain suppliers and/or a new licence condition.
- 8.126 We have also considered whether the remedies suggested by Centrica and Scottish Power, which would involve a prohibition on evergreen default tariffs and prompting customers on fixed-term contracts, would achieve the same aim as, but would be less onerous than, our proposed engagement remedies. However, in our provisional view these proposals fail to meet the effectiveness and proportionality tests. Centrica's proposal would not be effective to address (in whole or in part) the Domestic Weak Customer AEC and/or associated detriment as we do not consider this proposal to be a substantial departure from the status quo. While Scottish Power's proposal could potentially be effective to address (in whole or in part) the Domestic Weak Customer Response AEC, we consider that this proposal would not be proportionate based on its potential high implementation costs, and its

potential adverse unintended consequences on domestic customers and, in particular, the risk of higher prices for default tariffs.

- 8.127 In our proposed package of remedies, we have also decided not to include measures that would not make a material contribution to remedying the Domestic AECs. For instance, in the context of our proposed removal of the simpler choices component of the RMR rules and our proposed removal of the Whole of the Market Requirement, we have provisionally decided not to recommend Ofgem to provide an independent price comparison service as this service would not add significant further value to that already provided by the Citizens Advice service.
- 8.128 As regards the price cap, we have considered multiple alternative design options, including an external reference price approach which involves setting a cap on prepayment tariffs based on direct debit acquisition tariffs in the market plus an uplift reflecting our assessment of the costs associated with prepayment, and options that would be more complex, costly to and time-consuming to implement and monitor. Our consideration of these alternative options are set out in Section 7. Our preferred design option, involving a hybrid reference price and cost index approach is, in our view, the design that achieves the best balance between practicability, minimising the scope for gaming, accuracy, and our key criterion for being capable of implementation in the near future (in order to maximise its effectiveness). We believe such a design will meet our key criterion for the price cap remedy to be timely to implement, given the timescales involved with our other proposed remedies.
- 8.129 In light of the above, we have concluded that, to the limited extent that we have a choice between effective remedies, we have identified the package of remedies that imposes the least cost and is least restrictive.

Does not produce adverse effects which are disproportionate to the aim

- 8.130 We have considered whether the package of remedies is likely to produce adverse effects which are disproportionate to the aim of remedying the Domestic AECs and/or the resulting customer detriment.
- 8.131 In reaching a judgement about whether to proceed with a particular remedy, the CMA will consider its potential effects – both positive and negative – on those persons most likely to be affected by it. The CMA will pay particular regard to the impact of remedies on customers. The CMA will also have regard to the impact of remedies on those businesses subject to them and on other affected parties, such as other businesses (eg potential entrants, or

firms active in upstream or downstream markets), government and regulatory bodies, consumer organisation, and other monitoring agencies.

Benefits of the proposed remedy package

- 8.132 We have considered the likely benefits of the proposed package of remedies.
- 8.133 As described in paragraphs 8.9 above, the key benefits of the package of remedies that we have proposed are threefold: (a) to create a framework for effective competition, (b) to improve customer engagement, and (c) to protect prepayment customers.
- 8.134 In our provisional findings, the Addendum, and Sections 3 and 7, we have concluded that the scale of detriment caused by the Domestic AECs was substantial, in particular, as regards prepayment customers.¹⁰⁹⁵ We have also observed heightened features for customers on restricted meters. The magnitude of the detriment involved supports a provisional decision that a wide-ranging package of remedies, of the kind we are proposing, is necessary and appropriate.
- 8.135 As discussed in paragraphs 8.85 to 8.100, we believe the package we are proposing is a coherent package of mutually reinforcing remedies. This is particularly the case concerning the remedies addressing exclusively the Prepayment AEC, those addressing the RMR AEC and those addressing aspects of the Domestic Weak Customer Response AEC, which will free suppliers from regulatory restrictions that unnecessarily restrict competition, while putting in place measures aimed at overcoming suppliers' misaligned incentives with those of customers seeking to conduct 'value-for-money' assessments, and enhancing the ability and incentives of those participants in the markets whose incentives are aligned with those of customers.
- 8.136 While the proposed price cap will reduce the extent to which prepayment customers are overpaying for their gas and electricity, and so reduce the scope for further price reductions by suppliers, we nevertheless consider that there remains an important role for competition between suppliers to prepayment customers, and for engagement by prepayment customers, and we have carefully designed our price cap remedy to allow such competition and engagement to develop.
- 8.137 In light of this assessment, we have considered the scope for customers to benefit from increased competition and engagement as a result of our

¹⁰⁹⁵ See paragraphs 3.191 & 7.12.

proposed remedy package, which we consider would be substantial. We reached this view, in light of the following considerations:

- (a) Our assessment of the detriment that has been, and is being suffered, by domestic customers as a result of the Domestic AECs is around £1.7 billion per year over the last three and a half years,¹⁰⁹⁶ with a marked increase in detriment year on year. We have noted a considerable variation in the detriment suffered by customers of different suppliers and between different categories of customer.
- (b) In particular, we have observed particularly high detriment for prepayment customers of almost £500 million per year, or £178 per customer in Q2 2015 for a dual fuel prepayment customer consuming at Ofgem's medium Typical Domestic Consumption Value.¹⁰⁹⁷

Costs of the proposed remedy package

- 8.138 We have considered the potential scale of the costs generated by the proposed remedy package. Our consideration of the costs of these remedies is ongoing and we would welcome further submissions on the costs of the various elements of the package, in light of the further detail provided on their specification in Sections 5, 6 and 7.
- 8.139 The following aspects of our proposed package may generate material costs:
- (a) The Ofgem-led programme is a potentially resource-intensive and long-term programme that would involve material costs being incurred by Ofgem. The Behavioural Insights Team told us that the costs of the trials that it had conducted to date had been between £[§], although we note that costs may vary substantially, depending on the size and complexity of the trial. We have noted that Ofgem's current research budget of £450,000 would require substantial additional resources in order to carry out RCTs in the four shortlist areas that we have set out in Section 6. It would also require participation from suppliers and we would welcome views, in the context of discussions concerning potential undertakings, on the costs generated by this remedy.
 - (b) The Database remedy could be expected to involve costs in the region of £50,000 to £100,000 to create a secure cloud database capable of securely holding the relevant details of the Disengaged Domestic

¹⁰⁹⁶ Section 3.

¹⁰⁹⁷ See paragraph 7.12.

Customers. In addition, suppliers and Ofgem would incur certain costs to put in place agreements concerning access to the Database, and Ofgem would incur ongoing costs concerning the maintenance and operation of the database. However, many suppliers' costs of entering into agreements with Ofgem are likely to be displaced (in whole or in part) by profits from potential new customers that switch to the supplier pursuant to a targeted marketing campaign. Consequently, we did not consider any additional costs of entering into access agreements with Ofgem as a material cost of this proposed remedy. We have also noted the importance of the Opt-out Letter being appropriately worded so as to avoid unsettling customers, minimise confusion and otherwise avoid developing mistrust. While some costs would therefore be incurred by the CMA, Ofgem and suppliers in developing a suitable Opt-out Letter (during the period prior to publication of the CMA's final order), we would expect such costs to be modest.

- (c) The requirement on suppliers to offer their single-rate tariffs to customers on restricted meters without making such offers conditional on changing their meter may impose costs on suppliers, as regards updates to their billing systems. However, given that two of the Mid-tier Suppliers currently make their single-rate SVTs and single-rate fixed-term tariffs available to new or existing customers, we would not expect such costs to be significant.
- (d) As regards the price cap, we note that we have sought to minimise implementation costs by choosing a straightforward design for the cap. We consider the particular design of the price cap that we have provisionally decided to introduce would have modest costs in terms of implementation, and would principally relate to updating tariff prices according to the exogenous cost indices, and also the costs of monitoring compliance with the price cap. We note in this regard that the Water Industry Commission for Scotland (WICS) spent £0.9 million in 2014/15 (and £1.0 million in 2013/14)¹⁰⁹⁸ on 'determination of prices and monitoring of performance' and that this covered the period in which WICS determined the price control for 2015–2021. Given the scale of Ofgem's anticipated involvement in administering the price cap we expect that the incremental cost for Ofgem would be closer to the costs we note WICS incurred. We would expect that suppliers would incur low implementation costs, since they would merely need to inform relevant

¹⁰⁹⁸ See [WICS resource accounts 2014-15](#), note 3.

customers that are subject to the price cap that their annual bill will not exceed a predetermined level assuming an average consumption level.

- 8.140 We have also noted the potential impact of the proposed price cap on the annual bills for the Six Large Energy Firms and the Mid-tier Suppliers, which would be reduced as a result of the price cap by an amount of £303 million.¹⁰⁹⁹ [X] However, we have not assessed this estimated bill reduction as a cost of the proposed remedy given that the purpose of the remedy is to achieve reasonable prices for prepayment customers, and bill reduction would be the direct effect of any remedy that was effective in addressing the associated customer detriment (which as noted above, our assessment has shown is almost £500 million per year).
- 8.141 As regards the other remedies comprising the proposed package we do not consider they will generate material costs.
- (a) We do not believe the proposed remedies exclusively concerning the Prepayment AEC will involve substantial costs, in particular as regards the softening of SLC 22B.7(b) and the recommendation concerning the Debt Assignment Protocol, which supplements Ofgem's ongoing work in this area. As regards agreeing undertakings to release certain gas tariff codes and/or amending suppliers' licence conditions to set a cap on the number of gas tariff pages that a supplier can hold, we recognise that an unused tariff page may have some option value for a supplier. However, we have not received any evidence that any such value would be significant. We have also sought to ensure that any of the Six Large Energy Firms that would be required to release gas tariff pages would have a sufficient number remaining.
 - (b) We do not believe the proposed remedies concerning the RMR AEC will involve substantial costs, which involve, at most, a short consultation on proposed changes to suppliers' licence conditions.
 - (c) We do not believe that providing access to PCWs to the ECOES or SCOGES databases will involve substantial costs for Gemserv or Xoserve. Similarly, we do not believe our proposed remedy concerning an enhanced Midata specification and access for PCWs will involve material costs.
 - (d) We do not believe that requiring suppliers to provide certain additional information to their customers on restricted meters, and recommending

¹⁰⁹⁹ See paragraph 7.161.

Citizens Advice to become a recognised provider of information and support to such customers will involve material costs.

8.142 Finally, we note that we have also considered the risks of our package of remedies leading to unintended adverse consequences, and they have been designed in such a way as to minimise the risk of unintended adverse consequences. In particular:

- (a) We do not expect our proposed price cap to have a material adverse impact on competition in the prepayment segments, which we have identified as currently exhibiting limited effective competition and engagement by prepayment customers, leading to substantial detriment that we expect to continue, in particular, in the period leading to the effective implementation of our other proposed remedies.
- (b) The duration of the price cap will be limited, and closely linked to the substantial completion of the roll-out of smart meters, thereby minimising any medium-term and eliminating any long-term unintended adverse consequences.
- (c) Many of our other proposed remedies will, to a greater or lesser extent, involve Ofgem in their implementation, monitoring and/or enforcement. As sector regulator, Ofgem will be able to assist with the mitigation of any unintended adverse consequences that may arise from our proposed remedies.

8.143 In light of the assessment we have conducted above and in Sections 4 to 7, we provisionally consider that the costs and unintended adverse consequences associated with our proposed remedy package are likely to be modest in comparison with the levels of detriment that we have observed as arising, in particular, from the Prepayment AEC and the Domestic Weak Customer Response AEC.

8.144 We will continue to review the costs of our remedies up to publication of our final report and would welcome further submissions and evidence on this matter.

Balance of benefits and costs

8.145 We have considered whether the benefits of the proposed remedy package are likely to exceed the likely costs.

8.146 We have provisionally concluded in paragraphs 8.132 to 8.13 that the benefits of increased competition and engagement as a result of our proposed remedy package would be substantial, in particular, in light of the

detriment that we have observed as arising from the Domestic Weak Customer Response of £1.7 billion per year for domestic customers, and as arising from the Prepayment AEC and the Domestic Weak Customer Response AEC specifically concerning prepayment customers of almost £500 million per year. Set against these benefits, we have considered, for the reasons set out in paragraphs 8.138 to 8.142, that the costs of implementing our remedy package are likely to be modest in comparison to the levels of detriment that we have observed as arising, in particular, from the Prepayment AEC and the Domestic Weak Customer Response AEC. We have not, at this stage, quantified every aspect of our proposed remedies, nor is it possible to do so given the nature of some remedies such as the Ofgem-led programme which by necessity leave considerable discretion for Ofgem to determine what and how it should test as part of its research programme, taking into account what would be proportionate for the programme to be effective.

- 8.147 We have therefore provisionally concluded that the benefits of the proposed remedy package are likely to exceed its costs and that, consequently, the proposed remedy package is unlikely to give rise to adverse effects that are disproportionate to its legitimate aim. We will continue to review the costs and benefits of our proposed remedies up to publication of our final report and would welcome further submissions and evidence on this matter.

Provisional conclusion on proportionality

- 8.148 We have provisionally concluded that our proposed package of remedies represents a proportionate solution to the Domestic AECs and resulting customer detriment.

9. Retail supply to microbusinesses

Introduction

- 9.1 In the provisional findings report, we found that a combination of features of the markets for the retail supply of gas and electricity to SMEs in GB gave rise to an AEC through an overarching feature of weak customer response from microbusiness customers. We said that this gave suppliers a position of unilateral market power over their inactive microbusiness customers, which the suppliers were able to exploit through their pricing policies or otherwise (the Microbusiness Weak Customer Response AEC).¹¹⁰⁰
- 9.2 We note that the features (giving rise to the AEC) that we identified in the provisional findings report concerned the markets for the retail supply of gas and electricity to SMEs in Great Britain. However, it is the microbusiness customers, as opposed to the larger customers within the SME sector, that are most affected by these features. In addition, the terms of reference of the energy market investigation focus on microbusiness customers.¹¹⁰¹ Therefore, our proposed remedies concern the microbusiness segments only.
- 9.3 This section of our provisional decision on remedies first sets out a brief overview of our updated analysis of the detriment arising from the Microbusiness Weak Customer Response AEC and the strategic approach we have adopted to remedies design. Thereafter, it identifies the individual remedies which we have proposed to address the Microbusiness Weak Customer Response AEC, followed by the individual remedies that we have provisionally decided not to proceed with. Finally, it includes our assessment of the effectiveness and proportionality of the overall package of remedies in relation to the microbusiness segments of the retail supply markets.

Assessment of detriment arising from the Microbusiness Weak Customer Response AEC

- 9.4 The objective of the proposed remedies is to remedy, mitigate or prevent the provisional AEC that we have identified or its detrimental effects. When deciding upon the appropriate remedies in the microbusiness segments, we have considered the nature and extent of the Microbusiness Weak Customer

¹¹⁰⁰ [Provisional findings report](#), paragraph 9.111.

¹¹⁰¹ Energy market investigation, [terms of reference](#).

Response AEC and the resulting detrimental effects on microbusiness customers arising from this provisional AEC.

9.5 A detrimental effect on customers could arise from:

(a) higher prices, lower quality or less choice of goods or services in any market in the UK (whether or not the market to which the feature or features concerned relate); or

(b) less innovation in relation to such goods or services.¹¹⁰²

9.6 In the microbusiness segments, we considered that there was customer detriment in the form of gas and electricity microbusiness customers of the Six Large Energy Firms paying higher prices, on average, than would otherwise be the case in a better-functioning market.¹¹⁰³ Furthermore, we considered that there could be detriment arising from the microbusiness customers of suppliers that were not one of the Six Large Energy Firms (the independent suppliers). This is because the features that give rise to the Microbusiness Weak Customer Response AEC are the same for the microbusiness customers of the Six Large Energy Firms and independent suppliers. Hence, we consider that the provisional package of remedies should apply to the Six Large Energy Firms and the independent suppliers in the microbusiness segments.

Analysis of detriment in the provisional findings report

9.7 In the provisional findings report, we calculated an annual detriment of approximately £500 million for the SME customers of the Six Large Energy Firms,¹¹⁰⁴ from FY 2009 to FY 2013 using the 'competitive benchmark revenue' analysis. This detriment equated to approximately 15% of SME revenues of the Six Large Energy Firms. This analysis made adjustments for cost inefficiencies and capital charges on the asset base of the Six Large Energy Firms using the industry weighted average cost of capital (WACC).

9.8 The annual SME detriment of £500 million for the Six Large Energy Firms can be broken down into two key elements. First, approximately £325 million (65%) related to 'profits in excess of the cost of capital'. Second,

¹¹⁰² CC3, paragraph 326.

¹¹⁰³ CC3, paragraph 30.

¹¹⁰⁴ Provisional findings report, [Appendix 10.5](#), paragraph 76a.

approximately £175 million (35%) related to relative inefficiencies (with an immaterial amount related to wholesale energy cost purchases).¹¹⁰⁵

9.9 Separately, in the provisional findings report, we analysed the profit margins of the Six Large Energy Firms from FY 2009 to FY 2013. The results of this analysis showed that the combined EBIT margin for the Six Large Energy Firms in the SME markets was 8.4%, compared with 3.3% in the domestic retail markets and 2% in the I&C markets.¹¹⁰⁶

9.10 In the provisional findings report, we also observed that the Six Large Energy Firms earned the highest average revenues and gross margins on deemed and out-of-contract (OOC) contracts, which were substantially higher than those relating to acquisition and retention contracts.¹¹⁰⁷

Updated analysis of detriment for the provisional decision on remedies

9.11 We have amended our approach to assessing microbusiness detriment in several key respects since the provisional findings report:

(a) We have confined our estimate of detriment to a consideration of profits in excess of the cost of capital – that is, we have not included an estimate of inefficiency. We also note that we have not been able to conduct an analysis of supplier bills to produce an alternative, and more direct, estimate of detriment, as we have done for domestic customers (see Appendix 3.2).

(b) We have included FY 2014 numbers in the financial results.

(c) We have made some amendments to capital employed based on company specific representations.

(d) We have estimated the proportion of the SME detriment that covers the microbusiness segments.

9.12 In relation to inefficiency, we have taken on board comments in relation to the heterogeneity of the SME markets and microbusiness segments. This heterogeneity consists of differences between suppliers in respect of:

¹¹⁰⁵ We note that there are challenges associated with quantifying any detriment arising from indirect costs or reported energy costs in the SME segment (see Appendix 3.5, efficiency analysis, paragraph 23).

¹¹⁰⁶ Provisional findings report, [Appendix 9.1](#), paragraph 159.

¹¹⁰⁷ [Provisional findings report](#), paragraph 9.36. Also, acquisition contracts are energy contracts made available by energy suppliers to acquire new microbusiness customers and retention contracts are energy contracts made available by energy suppliers to retain their existing microbusiness customers. Microbusinesses explicitly choose to enter into these contracts (see the provisional findings report, [Appendix 9.1](#), paragraph 9.29 for further details).

- (a) scale: for example several independent suppliers have greater market shares than some of the Six Large Energy Firms;
 - (b) financial reporting: for example, lack of consistency in the way suppliers define SMEs; and
 - (c) customer types: for example, the diversity of businesses and types of tariffs/contracts that they are on is more varied than the domestic retail markets.
- 9.13 Given the responses we have decided not to calculate the inefficiency of suppliers operating within the microbusiness segments. Therefore our current estimate of the detriment is solely based on profits in excess of the cost of capital. We note that this is a conservative assumption – there may well be inefficiencies in serving microbusiness customers, but it is problematic to assess the extent of inefficiency from the data for the reasons set out above. The revised estimate can therefore be considered a lower bound estimate of overall detriment as regards the microbusiness segments.
- 9.14 For the provisional decision on remedies, we have therefore assessed detriment by assessing the extent to which the Six Large Energy Firms earned profits¹¹⁰⁸ in excess of their cost of capital in relation to the microbusiness segments.
- 9.15 Our revised estimate is that the profits in excess of the cost of capital earned by the entire retail supply businesses (including domestic, I&C and SME) of the Six Large Energy Firms were approximately £550 million¹¹⁰⁹ to £800 million¹¹¹⁰ per year, from FY 2007 to FY 2014¹¹¹¹ and that the supply of gas and electricity to SME customers generated profits of approximately £280 million (per year) in excess of the cost of capital.
- 9.16 In the absence of financial reporting data for the microbusiness segments of the Six Large Energy Firms, we have estimated the proportion of the £280 million of SME profits in excess of the cost of capital that could be attributed to the microbusiness segments. We did so by asking the Six Large Energy Firms what proportion of their revenues from FY 2007 to FY 2014 could be attributed to the microbusiness segments, ie we assumed that

¹¹⁰⁸ We sourced the profitability numbers from the financial statements provided by the Six Large Energy Firms as part of the SQ responses.

¹¹⁰⁹ The £550 million per year estimate includes the profits in excess of the cost of capital and losses of all of the Six Large Energy Firms including the losses of two firms.

¹¹¹⁰ The £800 million per year estimate only includes the profits in excess of the cost of capital made by four of the Six Large Energy Firms, ie the losses made by two of the Six Large Energy Firms were excluded.

¹¹¹¹ See Appendix 3.4, paragraph 142.

profits in excess of the cost of capital earned across the microbusiness segments and the larger SME markets would broadly be in proportion to their respective revenues. Based on the parties' responses, this proportion amounted to 83% on average for all of the Six Large Energy Firms.¹¹¹² On this basis, we have estimated that approximately £230 million per year of the £280 million profits in excess of the cost of capital earned by the Six Large Energy Firms related to microbusiness customers.¹¹¹³

- 9.17 We note that the revenue apportionment methodology that we have adopted may not provide a completely accurate number for profits in excess of the cost of capital. Nevertheless, given the lack of availability of accurate data for the microbusiness segments, we consider that the apportionment of profits in excess of the cost of capital by revenue would give a reasonable approximation of the profits in excess of the cost of capital for the microbusiness segments, although again this approach is relatively conservative. In the provisional findings report, we observed 'higher average revenues and gross margins for smaller customers compared to larger ones. This applied to some extent across consumption bands, though it was particularly noticeable for small microbusinesses'.¹¹¹⁴ This suggests that the detriment is more likely to be concentrated in the microbusiness segments.
- 9.18 For the above reasons, we consider that our estimated profits in excess of the cost of capital of £230 million is a lower bound of overall profits in excess of the cost of capital for the microbusiness segments.
- 9.19 Despite this conservative approach, we believe that the size of the microbusiness profits in excess of the cost of capital that we have identified is significant. The annual profits in excess of the cost of capital amounted to 6% of average annual microbusiness revenues for the Six Large Energy Firms from FY 2007 to FY 2014. This suggests that prices could have been on average 6% higher between FY 2007 to FY 2014 than would have been the case in a better-functioning market. If aggregated over the review period from FY 2007 to FY 2014, the profits in excess of the cost of capital amounted to approximately £1.8 billion.
- 9.20 We also note that a disproportionate share of the profits in excess of the cost of capital that we have identified for the entire retail supply businesses of the

¹¹¹² EDF Energy and RWE could only provide the revenue split for the microbusiness segments from FY 2012 to FY 2014. Therefore, we applied the same split from FY 2007 to 2014 for these firms – as the most appropriate estimate for the entire period of review.

¹¹¹³ We note that Centrica's and E.ON's SME consumption thresholds are significantly higher than Ofgem's microbusiness consumption thresholds, that RWE's is moderately higher than Ofgem's and that Scottish Power's, EDF Energy's and to some extent SSE's SME definitions have similar consumption thresholds or profile classes to Ofgem's microbusiness definition (see provisional findings report, [Appendix 9.1](#), Table 1).

¹¹¹⁴ Provisional findings report, [Appendix 9.1](#), paragraph 172.

Six Large Energy Firms can be attributed to the microbusiness segments. The microbusiness segments contributed approximately 9.5% of total revenue of the entire supply businesses of the Six Large Energy Firms between FY 2007 to FY 2014, but between 29% and 42% of the profits in excess of the cost of capital that we have identified over the same period.

- 9.21 For the microbusiness segments, we have not attempted to quantify any possible detriment arising from non-price sources of detriment (such as impacts on innovation or quality of service).

Strategic approach to remedies design

- 9.22 At a high level, the provisional package of remedies for microbusiness customers can be divided into two strategic components:

(a) Measures to help microbusiness customers engage to exploit the benefits of competition. These include remedies to:

- (i) increase price transparency;
- (ii) end auto-rollover contracts with certain restrictions (such as termination fees) that restrict microbusiness customers' ability to switch;
- (iii) establish a programme to provide microbusiness customers with information to prompt them to engage; and
- (iv) provide prompts to microbusiness customers on default contracts by enabling rival suppliers to contact them.

(b) Measures to help create a framework for effective competition. Our proposed remedies regarding reforms of the settlement system for gas and electricity, discussed in Section 5, also apply to microbusiness customers. These include remedies to:

- (i) develop a firm plan to move microbusiness electricity customers to half-hourly settlement while also implementing a cost-effective option for elective half-hourly settlement; and
- (ii) increase the accuracy of the gas settlement system.

Engagement remedies

- 9.23 We believe that our engagement remedies will play a key role in addressing the features leading to the Microbusiness Weak Customer Response AEC, and in particular the following:

- (a) that microbusiness customers face actual and perceived barriers to accessing and assessing information. This arises from two aspects of the energy markets: a general lack of price transparency concerning the contracts that are available to microbusiness customers, and the role of third party intermediaries (TPIs);
 - (b) that microbusiness customers have limited awareness of and interest in their ability to switch energy supplier; and
 - (c) that some microbusiness customers on auto-rollover contracts may have limited ability to switch contract and/or supplier.¹¹¹⁵
- 9.24 We have proposed four remedies that, in our provisional view, would be effective in addressing these features and, accordingly, the Microbusiness Weak Customer Response AEC and the resulting customer detriment.
- 9.25 The price transparency remedy would require suppliers to disclose the prices of all their available acquisition and retention contracts to a large proportion of their microbusiness customers. As an additional measure, it would also require suppliers to disclose the prices of their out-of-contract (OOC) and deemed contracts on their websites. The measure in relation to acquisition and retention contracts would significantly increase microbusiness customers' abilities to access and assess price information. It would also facilitate the development of PCWs catering for microbusiness customers, which would further reduce the high search costs faced by microbusiness customers.
- 9.26 As a result, the price transparency remedy would address barriers to accessing and assessing information experienced by microbusinesses without the need to implement an alternative remedy we have considered relating to the role of TPIs. We also note that this remedy may contribute towards increasing the level of trust in (and possibly the use of) TPIs as microbusiness customers would be able to effectively assess and verify online whether the prices they were quoted by TPIs were reasonable.
- 9.27 The auto-rollover remedy would address certain barriers to switching that microbusiness customers on default (including auto-rollover contracts) contracts face by: (a) increasing the time window during which microbusiness customers would be able to give their termination notice to

¹¹¹⁵ The features that give rise to the Microbusiness Weak Customer Response AEC are listed in the provisional findings report.

suppliers; and (b) prohibiting suppliers from including certain restrictions (prohibiting both termination fees and the use of no-exit clauses).

- 9.28 We have also sought to prohibit termination fees in relation to evergreen and OOC contracts. This measure, together with the measure to prohibit termination fees in relation to auto-rollover contracts, would effectively ensure that suppliers would not be permitted to charge termination fees on default contracts with their microbusiness customers.¹¹¹⁶ It would thereby reduce the barriers to switching for microbusiness customers on evergreen and OOC contracts. This position would be consistent with the domestic retail markets, where suppliers do not charge termination fees on the SVT.
- 9.29 The remedies to establish a programme to identify additional (or new) information from suppliers to prompt microbusiness customers to engage, and to disclose the details of their most disengaged microbusiness customers to rival suppliers would increase the engagement of microbusiness customers on default contracts. By incentivising microbusiness customers to engage, we would expect the competitive constraint on energy suppliers to increase. This would incentivise suppliers to reduce the prices of their available acquisition and retention contracts for microbusiness customers.
- 9.30 We note that the price transparency and auto-rollover remedies are specific to the microbusiness segments. However, the other two remedies, which relate to the establishment of a programme to provide microbusiness customers with information and access to microbusiness customers' data, mirror two remedies we have proposed in the domestic retail markets. In the design of these remedies for the microbusiness segments, we have adopted a similar framework to that used for domestic retail markets.

Other remedies

- 9.31 Our remedies concerning the electricity and gas settlement systems, as discussed in Section 5, would also apply to microbusiness customers. In particular, the plan to move customers in profile classes 1 to 4 to mandatory half-hourly settlement in electricity would affect the majority of microbusiness customers (almost 90% of which currently fall into profile classes 3 and 4).
- 9.32 The other remedies that we are proposing with a view to improving the framework for competition for domestic customers either affect very few

¹¹¹⁶ We understand that suppliers are prohibited from charging termination fees on deemed contracts (see paragraph 9.151 below).

microbusiness customers or do not apply at all in the microbusiness segments. In particular:

- (a) the simpler choices component of the RMR rules applies to domestic customers alone; and
- (b) very few microbusiness customers (less than 1% of the total) are on prepayment meters. For those that are, the remedies we have proposed to address technical constraints relating to prepayment tariff slots should help to improve the range of tariffs available.

9.33 We have also considered the case for introducing a price cap for microbusiness customers on prepayment meters. We have provisionally decided not to do so, on the grounds that the costs associated with implementing a price cap for the microbusiness segments would be large relative to the potential benefits, which would accrue to a very small number of microbusiness customers.

9.34 In developing our proposed remedies, we have been mindful to ensure that they work together as a coherent package, which, as a whole, provides an effective and proportionate means of addressing the Microbusiness Weak Customer Response AEC, and the resulting customer detriment. Our overall assessment of the package of remedies against these criteria, including an assessment of costs and benefits, is provided below (see paragraph 9.289 below). We have provisionally concluded that the benefits of the package as a whole are likely to exceed the costs by a substantial degree.

Helping customers engage to exploit the benefits of competition: Remedies to address the Microbusiness Weak Customer Response AEC

Price transparency remedy

9.35 In the provisional findings report, one of the features of the SME retail energy markets that gave rise to the Microbusiness Weak Customer Response AEC (and the resulting detriment) was that customers faced actual and perceived barriers to accessing and assessing information arising from certain aspects of those markets. One of the aspects that contributed to this feature was a general lack of price transparency concerning the contracts (or tariffs) that are available to microbusinesses, which results from:

- (a) many microbusiness tariffs not being published by suppliers;

- (b) a substantial proportion of tariffs being individually negotiated between customers and suppliers; and
 - (c) the nascent state of PCWs for non-domestic customers.
- 9.36 To address this aspect, one of the possible remedies included in the Remedies Notice proposed the ‘introduction of a new requirement in the licences of retail energy suppliers to provide price lists for microbusinesses on their own websites and to make this information available to PCWs.’
- 9.37 The Parties’ views on the proposed remedy are set out in paragraphs 9.48 and 9.49 below. However, it is important to note here that parties made two suggestions in their responses to the Remedies Notice:
- (a) The means of price disclosure by energy suppliers should be an online quotation tool made available on suppliers’ websites, rather than the publication of price lists.
 - (b) The proposed price transparency remedy should only apply to a specific subsegment of microbusiness customers, rather than to all microbusiness customers under Ofgem’s current definition of microbusinesses.¹¹¹⁷
- 9.38 Following these suggestions we sought further views from the Six Large Energy Firms, certain independent suppliers¹¹¹⁸ and Ofgem on a potential price transparency remedy that would require energy suppliers to disclose prices for all contracts on offer for a ‘Proposed Segment’ via suppliers’ online quotation tools or third party online platforms such as PCWs.
- 9.39 We acknowledge that online quotation tools would be a more practical solution than the publication of price lists because it would allow suppliers to update prices more regularly.¹¹¹⁹ We have therefore provisionally concluded that the proposed means of price disclosure in the context of this remedy will be an online quotation tool on suppliers’ websites (see paragraph 9.66 below).
- 9.40 Based on the feedback received from the parties, we consider that Ofgem’s definition of microbusiness would be too broad as regards the scope of the proposed remedy. This was due to the complexities and costs involved in disclosing prices for larger microbusinesses; and also to the fact that larger

¹¹¹⁷ SLC 7A.14.

¹¹¹⁸ The independent suppliers were Opus Energy, Haven Power, Total, BES, Gazprom, Corona, Ovo Energy, Ecotricity, Good Energy, Dong Energy, CGG Ltd, and ENGIE (previously GDF Suez).

¹¹¹⁹ For example, suppliers’ online quotation tools would be able to price contracts on a real-time basis by accounting for the wholesale energy costs, which can fluctuate frequently.

microbusinesses prefer to contract over the telephone. Accordingly, we propose to apply the price transparency remedy to microbusiness customers that meet specific requirements (the 'Proposed Segment'). In particular:

- (a) In respect of the supply of electricity, the proposed remedy would apply to non-domestic customers with single meter points, and meeting all of the following criteria:
 - (i) falling under profile classes¹¹²⁰ 1 to 4; and
 - (ii) consumption threshold equal to or below 50,000 kWh per year; and
 - (iii) on simple meters.¹¹²¹
- (b) In respect of the supply of gas, the proposed remedy would apply to non-domestic customers with small supply points only. This would effectively include microbusiness customers with consumption levels of less than 73,200 kWh per year.

9.41 The key benefits of the Proposed Segment are that it would include almost all¹¹²² customers within the definition of microbusiness used by Ofgem and in the terms of reference,¹¹²³ while excluding the largest microbusinesses, which would be the most expensive and complex to serve through an online quotation tool. Such customers constitute an insignificant minority of the overall microbusiness customer base, and including them would significantly increase the costs for suppliers to comply with the remedy. In contrast, the smallest businesses, whose energy needs are more akin to those of domestic customers would have the most to gain from this remedy.

9.42 Non-domestic customers in the Proposed Segment have relatively straightforward metering and contract requirements. The Proposed Segment is also consistent with the settlement process and suppliers would be able to easily identify the relevant meters. We also note that there was broad-based support among suppliers for the Proposed Segment (see paragraphs 9.51 to 9.62 below for further details on the Proposed Segment).

¹¹²⁰ Profile classes relate to the electricity settlement process (see Appendix 8.6 of the provisional findings report for further details). Profile classes 3 and 4 concern non-domestic customers, which have relatively more straightforward metering and consumption profiles, compared to those on profile classes 5 to 8. In addition, profile classes 1 and 2 relate to domestic customers. However, some non-domestic customers are included in profile classes 1 and 2.

¹¹²¹ We define simple meters as (the number of meter registers is set out in brackets): Single Rate (1); Off-Peak (1); Day/Night (2); Day/Evening/Weekend (2); and Day/Evening/Weekend/Night (3). This excludes standard time of day (SToD) meters.

¹¹²² See Appendix 9.1.

¹¹²³ Energy market investigation, [terms of reference](#).

Aims of the price transparency remedy

- 9.43 The main aim of the proposed remedy would be to increase the price transparency of available contracts to microbusiness customers in the Proposed Segment. Specifically, as noted in our provisional findings report, many tariffs (contracts and their prices) are not published (online) by suppliers. First, most suppliers (including one of the Six Large Energy Firms) do not have online tools or do not disclose online the prices of their available contracts. Second, suppliers that have online quotation tools do not publish the prices of all available contracts to microbusiness customers. For instance, some suppliers do not disclose the prices of their available retention contracts to their existing microbusiness customers.
- 9.44 As we discuss below, the price transparency remedy would require suppliers to disclose the prices of all available acquisition and retention contracts to non-domestic customers in the Proposed Segment. Hence, the remedy would significantly increase the price transparency of contracts in relation to the microbusiness segments. Accordingly, the proposed remedy would partly address one of the features that contributes to the Microbusiness Weak Customer Response AEC (and the resulting detriment), ie that customers face actual and perceived barriers to accessing and assessing information to help them engage.
- 9.45 The first key effect of this proposed remedy would be to reduce the high search costs currently faced by microbusiness customers. After the implementation of this proposed remedy, non-domestic customers in the Proposed Segment would be able to check the prices for gas and electricity not only through direct telephone contact with individual energy suppliers and/or TPIs, but also through the suppliers' websites. This would reduce the steps and time required for these customers to obtain price information. Moreover, the proposed remedy would facilitate the development of PCWs in the microbusiness segments, which would allow these customers to compare prices across suppliers by visiting a single website, reducing their search costs.
- 9.46 An additional benefit of the development of PCWs would be to increase microbusiness customers' awareness of their ability to switch energy suppliers or contract because PCWs would have an incentive to advertise their services to potential microbusiness customers and to enable them to switch. This, in turn, should result in microbusinesses switching to lower priced acquisition and retention contracts.
- 9.47 Finally, we note that the proposed price transparency remedy would likely benefit not only non-domestic customers in the Proposed Segment, but

could also benefit some of the larger microbusiness customers falling outside the Proposed Segment. A few of the Six Large Energy Firms that have online quotation tools currently offer online quotations to non-domestic customers with higher consumption thresholds than those set out in the Proposed Segment. For that reason, we consider that suppliers would likely continue to offer¹¹²⁴ online quotes to these larger microbusinesses from the same online quotation tool that they would use to serve non-domestic customers within the Proposed Segment. We have sought to make the online quotation tool more user-friendly to aid with price discovery (see paragraphs 9.67 to 9.76), so that larger microbusinesses would also benefit from this feature.

Parties' views on a price transparency remedy

9.48 In their responses to the Remedies Notice and subsequent consultations, parties were generally supportive of a remedy to improve price transparency for microbusiness customers. These parties included:

- (a) all of the Six Large Energy Firms:¹¹²⁵ Scottish Power, EDF Energy, Centrica, E.ON, SSE¹¹²⁶ and RWE;¹¹²⁷
- (b) certain of the independent suppliers:¹¹²⁸ Opus Energy, Ovo Energy, Good Energy, Drax (Haven Power), Dong Energy and ENGIE;
- (c) certain PCWs: EnergyLinx, Make It Cheaper and [redacted];¹¹²⁹
- (d) certain TPIs:¹¹³⁰ [redacted] and UIA;¹¹³¹ and
- (e) certain regulatory and industry bodies:¹¹³² Ofgem¹¹³³ and FSB.

¹¹²⁴ The price transparency remedy places no restrictions on suppliers providing online quotes to non-domestic customers beyond the Proposed Segment. In addition, suppliers would be required to disclose prices on websites they use to market their products and services to microbusiness customers.

¹¹²⁵ Responses to Remedies Notice

¹¹²⁶ SSE said it was supportive of the remedy as long as the requirements on suppliers were reasonable and proportionate.

¹¹²⁷ In its response to the put-back sent 11 February 2016, RWE said that it broadly supported the remedy but had reservations about its effectiveness for more complex products and said it considered that the remedy was most likely to be effective in increasing price transparency if it were applied to a specific set of simple products, which could be readily compared by consumers. See Appendix 9.1 for a more detailed summary of RWE's views.

¹¹²⁸ Responses to Remedies Notice

¹¹²⁹ [redacted]

¹¹³⁰ Responses to Remedies Notice.

¹¹³¹ In paragraph 76a of UIA's response to the Remedies Notice, UIA said that price transparency would work if the scope of this remedy included the smaller end of the microbusiness market and not the wide range of businesses.

¹¹³² Responses to Remedies Notice.

¹¹³³ Ofgem noted that there were important considerations to take into account.

- 9.49 Certain independent suppliers did not fully support this remedy. They included Corona Energy, Ecotricity, Gazprom, Haven Power, Total Gas and Power¹¹³⁴ and BES. Their (albeit not Gazprom's) key ground for objection related to the high costs of developing online quotation tools. Some of these suppliers such as Gazprom stated that they did not offer tariffs¹¹³⁵ to microbusiness customers. Instead they only offered bespoke¹¹³⁶ products that did not lend themselves well to price transparency or online price disclosure. [✂]¹¹³⁷

Design considerations of the price transparency remedy

- 9.50 We have considered the following elements in the design of the price transparency remedy:

- (a) The scope of the remedy.
- (b) The types of contracts for which prices would need to be disclosed.
- (c) The means of price disclosure.
- (d) How the remedy should be implemented.¹¹³⁸

- *Scope of the price transparency remedy*

- 9.51 As indicated in paragraphs 9.37 to 9.42 above, based on the parties' views we consider that Ofgem's definition of microbusiness (and the definition in our terms of reference) would be too broad with regards to the proposed remedy and, accordingly, we propose to apply the price transparency remedy to non-domestic customers in the Proposed Segment.
- 9.52 The terms of reference for the energy market investigation refer to Ofgem's definition of microbusiness set out in SLC 7A.14.¹¹³⁹ Ofgem classifies a microbusiness as any non-domestic customer that:
- (a) employs fewer than ten employees (or their full time equivalent) and has an annual turnover or balance sheet no greater than €2 million; or

¹¹³⁴ Total added that the online quotation tools were unnecessary.

¹¹³⁵ Standardised tariffs are those that are not individually tailored, such as those offered by some suppliers in the non-domestic retail markets, and by suppliers in the domestic retail markets.

¹¹³⁶ Individually tailored contracts to microbusiness customers, ie contracts that are not off-the-shelf. For example, energy contracts with a cost pass-through element for wholesale energy costs.

¹¹³⁷ See Appendix 9.1 for a more detailed summary of these parties' views on the price transparency remedy.

¹¹³⁸ See Appendix 9.1 for evidence regarding the design considerations of the price transparency remedy.

¹¹³⁹ Energy market investigation, [terms of reference](#).

(b) consumes no more than 100,000 kWh of electricity per year; or

(c) consumes no more than 293,000 kWh of gas per year.¹¹⁴⁰

- 9.53 Some suppliers said that it would be complex and expensive to build online quotation tools if the remedy were scoped as per Ofgem's microbusiness definition. They mentioned that microbusiness customers at the top end of Ofgem's microbusiness definition could also be in profile classes 5 to 8 or be half-hourly settled, and not have simple meters.¹¹⁴¹ Suppliers also told us that their experience showed that such customers preferred individually tailored contracts, which were contacted through offline channels such as the telephone. Therefore, suppliers told us that such customers should fall outside the scope of the price transparency remedy.
- 9.54 In addition, Ofgem told us that its microbusiness definition was intentionally broad.¹¹⁴² For example, a customer at the top end of Ofgem's microbusiness consumption threshold can have an annual bill of £10,000 per fuel (before VAT).¹¹⁴³ Ofgem suggested that the CMA should consider narrowing the scope of the proposed remedy to target smaller microbusiness customers, which are less engaged, less likely to use a broker and find it more difficult to navigate around energy contracts. It said that suppliers may be able to offer standardised contracts that could be transacted online to cater for these smaller microbusiness customers.¹¹⁴⁴
- 9.55 We agree with Ofgem that smaller microbusinesses are more likely to face barriers to accessing and assessing information as a result of the lack of price transparency due to their lack of size and sophistication. In addition, as suggested by the suppliers, we acknowledge that larger microbusiness customers may prefer to negotiate contracts directly with suppliers over the telephone.
- 9.56 In light of the above comments and evidence, we have defined a Proposed Segment for the proposed price transparency remedy (see paragraph 9.40 above).

¹¹⁴⁰ The definition of microbusinesses has changed over time. It was originally defined by government for the purposes of the complaints handling standards and redress scheme. The definition was then updated following Ofgem's Energy Supply Probe and again changed following its RMR.

¹¹⁴¹ We define simple meters as (the number of meter registers is set out in brackets): Single Rate (1); Off-Peak (1); Day/Night (2); Day/Evening/Weekend (2); and Day/Evening/Weekend/Night (3). In effect these are meters other than STOD meters.

¹¹⁴² Ofgem's working paper on non-domestic regulatory regime dated 18 November 2015.

¹¹⁴³ Provisional findings report, [Appendix 9.1](#), paragraph 5.

¹¹⁴⁴ Ofgem's working paper on non-domestic regulatory regime dated 18 November 2015.

- 9.57 The Proposed Segment would be based on single meter points per fuel. So, a customer in the Proposed Segment would be able to get a quote for each meter (and on a per fuel basis). In a few cases¹¹⁴⁵ where a non-domestic customer would have more than one meter per fuel, it would have the option of obtaining separate online quotes for each meter, or telephoning the supplier to obtain a quote for all of its meter points for that fuel. We also note that suppliers' non-domestic online tools and EnergyLinx currently offer quotes for single meter points as well.
- 9.58 This approach was supported by all of the suppliers that responded to the consultation on this feature. It would also be cost effective for suppliers because the online quotation tool would not have to calculate excessive price permutations for multiple meters. In relation to meter types, compared to simple meters (included within the Proposed Segment), SToD¹¹⁴⁶ meters require a greater number of price permutations for price production, and it would thus increase the costs of the online tool. Therefore we have excluded StoD meters from the Proposed Segment.
- 9.59 In respect of the Proposed Segment for the supply of electricity, non-domestic customers in profile classes 1 to 4¹¹⁴⁷ (and with lower levels of consumption below 50,000 kWh per year and with simple meters) tend to include the smaller end of the microbusiness segment who would benefit most from reduced search costs, given that they have limited resources to search for the best deals (compared to larger businesses). Moreover, compared to non-domestic customers in profile classes 5 to 8 (excluded from the Proposed Segment), non-domestic customers in profile classes 1 to 4 tend to have straightforward metering and contract/tariff requirements that are well suited to online price production.
- 9.60 We note that even though a significant majority of non-domestic customers¹¹⁴⁸ (and consequently a significant majority of microbusiness customers) are included within profile classes 3 and 4, we have included non-domestic customers in profile classes 1 and 2¹¹⁴⁹ within the scope of the proposed remedy because these businesses represent the smallest

¹¹⁴⁵ Based on our consultation with suppliers, we understand that non-domestic customers with more than one meter point per fuel are unlikely to fall within the Proposed Segment. This is because they tend to be the larger SMEs and I&C customers.

¹¹⁴⁶ SToD are meters with greater than three meter registers, ie these are not 'simple meters'.

¹¹⁴⁷ We understand that non-domestic customers in profile classes 1 and 4 are not half-hourly settled. By implication we are excluding half-hourly settled customers from the scope of this remedy. We note that such half-hourly settled non-domestic customers tend to be larger SMEs and I&C customers.

¹¹⁴⁸ Non-domestic customers include microbusiness, SME and I&C customers. See Appendix 9.1 for details on the proportions of non-domestic and microbusiness customers included within the scope of this remedy.

¹¹⁴⁹ Profile classes 1 and 2 are for domestic customers. However in some instances, non-domestic customers are included in profile classes 1 and 2.

customers in microbusiness segments, which are likely to face the greatest barriers to searching for price information.

- 9.61 In respect of the Proposed Segment for the supply of gas, an important consideration was distinguishing between various sizes of supply points. Our current view is that only small supply points should be included within the scope of this proposed remedy because smaller microbusinesses face the greatest barriers to searching and the highest search costs.
- 9.62 In relation to consumption thresholds for both the supply of gas and electricity, we note that consumption is a good proxy for the size of the non-domestic customer, and whether its energy and contract requirements are straightforward. For instance, large SMEs and I&C non-domestic customers are more likely¹¹⁵⁰ to have higher consumption than microbusiness customers. By incorporating the consumption thresholds set out in the Proposed Segment, we have included smaller non-domestic customers, which have the most to benefit from increased price transparency and reduced search costs; and have excluded those larger non-domestic customers, which prefer to contract over the telephone. The lower consumption thresholds would also make it less burdensome for the independent suppliers to comply with this proposed remedy and reduce their costs to develop online quotation tools. Despite adopting a consumption threshold, the Proposed Segment would include a significant majority of customers falling within Ofgem's definition of a microbusiness.

- *Types of contracts for which prices would need to be disclosed*

- 9.63 In order to enhance price transparency in the microbusiness segments, suppliers would be required to disclose the prices of all of their available acquisition and retention contracts within the Proposed Segment, via their online quotation tools or third party online platforms.
- 9.64 As an additional measure to increase the price transparency of default contracts, we propose that suppliers would also be required to disclose the prices of their OOC and deemed contracts on their websites (suppliers would not be required to disclose the prices of OOC and deemed contracts through the online quotation tool for acquisition and retention contracts).

¹¹⁵⁰ There may be exceptions in the case of microbusinesses that are highly energy intensive businesses, which may have high consumption of energy. We understand that such businesses might be expected to be more engaged already in searching and switching due to the relative importance of the energy inputs to their businesses. Therefore, if they were excluded from the scope of this remedy due to their high consumption level, such businesses would unlikely be significantly negatively affected.

9.65 We do not propose any additional measures in relation to evergreen contracts because microbusiness customers on evergreen contracts have different contract prices, depending on when they started the contract and so producing price lists for these customers would be onerous for suppliers.

- *The means of price disclosure*

9.66 We propose to require suppliers to disclose prices for microbusiness customers within the Proposed Segment through the use of online quotation tools made available on their websites, or through one or more third party online platforms (eg PCWs).

- *Online quotation tools*

9.67 Many parties supported the use of online quotation tools over price lists. They said that published price lists would be static and therefore unsuitable because several factors contributed to price production. These factors would make the price lists burdensome to produce for suppliers, and confusing to interpret for microbusiness customers. Suppliers also noted that it would be cumbersome to update price lists frequently. For example, they pointed out that wholesale energy costs fluctuated frequently and that these fluctuations would need to be reflected in a timely manner in the price quotations. Some parties also pointed out that online quotation tools would facilitate the development of PCWs in the microbusiness segments.¹¹⁵¹

9.68 We also observe that all of the Six Large Energy Firms (except for Scottish Power)¹¹⁵² currently have automated online quotation tools for the microbusiness customers, and that none of the suppliers¹¹⁵³ use static price lists to disclose the prices of acquisition and retention contracts for their microbusiness customers. Also, as noted in paragraph 9.43 above, the Six Large Energy Firms with online quotation tools do not disclose the prices for all their available acquisition and retention contracts.

9.69 As this proposed remedy aims to reduce the search costs for customers within the Proposed Segment, we consider it important that the online quotation tools should be reasonably easy to use for these customers. Accordingly, under this proposed remedy, suppliers would be required to

¹¹⁵¹ See Appendix 9.1 for a summary of parties' views on why they support online quotation tools over price lists.

¹¹⁵² In its response to the Remedies Notice, Scottish Power told us [X].

¹¹⁵³ Except for EDF Energy, which publishes the price of its non-domestic variable 'Freedom' tariff.

provide an achievable quote, ie one that the customers can transact upon, subject only to them passing a credit check. Specifically, suppliers:

- (a) would be required to disclose the prices of all available acquisition and retention contracts¹¹⁵⁴ (quotations) once a customer enters its primary information inputs (postcode and consumption) into the online quotation tool;
- (b) have complete discretion on choosing (or not choosing) any number of 'secondary information inputs', which would act as filters on the search results from the primary information inputs; and
- (c) would be required to make the quote valid for as long as it does not change the prices for the contract (or tariff), or make it clear to the customer how long the quote would be valid for.

- 9.70 We consider that it should be possible for customers within the Proposed Segment to obtain a quote based on entering its primary information inputs (ie postcode and consumption) into the online quotation tool. The postcode would allow the supplier to identify the customer's address and region, which would allow the supplier to determine the locational pricing. The postcode would also allow the supplier to obtain the MPAN and MPRN numbers via the ECOES, SCOGES or another third party database. This would allow the supplier to identify the meter type, profile class, and other meter specific information that contributes to price production.
- 9.71 These inputs (ie postcode and consumption) would be mandatory fields on online quotation tools. However suppliers would also be allowed to add two additional fields – MPRN and/or MPAN and spend (£) – to complement the primary information inputs in case the customer's meter is not registered with the ECOES or SCOGES databases, or the customer does not immediately have access to its consumption figure.
- 9.72 The function of the secondary information inputs would be to allow for more tailored and cost reflective quotations, especially in cases when the search results for a given set of primary information inputs display the prices of several contracts. Examples of secondary information inputs include contract start/end date, contract duration, payment type, fixed/variable price, paperless billing or billing frequency.

¹¹⁵⁴ If a supplier offers bundled products, then the prices of such contracts would also have to be disclosed alongside all acquisition and retention contracts. Bundled products have a component(s) of additional services/features, such as energy advice, that are embedded within the price of energy supply.

- 9.73 We note that the emphasis of this proposed remedy is on contracts ‘available’ to customers in the Proposed Segment. Therefore, suppliers would have discretion on when to bring contracts to the market. This proposed remedy would not compel suppliers to offer renewal quotations to their microbusiness customers that recently started a fixed-term contract.¹¹⁵⁵
- 9.74 Suppliers would be permitted to quote the prices of negotiable contracts and offer price and non-price discounts through online and offline (telephone) channels. However, to make it easier for customers to compare the prices of acquisition and retention contracts, suppliers would be required to:
- (a) quote a single price¹¹⁵⁶ per fuel for a given set of primary and secondary information inputs;¹¹⁵⁷ and
 - (b) identify what charges are included in the quote. To avoid the possibility of hidden charges, if the customer passes the credit check, suppliers would not be permitted to increase the price of a quote after the initial quote based on the customer’s primary information inputs.
- 9.75 Suppliers would be required to clearly signpost, in a prominent way, the location of their online quotation tools on their websites. For example, their websites’ homepages and non-domestic homepages would need to have web link(s) to the online quotation tool or the third party online platform(s).
- 9.76 Requiring customers to undergo credit checks prior to obtaining a quote would create a significant disincentive to search the market and would significantly delay the price discovery process. Furthermore, credit risk is not one of the key determinants of price production (see paragraphs 9.70 to 9.72 above). Suppliers would be able to alter the quoted price if a customer were to fail a credit check. We note that suppliers would also have other options to manage credit risk, such as taking a security deposit or choosing not to supply that customer.
- *Use of third party online platforms*
- 9.77 As noted in paragraph 9.66 above, suppliers would have the choice of disclosing prices for customers within the Proposed Segment, through an

¹¹⁵⁵ For example, this remedy would not compel a supplier to offer a renewal quote to a microbusiness customer that is on day 2 of its three-year fixed-term acquisition contract.

¹¹⁵⁶ For example, in relation to annual quote, suppliers would be required to quote a single price, and not simply a range between £X and £Y. Suppliers would also be required to disclose a single price for the unit rate and standing charge.

¹¹⁵⁷ If a supplier has products with multiple price points for a given set of information inputs, then that supplier would be required to disclose each of them as separate contracts, with the scope to filter these contracts by way of secondary information inputs.

online quotation tool on their websites, or through third party online platforms such as PCWs. The primary motivation for this approach was to not add to the costs of smaller suppliers. We understand that providing prices to PCWs would be a low cost option with a minimal administration burden for suppliers. For example, based on our discussion with suppliers, we understand that this would basically require a supplier to send price lists to a PCW in a flat file format such as a CSV. Additionally, we also believe that the smaller suppliers would have an incentive to have their prices disclosed on PCWs.¹¹⁵⁸

9.78 A supplier would be required to comply with the key conditions (see paragraphs 9.63 to 9.65 and 9.69 to 9.75 above) whether it chooses to use its own online tool or a third party's. Most importantly, the supplier would be responsible for ensuring that the third party online platforms disclose all of the available acquisitions and retention contracts, and comply with the primary information input requirements.

9.79 Suppliers would be able to choose any number of third party online platforms. However, suppliers would be required to have web links on their websites to the prices of all of their available acquisition and retention contracts. It would not be necessary for one particular link (or third party hosting platform) to disclose the prices of all available contracts, although the supplier could choose to arrange its marketing channels in this way. Also, if a supplier were to disclose the price of the same contract (or tariff) through more than one third party online platform, then it would be required to provide the web link of at least that third party online platform which discloses the cheapest price.

- *Implementation of the price transparency remedy*

9.80 We have provisionally decided to implement the proposed price transparency remedy through the following:

(a) An order that would:

- (i) require energy suppliers to disclose the prices of all available acquisition and retention contracts to non-domestic customers falling within the Proposed Segment either through an online quotation tool made available on their websites, or through one or more third party online platforms (and including a web link on their own website to

¹¹⁵⁸ CSV is the abbreviated form for 'comma separated values'.

direct non-domestic customers to such third party online platform(s));

(ii) require suppliers to disclose the prices of all their OOC and deemed contracts on their websites; and

(iii) amend suppliers' licences to incorporate these requirements.

(b) A recommendation to Ofgem to make any necessary minor consequential amendments to suppliers' licences.

Assessment of effectiveness of the price transparency remedy

9.81 In this section, we consider whether the proposed price transparency remedy would be effective in achieving its aim.

9.82 In evaluating the effectiveness of the proposed remedy, we have considered:

(a) the effectiveness of the key design elements;

(b) the extent to which it would be capable of effective implementation, monitoring and enforcement;

(c) the timescale over which it would be expected to take effect; and

(d) the proposed remedy's consistency and compliance with existing or expected laws or regulations.

• *Effectiveness of the key design elements*

9.83 Following the implementation of the proposed remedy, we would expect non-domestic customers within, at least, the Proposed Segment, to engage to a greater extent than they would otherwise do (and are currently doing). The proposed remedy would therefore achieve its aim in addressing, in part, the feature of the Microbusiness Weak Customer Response AEC concerning microbusiness customers' ability to access and assess information (see paragraphs 9.43 to 9.47 above).

9.84 Non-domestic customers in the Proposed Segment would be able to obtain quotes for all available acquisition and retention contracts by entering just two pieces of information – the primary information inputs. This would enhance price transparency by reducing the time taken to collect (and compare) quotes from a number of suppliers.

- 9.85 Suppliers would not be able to circumvent the proposed remedy by only disclosing their most competitive and/or best prices in an obscure location: suppliers would be required to disclose the prices of all their available acquisition and retention contracts in a prominent way with signposting (see paragraph 9.75 above). Also, if a supplier were to disclose the price of the same contract (or tariff) through more than one third party online platform, then it would be required to provide the web link of at least that third party online platform, which discloses the cheapest price (see paragraph 9.79 above).
- 9.86 Suppliers would also be required to disclose their prices in a prominent way, irrespective of the means of price disclosure. Suppliers would be required to signpost either the online quotation tool on the suppliers' websites or the relevant third party online platform websites. Customers would then be able to enter their relevant information and see the prices for the relevant and available contracts.
- 9.87 We consider that giving suppliers the choice of disclosing prices via online quotation tools or third party online platforms would not undermine the effectiveness of this proposed remedy. For instance, if all suppliers were to opt for the third party online platform, it would not reduce the effectiveness of the proposed remedy. This is because suppliers would be required to meet the same conditions under both means of disclosure (see paragraph 9.78 above). In addition, suppliers choosing the third party online platform would be required to provide web links on their websites to all available contracts (price disclosures).
- 9.88 Therefore, we consider that the key design elements of the proposed remedy would be effective in achieving its aim.
- *Implementation, monitoring compliance and enforcement of the proposed remedy*
- 9.89 In determining whether a proposed remedy is effective, we have considered how it would be implemented and the need for the proposed remedy to be clear to the persons to whom it is directed, such as suppliers; and also to other interested persons, such as Ofgem (which would have responsibility, together with the CMA, for monitoring compliance), and microbusiness customers.
- 9.90 As regards implementation of the proposed remedy, we have set out a number of detailed specifications (see paragraphs 9.63 to 9.79 above). We have described the terms of the proposed remedy (and associated licence

condition) so that it would be clear to suppliers to understand, and straightforward for them to introduce.

- 9.91 In defining the scope of the Proposed Segment, we have taken into account the existing settlement system (eg profile classes) so that suppliers would be able to easily identify the relevant customers.
- 9.92 By around 2020, all of the profile class 1 and 4 non-domestic customers for electricity are planned to be moved to half-hourly settlement.¹¹⁵⁹ Some suppliers told us that, at this point, they would be able to continue to identify the relevant meters and the non-domestic customers and offer them online quotations. Therefore our proposed remedy would continue to be effective.
- 9.93 As regards monitoring compliance with the proposed remedy, we note that, by introducing a new licence condition, which would be consistent with the CMA's order, Ofgem would be under a duty to perform a monitoring role. Monitoring compliance with the proposed remedy should be straightforward. It would involve periodically checking suppliers' websites to verify that they are adhering to the terms of the order by making available links to the information concerning the pricing of all of the contracts that they offer to non-domestic customers within the Proposed Segment. Ofgem would be well placed as the sector regulator to receive, and follow up on, complaints made by microbusiness customers concerning suppliers' ongoing compliance with the licence condition.
- 9.94 As regards enforcement, by introducing the proposed remedy by way of order and new licence condition, Ofgem would also be able directly to enforce against any breach of the new licence condition, without making an application to the court (as compared to enforcing against a breach of the order, for which a court application would be required).

- *Timescale for the price transparency remedy*

- 9.95 In evaluating the effectiveness of the proposed remedy, we have considered the timescale over which the Microbusiness Weak Customer Response AEC would be expected to endure, and the timescale over which the proposed remedy would be likely to take effect. As regards the Microbusiness Weak Customer Response AEC, our view is that, absent the proposed remedy (and the other proposed remedies we have provisionally decided upon concerning this AEC), the detriment would persist. Whilst future market developments such as the completion of the national programme for the roll-

¹¹⁵⁹ See Appendix 9.1.

out of smart meters and the implementation of our other proposed remedies may go some way to addressing the Microbusiness Weak Customer Response AEC or its associated detriment, they will not fully address either this AEC or the associated detriment.

- 9.96 In this regard, we do not believe that the planned move to half-hourly settlement for profile classes 1 to 4, which is expected to be completed in 2020, would fully address the Microbusiness Weak Customers Response AEC or associated detriment, and that the proposed remedy would continue to be necessary. This is because the lack of price transparency is the key aspect of the feature that gives rise to the AEC. For these reasons, we have provisionally decided that the proposed remedy would not be subject to a sunset provision.
- 9.97 As regards the timescales for implementation, we consider that the proposed remedy could be implemented by all suppliers within reasonable timescales. For example, suppliers' range of estimates to build online quotation tools range from 6 to 18 months, with most giving timeframes of less than 12 months.¹¹⁶⁰ Suppliers choosing merely to provide links to one or more third party online platforms would be able to implement this proposed remedy within an even shorter timeframe (for example, shortly after having concluded commercial negotiations with such platforms).
- 9.98 We therefore propose to set a deadline for implementation by suppliers within 12 months of the publication of the final report by which time suppliers would need to have their online quotation tools or third party online platforms fully functional concerning the Proposed Segment. We consider that, in light of suppliers' submissions, this would give suppliers adequate time to prepare their online quotation tool (or failing that, to put in place arrangements with third party online platforms).
- *Consistency and compliance with existing or expected laws or regulations*
- 9.99 As part of our consideration of the design of the proposed remedy, we have considered whether any elements of the proposed remedy would be inconsistent with other relevant laws and regulations. A particular focus of our assessment of this aspect of remedy design has been the interaction of our proposed remedy with the forthcoming changes governing the move to half-hourly settlement for profile classes 1 to 4 (see paragraph 9.285 below),

¹¹⁶⁰ Time periods given by suppliers indicate the time they would need to adapt/build the online quotation tools. We considered that suppliers would most likely start building or modifying their online tools (and/or platforms) once they had a good level of clarity of how the proposed remedy would work in practice. This would have to include all the prescriptive detail. We considered that this would upon the publication of the final report.

and Ofgem's desire to move towards a more principles based system of regulation concerning the retail supply markets, more generally (see Section 3). We will continue to keep the scope of such interactions under review as we finalise our decision on our preferred remedy options.

- *Conclusion on the effectiveness of the proposed remedy*

9.100 In light of the above analysis, we provisionally conclude that this proposed remedy would be effective in reducing the barriers to accessing and assessing information faced by microbusiness customers, which is a feature of the retail energy markets that gives rise to the Microbusiness Weak Customer Response AEC, and the resulting customer detriment.

Assessment of proportionality of the price transparency remedy

9.101 In this section we set out our assessment of whether the proposed remedy would be a proportionate remedy. We have done so by considering whether the proposed remedy would:

- (a) be effective in achieving its legitimate aim;
- (b) not be more onerous than needed to achieve its aim;
- (c) be the least onerous if there were a choice between several effective measures; and
- (d) not produce disadvantages that are disproportionate to the aim.¹¹⁶¹

- *Effective in achieving its aim*

9.102 For the reasons set out above, we consider that the proposed remedy would be effective in achieving its aim of increasing price transparency. Accordingly, it would be effective in partly addressing one of the underlying features that gives rise to the Microbusiness Weak Customer Response AEC, and the resulting customer detriment.

- *No more onerous than needed to achieve its aim*

9.103 We have considered whether there were other channels to disclose prices (eg via letters or over the telephone) that would be as effective as the online means proposed under this remedy. However, we did not identify any such

¹¹⁶¹ CC3, paragraph 344, citing the principles established in the Fedesa case, Case C-331/88, the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others, [1990] ECR I-4023, paragraph 13.

means, nor were any proposed by the parties. In addition, we considered that letters might quickly become outdated as wholesale energy costs changed, limiting their effectiveness as a means of increasing price transparency. The disclosure of prices over the telephone would not reduce search costs and a customer would be unable to compare prices across all or most of the market. In contrast, online search, as proposed under the remedy, would bring benefits to customers as a whole in terms of allowing them to easily compare prices and reduce their search costs.

- 9.104 We considered whether a narrower Proposed Segment could be less onerous, for example, if the Proposed Segment were to only include profile class 4. However any such reduction in scope would result in non-domestic customers in profile classes 1 to 3 being harmed, ie they would continue to experience high search costs. Therefore, we concluded that a narrower Proposed Segment would not be effective.
- 9.105 In addition, we propose to allow all suppliers the choice of the means of price disclosure between the online quotation tool and third party online platforms. They would therefore be able to choose the option that would represent the more cost effective option for them. This would specifically reduce the potential burden of the proposed remedy on small suppliers, which might have insufficient resources to establish an online quotation tool.
- 9.106 We therefore conclude that this proposed remedy would be no more onerous than needed to achieve its aim. In particular, we note that the proposed remedy would not impose costs and restrictions on suppliers that go beyond what is needed to achieve price transparency for non-domestic customers in the Proposed Segment.

- *Least onerous if there were a choice between several effective measures*

- 9.107 As noted above, we have considered several variations concerning the proposed remedy, and whether there may be alternative remedies that achieve the same aim. However, we have provisionally found that the proposed remedy is the only form of remedy that would be effective (for the reasons discussed in paragraphs 9.103 above). We therefore do not consider that there is a less onerous remedy that would be effective.

- *Would not produce disadvantages disproportionate to the aim*

- 9.108 The scope of the Proposed Segment is designed so that it would target the non-domestic customers (including microbusiness customers) which most commonly use such online systems to search for prices; and it would not require suppliers to make available their prices to larger microbusinesses

with considerably more resources to devote to negotiating their prices with suppliers directly (see paragraphs 9.41 and 9.42 above).

- 9.109 Targeting our remedy on the Proposed Segment as opposed to the whole microbusiness customer base (which formed part of our terms of reference) would significantly reduce the costs borne by suppliers (see paragraphs 9.41 and 9.53 to 9.62 above). It would also reduce the proposed remedy's complexity during implementation: extending the remedy beyond the Proposed Segment would significantly increase the number of price permutations that the online quotation system (and the third party online platform) would need to manipulate in order to produce a quote.
- 9.110 Finally, we have compared the potential costs of implementing the proposed remedy via an online quotation tool to the size of the detriment that the proposed remedy may be expected to address.
- 9.111 The Six Large Energy Firms provided the following cost estimates to amend their current¹¹⁶² online quotation tools in order to comply with the proposed price transparency remedy: [redacted] (£nil); [redacted]¹¹⁶³ (£100,000 to £150,000); [redacted] (£200,000¹¹⁶⁴); [redacted] (£250,000¹¹⁶⁵); [redacted] (£1 million); and [redacted] (£3 million to £5 million). None of the parties brought to our attention that the running costs of the online quotation tool would be significant, subject to the functionality specified in the remedy design.
- 9.112 Certain other suppliers provided the following cost estimates to build new¹¹⁶⁶ online quotation tools in order to comply with the proposed price transparency remedy: [redacted]¹¹⁶⁷ (minimal costs); [redacted] (£40,000), [redacted] (£160,000 to £200,000); [redacted] (£300,000); [redacted] (£300,000 to £500,000); [redacted] (£550,000); [redacted], [redacted] (significant costs).¹¹⁶⁸
- 9.113 Additionally, based on suppliers' responses to our provisional findings and Remedies Notice, we understand that the third party online tool (ie the PCW option) would not require significant set-up and running costs (see

¹¹⁶² In its response to the Remedies Notice, Scottish Power said that it did not currently operate an online quotation tool. [redacted]

¹¹⁶³ [redacted] provided the set-up cost estimate for a brand new online quotation tool. It clarified that if the Proposed Segment were to include meters with three registers (as opposed to only one or two meter registers), then the costs would increase from £100,000 to £150,000.

¹¹⁶⁴ [redacted] said that its costs would likely be in excess of £200,000 of development costs plus internal business change costs.

¹¹⁶⁵ Subject to the precise design of the remedy

¹¹⁶⁶ Except for Good Energy, we observe that none of the other independent suppliers have an online quotation tool on their websites.

¹¹⁶⁷ We observe that [redacted] has an online quotation tool, which largely complies with the proposed price transparency remedy. For instance, a microbusiness customer could obtain quotes by only entering its primary information inputs.

¹¹⁶⁸ See Appendix 9.1 for suppliers' submissions of the estimated costs.

Appendix 9.1). Therefore the costs that this proposed remedy would impose on suppliers can be reduced to a relatively insignificant level, if the suppliers were to opt for the PCW option as opposed to the online quotation tool.

- 9.114 We have compared the estimated costs provided by the Six Large Energy Firms to amend or build new online quotation systems, to our estimate of the detriment of around £230 million per year. As regards the combined estimated costs of all of the Six Large Energy Firms' costs, the upper bound¹¹⁶⁹ of their reported estimates to build/amend online quotation tools totalled £6.6 million, although this included [X] £5 million estimate, which is substantially higher than the cost estimates provided by all other suppliers.
- 9.115 We consider that a more realistic¹¹⁷⁰ figure for all of the Six Large Energy Firms could be derived by using [X] estimate as a benchmark. Scottish Power's estimate is based on it building a new quotation tool, which would normally be more expensive than modifying an existing system. If the modification of an existing system were more expensive than purchasing a new online system, then the supplier could chose the latter option. For the Six Large Energy Firms,¹¹⁷¹ this would give a total one-off cost of approximately £750,000. For the approximately 30 suppliers within the Proposed Segment, the total cost would add up to approximately £4.5 million. These figures, which relate to one-off set-up costs, are still significantly lower than the estimated profits in excess of the WACC of £230 million per year. We also consider these figures are an upper bound because some suppliers might opt for the third party online platform, which would be a cheaper option.
- 9.116 As regards our estimate of the likely benefits arising from increased price transparency, we note that it was not possible to accurately predict the increase in switching rates and any price reductions from increased customer response that could result from this proposed remedy. Nevertheless, using the Six Large Energy Firms' upper bound estimates of the costs incurred in implementing this proposed remedy via an online quotation tool, we estimated that prices would only need to fall by 0.3% as a result of this proposed remedy for the benefits to exceed the costs. Using a more reasonable estimate of costs, prices would only need to fall by 0.03%.¹¹⁷² Given the very small scale of this price reduction, and the likely effectiveness of the proposed remedy in increasing the transparency of

¹¹⁶⁹ This includes the £5 million estimated by [X], which we considered to be an outlier.

¹¹⁷⁰ We also note that [X] estimate was within reasonable range to the higher estimates provided by [X].

¹¹⁷¹ Excludes [X] because it told us that it would not incur any costs to comply with the remedy because its online quotation tool already met the design specifications that would be required under the provisional remedy.

¹¹⁷² We have not conducted comparable analysis to include the independent suppliers due to a lack of availability of data.

prices and in facilitating more effective competition, we are satisfied that such price benefits could be expected even if only a small proportion of microbusiness customers made use of the enhanced price transparency to search for a lower priced energy supplier.

9.117 We have therefore provisionally concluded that the proposed remedy would not produce adverse effects that would be disproportionate to its aim.

- *Ofgem's statutory duties*

9.118 Where the CMA is considering whether to modify one or more of the conditions of a retail gas or electricity supplier's licence, in deciding whether such action would be reasonable and practicable, the CMA must 'have regard' to the relevant statutory functions of Ofgem.¹¹⁷³

9.119 Ofgem's statutory functions concerning gas and electricity supply are set out in Part 1 of the Electricity Act 1989 (EA89) and the Gas Act 1986 (GA86), as amended by the Energy Act 2010, and include (among other things) granting supply licences, keeping under review retail supply, and ancillary, activities, publishing advice and information about consumer matters, taking action under Part 4 of the 2002 Act, and requiring the provision of information.¹¹⁷⁴

9.120 Ofgem's principal objective, in carrying out such functions, is to protect the interests of existing and future customers of gas and electricity supply. For these purposes, 'consumers' includes microbusinesses. The interests of such consumers are taken as a whole, including their interests in (i) the reduction of greenhouse gases, (ii) the security of supply, and (iii) the fulfilment by Ofgem of the objectives set out in Article 40(a) to (h) of the Gas Directive¹¹⁷⁵ and Article 36(a) to (h) of the Electricity Directive.¹¹⁷⁶

9.121 Ofgem is generally required to carry out its functions in the manner it considers best calculated to further the principal objective, wherever appropriate by promoting effective competition between (among other things) suppliers of gas and electricity.¹¹⁷⁷ Before deciding to carry out its functions in a particular manner with a view to promoting competition, Ofgem is required to consider the extent to which the interests of consumer would be protected by that manner of carrying out its functions and whether there

¹¹⁷³ Section 168 of the 2002 Act, and [CC3](#), paragraph 347.

¹¹⁷⁴ Sections 34, 34A, 35, 36, 36A of the GA86 [and equivalent provisions of the EA89].

¹¹⁷⁵ European Parliament and Council Directive 2009/73/EC of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L 211/94.

¹¹⁷⁶ European Parliament and Council Directive 2009/72/EC of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L 211/55.

¹¹⁷⁷ Section 4AA(1)(1A), (1C) of the GA86; Section 3A(1)(1B), (1C) of the EA89; [Powers and duties of GEMA](#).

is any other manner (whether or not it would promote competition) in which Ofgem could carry out the functions which would better protect those interests, having regard (among other things) to: (i) the need to secure that, so far as economical to meet them, all reasonable demands for gas and electricity supply are met and can be financed; (ii) achieving sustainable development; and (iii) the interests of ‘vulnerable’ consumers.¹¹⁷⁸ Subject to those considerations, Ofgem must also carry out its functions in the manner it considers is best calculated (among other things) to (i) promote efficiency and economy by licensed suppliers, and (ii) secure long-term supply and with regard to the effect on the environment. Lastly, Ofgem must also have regard (among other things) to the principles of transparency, accountability, proportionality, and consistency with best regulatory practice.

- 9.122 In reaching our provisional decision to introduce a new licence condition concerning gas and electricity supply that requires the publication of prices for microbusiness customers with the Proposed Segment (either through an online quotation tool made available on their websites or through third party online platform(s)) (see paragraph 9.66 above), we have, as part of our own application of the legal framework requiring us to decide upon proposed remedies that are effective and proportionate,¹¹⁷⁹ explicitly taken into account many of the above factors to which Ofgem must have regard when carrying out its functions. We have therefore concentrated below on the considerations not explicitly taken into account elsewhere in this section of the provisional decision on remedies.
- 9.123 In particular, we do not consider that this proposed remedy would have an adverse impact on suppliers’ ability to meet all reasonable demands for gas and electricity supply, and nor does it engage Ofgem’s duty to have regard to achieve sustainable development, to protect the interests of vulnerable customers, to ensure security of supply and to consider environmental concerns. In this regard, the proposed remedy will only impact the ‘efficiency’ limb of the considerations built into Ofgem’s statutory duties and functions. The proposed remedy would incentivise suppliers to offer more attractive (ie lower) prices in order to attract new microbusiness customers and retain existing ones.
- 9.124 The proposed remedy would also enhance transparency by reducing search costs for microbusiness customers in the Proposed Segment, and we would expect this to facilitate the development of PCWs in the microbusiness segments, which would further enhance microbusiness customers’ ability to

¹¹⁷⁸ Those who are disabled or chronically sick, of pensionable age, with low incomes or residing in rural areas.

¹¹⁷⁹ CC3, pp71–73.

compare prices across suppliers, thus further reducing their search costs (see paragraphs 9.45 to 9.46 and 9.67 above).

9.125 Lastly, not all suppliers voluntarily publish their prices and of those that have online quotation tools not all disclose the prices of all their available acquisition and retention contracts to microbusiness customers. We therefore believe that the introduction of a new licence condition in the terms proposed is a necessary measure, and consistent with best regulatory practice.

9.126 We consider that the proposed remedy is consistent with Ofgem's principal objective of promoting the interests of existing and future customers.

- *Conclusion on the proportionality of the proposed remedy*

9.127 In light of the above, we conclude that the proposed remedy would be proportionate to its aim.

Auto-rollover remedy

9.128 In our provisional findings report, we provisionally found that one of the features of the SME retail energy markets that gave rise to the Microbusiness Weak Customer Response AEC (and the resulting detriment) was that some microbusiness customers were on auto-rollover contracts¹¹⁸⁰ and were given a narrow window in which to switch supplier or tariff.

9.129 An auto-rollover contract is a contract with a microbusiness customer that provides for an initial fixed-term period (the 'Initial Period') and allows a supplier to automatically roll the microbusiness customer onto a new fixed-term or non-fixed term period (the 'Roll-over Period') if, by the end of the Initial Period, the microbusiness customer has not terminated the contract or agreed to a new fixed-term period. An important characteristic of the auto-rollover contract is that the price applying during the Roll-over Period is not explicitly negotiated between the microbusiness customer and the supplier.

9.130 The specific concerns we identified in relation to auto-rollover contracts were:

- (a) the use of termination fees and/or 'no exit' clauses for the Roll-over Period; and

¹¹⁸⁰ Remedies Notice, paragraph 53c.

(b) microbusiness customers were being given a narrow window to give a termination notice to their supplier during the Initial Period.¹¹⁸¹

- 9.131 In the Remedies Notice, we invited views on a remedy that proposed prohibiting auto-rollover contracts with termination fees and/or no-exit clauses and a narrow window to switch contract or supplier.¹¹⁸²
- 9.132 The possible remedy broadly sought to give microbusiness customers on auto-rollover contracts more flexibility to terminate these contracts, and prohibit termination fees and/or no-exit clauses during the Roll-over Period. The specific aspects of the proposed remedy that we have provisionally decided upon are set out below.

Aims of the auto-rollover remedy

- 9.133 The aim of this proposed remedy would be to increase the ability of all microbusiness customers on auto-rollover contracts to switch contracts or suppliers. This would particularly help the microbusiness customers of those suppliers that still contract on the basis of fixed-term auto-rollover contracts with termination fees and no-exit clauses during the Roll-Over Period.
- 9.134 The proposed remedy would reduce the energy costs of microbusiness customers in two ways.
- 9.135 By switching from higher priced auto-rollover contracts to lower priced contracts, microbusiness customers would lower their energy costs. In addition, by reducing the barriers to switching during the Roll-over Period, this proposed remedy would encourage microbusiness customers to search for the available acquisition and retention contracts. In addition, as a result of this stronger customer response, we would expect the competitive constraint on energy suppliers to increase, which should incentivise suppliers to reduce the price of their available acquisition and retention contracts.
- 9.136 Therefore this proposed remedy would address the feature that some microbusiness customers on auto-rollover contracts may have limited ability to switch contract and/or supplier.

Parties' views on the auto-rollover remedy

- 9.137 In light of their current practices (of having already ended auto-rollover contracts with a fixed-term Roll-over Period), all of the Six Large Energy

¹¹⁸¹ Remedies Notice, paragraph 81.

¹¹⁸² Remedies Notice, paragraphs 81–83.

Firms were supportive of the key components of this proposed remedy, which were the prohibition of termination fees, and no-exit clauses. The Six Large Energy Firms also pointed out that this remedy should be designed in a way so that it would benefit all microbusiness customers currently in a Roll-Over Period.¹¹⁸³

9.138 There was further support for the key components¹¹⁸⁴ of this remedy from:

- (a) certain of the independent suppliers such as Ecotricity, Good Energy, and Ovo Energy;
- (b) certain TPIs such as [REDACTED], UIA and [REDACTED];
- (c) an industry body, the FSB; and
- (d) a PCW, Make it Cheaper.¹¹⁸⁵

9.139 Certain parties such as [REDACTED] and [REDACTED] also highlighted that since they had ended fixed-term auto-rollover contracts, they had observed increased engagement from microbusiness customers.

9.140 Despite significant support for the key components¹¹⁸⁶ of this remedy, there were a number of respondents (among some of the independent suppliers), which did not support the remedy for the following reasons:

- (a) Corona Energy, Ineco, Drax (Haven Power), and Gazprom stated that banning auto-rollover contracts that included a termination fee or a no-exit clause during the Roll-over Period could lead to microbusiness customers being on higher prices. First, [REDACTED] told us that banning auto-rollover contracts with fixed-term Roll-over Periods would force more microbusiness customers on to relatively higher priced deemed or OOC contracts. Second, the other three parties explained without the certainty of a fixed term, suppliers could face increased customer churn risk. This was the risk that suppliers would be unable to effectively forecast their energy requirements to meet actual demand, given that microbusiness customers could leave at short notice. As a result, suppliers would face the risk that any energy purchased in advance for such microbusiness

¹¹⁸³ We note that this would ensure that microbusiness customers on fixed-term Roll-over Periods (when the remedy becomes effective) also benefit from the remedy. With regards to existing customers, we have also provisionally decided to implement the remedy 12 months after the publication of the final report, which would give suppliers adequate time to amend their business practices to comply with the remedy (see paragraph 9.169 below).

¹¹⁸⁴ The prohibition of termination fees, and no-exit clauses.

¹¹⁸⁵ See Appendix 9.2 for further details on parties' views on the auto-rollover remedy.

¹¹⁸⁶ The prohibition of termination fees and no-exit clauses.

customers (which left) would need to be sold back onto the wholesale market, potentially at a loss. They also added that it could lead them to purchase more energy on the near-term market, which could expose them to greater cost uncertainty. They concluded that the increased risk could lead to suppliers increasing the price of the auto-rollover contract to factor in the increased risk.¹¹⁸⁷ We note that suppliers could take a number of actions to mitigate the risks described above, without having to resort to price increases (please see paragraphs 9.178 to 9.183 below).

(b) IcoSS and Gazprom submitted that no action was required currently given Ofgem's recent amendments to the SLCs and its recent RMR (please see paragraphs 9.143, 9.146 and 9.148 below) have resulted in some positive changes.¹¹⁸⁸

(c) Ineco (a TPI) submitted that no action was required because switching rates were better than in the domestic market.¹¹⁸⁹

9.141 Ofgem told us that it was supportive of the CMA's measures designed to increase engagement in the microbusiness segments. Ofgem agreed that this remedy could deliver benefits for some customers. It also said that it would like to work with the CMA to ensure that any potential negative impacts of the policy on small suppliers were mitigated.

Design considerations of the auto-rollover remedy

9.142 The key measures of this proposed remedy would be to:

(a) allow microbusiness customers to give a termination notice to suppliers up to the last day of the Initial Period;¹¹⁹⁰

(b) allow microbusiness customers to give a termination notice¹¹⁹¹ to suppliers at any time during the Roll-over Period (regardless of whether the Roll-over Period is fixed or non-fixed);

(c) prohibit termination fees and/or a no-exit clause during the Roll-over Period; and

¹¹⁸⁷ Parties' responses to the Remedies Notice. See Appendix 9.2 for further details.

¹¹⁸⁸ Parties' responses to the Remedies Notice. See Appendix 9.2 for further details.

¹¹⁸⁹ Parties' responses to the Remedies Notice. See Appendix 9.2 for further details.

¹¹⁹⁰ ie amending SLC 7A.12B to allow microbusiness customers a longer notice period window.

¹¹⁹¹ Subject to any minimum notice period that complies with SLC 7A(11).

- (d) prohibit the transfer of microbusiness customers that have given a termination notice during the Roll-over Period to a more expensive contract during the relevant notice period.¹¹⁹²

- *Existing SLCs concerning auto-rollover contracts*

- 9.143 In the context of the design of this proposed remedy, we have taken into account existing licence conditions concerning auto-rollover contracts that we are not minded to amend or remove. In particular, we have considered the licence condition under which the minimum notice period to terminate a microbusiness contract must be no longer than 30 days (SLC 7A.11) (the 'Minimum Notice Period'). We have also considered the licence condition under which a fixed-term Roll-over Period must not be longer than 12 months (SLC 7A.13A(c)).
- 9.144 First, we consider that a Minimum Notice Period of up to 30 days strikes a reasonable balance between offering microbusiness customers the flexibility to exit the auto-rollover contract, and allowing suppliers a practicable time period to manage their commercial risk with regards to their forward purchasing of energy. We also note that most suppliers also said that a 30-day notice period would be reasonable. A longer termination notice period might also be perceived by microbusiness customers as a barrier to switching. Accordingly, we are not minded to amend or remove the Minimum Notice Period.
- 9.145 Second, a fixed-term Roll-over Period must be no longer than 12 months (SLC 7A.13A(c)). We understand that this was recently introduced by Ofgem following its RMR. Ofgem told us that the purpose of this licence condition was to offer suppliers a higher degree of security of supply, compared to the security under a shorter notice period.¹¹⁹³ We are not minded to amend this licence condition and, accordingly, suppliers would be able to roll microbusiness customers onto a fixed-term Roll-over Period (as long as the duration of this period does not exceed 12 months). However, we explain (in paragraphs 9.149 and 9.152 below) that under the proposed remedy suppliers would not be able to include certain provisions that restrict the ability of microbusiness customers to switch contract or supplier during the fixed-term Roll-over Period.

¹¹⁹² See Appendix 9.2 for evidence regarding the design considerations of the auto-rollover remedy.

¹¹⁹³ Ofgem's response to the Remedies Notice.

- *Which restrictions concerning the Initial Period should be addressed*

9.146 Under the current regulatory framework, a microbusiness customer can give a termination notice at any time up to 30 days before the end date of the Initial Period (or a later day specified in the contract).¹¹⁹⁴ Customers are typically rolled onto a new contract during the period just before the end date of the Initial Period. The result is that microbusiness customers are unable to give termination notice during the last 30 days of the Initial Period which is when they would be rolled over and is therefore the time they are most likely to contemplate switching.¹¹⁹⁵

9.147 Accordingly, the proposed remedy envisages that during the Initial Period:

- (a) Microbusiness customers would be able to give a termination notice at any time up to the last day of the Initial Period.
- (b) The termination of the auto-rollover contract would take effect:
 - (i) at the end date of the Initial Period, if the termination notice is given in accordance with the notice period stated in the contract or at least 30 days before the end date of the Initial Period; or
 - (ii) 30 days after the date when the termination notice has been served by the microbusiness customer, if the termination notice is given in the last 30 days of the Initial Period (ie in this case, the termination of the auto-rollover contract would take effect during the Roll-over Period).

- *Which restrictions concerning the Roll-over Period should be addressed*

9.148 Under the current regulatory framework, a microbusiness customer on a fixed-term Roll-over Period can give termination notice at any time up to 30 days before the end date of the fixed-term Roll-over Period (or a later day specified in the contract) (SLC 7A.12B). This means that they have to wait

¹¹⁹⁴ SLC 7A.12B. Prior to the implementation of the RMR, microbusiness customers could give termination notice during the 30 days before the end of the Initial Period only. Hence, under the RMR, Ofgem introduced SLC 7A.12B to ensure that there was a wider window (than before the RMR) within which microbusiness customers could provide termination notice during the Initial Period. This wider window currently runs from the contract start date to up to 30 days before the end of the Initial Period.

¹¹⁹⁵ For instance, in its response to provisional findings, p79, paragraph 298, Centrica told us that one of the most powerful triggers for customer engagement is the process customers go through when they are coming to the end of a fixed-term contract. Centrica's evidence showed that up to 60% of all customers in the domestic market now contacted its sales team to talk through their options.

until the end of the following fixed-term Roll-over Period to terminate the contract.

9.149 However, we consider that microbusiness customers should be allowed to give a termination notice at any time during the Roll-over Period (regardless of whether the Roll-over Period is fixed or non-fixed). Accordingly, our proposed remedy envisages that, during the Roll-over Period (fixed or non-fixed term):

(a) microbusiness customers would be able to give a termination notice at any time;¹¹⁹⁶ and

(b) the termination of the Roll-over Period will take effect at most 30 days after the date when the microbusiness customer has given a termination notice.

9.150 The current regulatory framework also allows suppliers to include termination fees or no-exit clauses for the Roll-over Period.¹¹⁹⁷ Under this proposed remedy, we propose to prohibit suppliers from including termination fees or no-exit clauses for the Roll-over Period. An absence of termination fees and no-exit clauses concerning the Roll-over Period would enable a microbusiness customer to engage to a greater degree in the microbusiness segments by switching away from an onerous part of a contract that it may feel it did not explicitly agree to or consider before accepting the auto-rollover contract.

9.151 Similarly, we propose prohibiting suppliers from charging termination fees in relation to OOC¹¹⁹⁸ and evergreen¹¹⁹⁹ contracts for microbusiness customers. Such a measure would ensure consistency with regards to termination fees on all default contracts¹²⁰⁰ in the microbusiness segments. It would also be consistent with the domestic retail markets, where suppliers tend not to charge termination fees on non-fixed term SVTs. We envision that this would result in less confusion for microbusiness customers,

¹¹⁹⁶ We note that this is currently a requirement for non-fixed Roll-over Periods (SLC 7A.12A).

¹¹⁹⁷ We note that, since the RMR, all of the Six Large Energy Firms and independent suppliers have ended these restrictions on a voluntary basis. The independent suppliers include Ecotricity, Good Energy and Ovo Energy.

¹¹⁹⁸ OOC contracts apply to non-domestic customers, which have terminated their contracts, but have not yet switched to a new supplier. Non-domestic customers are defaulted to this type of contract and will remain on this tariff unless they take action to switch, with price changes being applied automatically (see provisional findings report, [Appendix 9.1](#), paragraph 29).

¹¹⁹⁹ Evergreen contracts have no termination date and the prices are changed periodically. We understand that these contracts are of limited importance for acquiring new non-domestic customers (see provisional findings report, [Appendix 9.1](#), paragraph 29).

¹²⁰⁰ We note that currently SLC 7.6 does not permit suppliers to apply termination fees on deemed contracts to non-domestic customers.

especially those that might not be aware of the rules that apply to the various types of default contracts.

9.152 Finally, in order to avoid suppliers engaging in practices that would have the same effect as termination fees or no-exit clauses, the proposed remedy would prohibit suppliers from transferring a microbusiness customer that has served a termination notice during the Roll-over Period to a more expensive contract during the notice period. This type of practice may be perceived as a barrier to switching if a microbusiness customer would incur a cost (to switch), which would be similar in substance to a termination fee. However, suppliers would be able to transfer microbusiness customers to other contracts during the Roll-over Period under the following circumstances:

- (a) if the supplier has given notice of a price change prior to the termination notice being served by the microbusiness customer, then the supplier would be permitted to put in place the price change during the Roll-over Period;
- (b) if the microbusiness customer has served the termination notice and has not switched to a new supplier/contract after the relevant notice period, then the existing supplier would be permitted to place the microbusiness on an OOC contract, which may have a different price to the auto roll over contract; and
- (c) if a microbusiness customer elects to change its contract after serving notice to terminate the auto-rollover contract.

9.153 Separately, we have considered Scottish Power's submission regarding the modifications to the licence conditions in relation to grounds for objections that a supplier can raise to a non-domestic customer seeking to transfer its energy supply to another supplier. Having sought further views from Ofgem and suppliers, our provisional view is not to amend the licence conditions in relation to objections. This is because most objections made by suppliers related to attempted transfers within a fixed term, and debt owed by the non-domestic customer to the supplier. These did not impact the restrictions concerning the Roll-over Period, which we have sought to address.

- *Scope of the proposed remedy*

9.154 We provisionally consider that this remedy would be applicable to all microbusiness customers on auto-rollover contracts, OOC contracts and evergreen contracts, including those on these contracts when the proposed remedy is implemented. This would be regardless of whether the microbusiness customer is in the Initial Period or the Roll-over Period.

- *Implementation of the remedy*

9.155 We propose to implement this remedy through:

(a) A CMA order that would:

- (i) prohibit the inclusion of conditions in their existing and future auto-rollover contracts with microbusiness customers that:
 - prohibit the microbusiness customer from giving a termination notice up to the last day of the Initial Period.
 - prohibit the microbusiness customer from giving a termination notice up to the last day of the fixed-term Roll-over Period.
 - impose a termination fees and/or ‘no-exit’ clause for the Roll-over Period.
- (ii) prohibit the transfer of microbusiness customers that have given a termination notice during the Roll-over Period to a higher priced contract during the notice period.
- (iii) prohibit the inclusion of a condition in their existing and future OOC and evergreen contracts with microbusiness customers that include termination fees.
- (iv) amend the supply licence conditions to incorporate these requirements.

(b) A recommendation to Ofgem to make any necessary consequential amendments to the supply licences.

Assessment of effectiveness of the auto-rollover remedy

9.156 In this section, we have considered whether the proposed auto-rollover remedy would be effective in achieving its aim of increasing the ability of microbusiness customers on auto-rollover contracts to switch contracts or suppliers. As we explain below, our provisional view is that this remedy would be effective in addressing the concerns regarding the limited ability of microbusiness customers to engage, which was a feature that contributed to the Microbusiness Weak Customer Response AEC, and the resulting customer detriment.

9.157 In evaluating its effectiveness, we have considered the following factors:

(a) The effectiveness of the key design elements of the proposed remedy.

- (b) The extent to which the proposed remedy would be capable of effective implementation, monitoring and enforcement.
- (c) The timescale over which the proposed remedy would be expected to take effect.
- (d) The proposed remedy's consistency and compliance with existing or expected laws or regulations.

- *Effectiveness of the key design elements*

- 9.158 Our provisional view is that this proposed remedy would increase the ability of microbusiness customers on auto-rollover contracts to engage in the markets. Specifically, by allowing microbusiness customers to give a termination notice to suppliers up to the last day of the Initial Period the proposed remedy would allow them to engage, when they are most likely to want to engage. Similarly, the measure that would allow microbusiness customers to serve a termination notice and the measure to prohibit termination fees and/or a no-exit clause during the Roll-over Period would eliminate certain deterrents to switching, thus increasing microbusiness customers' ability to engage in the microbusiness segments. This latter prohibition would be complemented by prohibiting the transfer of microbusiness customers that have given a termination notice during the Roll-over Period to a more expensive contract during the relevant notice period, in order to prevent suppliers from circumventing the prohibition on termination fees by recovering them through indirect means.
- 9.159 In our view, these design elements would increase microbusiness customers' ability to switch from relatively higher priced auto-rollover contracts to acquisition and retention contracts, thus potentially reducing their energy costs. This would also increase the competitive constraint on suppliers' contract prices to microbusiness customers.
- 9.160 We also consider that there would be no other effective means to address our concerns regarding auto-rollover contracts as set out in the provisional findings report. In this regard, we note that not all suppliers have ceased to include (in their contracts with microbusiness customers) the particular clauses with which we have concerns, namely clauses that: prevent a customer giving notice within the last 30 days of the Initial Period; prohibit giving a termination notice; impose a termination fee; or include a no-exit provision during the Roll-over Period. As a consequence, we believe that the proposed remedy would only be effective by prohibiting suppliers from entering into contracts that include such restrictive clauses; and from enforcing such clauses in existing contracts.

- *Implementation, monitoring compliance and enforcement of the proposed remedy*

- 9.161 In determining whether a proposed remedy is effective, we will have regard to the operation and implications of the proposed remedy. We will also have regard for the need of the proposed remedy to be clear to the persons to whom it is directed; and also to other interested persons such as Ofgem (which would have responsibility, together with the CMA, for monitoring compliance), and microbusiness customers.
- 9.162 As regards the implementation of the proposed remedy, we have set out a number of detailed specifications in paragraphs 9.147 and 9.149 to 9.152 above so that it will be clear to suppliers and straightforward for them to implement.
- 9.163 As regards monitoring compliance with the proposed remedy, we note that, by introducing a new licence condition that would be consistent with the CMA's order, Ofgem will be under a duty to perform a monitoring role and can require the provision of information from suppliers concerning potential breaches of a licence condition. The CMA would also be responsible for monitoring compliance, as this proposed remedy would be implemented through an order.¹²⁰¹
- 9.164 Monitoring compliance with the proposed remedy would involve periodically checking suppliers' contracts (with their microbusiness customers) to verify that they are adhering to the terms of the order and licence condition (eg by not including termination fees for the Roll-over Period). In addition, Ofgem would be well placed as the sector regulator to receive, and follow up on, complaints made by microbusiness customers concerning suppliers' ongoing compliance with the licence condition.
- 9.165 As regards enforcement of the proposed remedy, by introducing the proposed remedy by way of order and new licence condition, Ofgem will also be able directly to enforce against any breach of the new licence condition, without making an application to the court (as compared to enforcing against a breach of the order, for which a court application would be required).

¹²⁰¹ Section 38 of the GA86 and section 28 of the EA89; Section 26 of the Competition Act 1998; Section 225 of the 2002 Act; Regulation 13 of the Unfair Terms in Consumer Contracts Regulations 1999; and, Regulation 21 of the Business Protection from Misleading Marketing Regulations.

- *Timescale for the auto-rollover remedy*

- 9.166 In evaluating the effectiveness of the proposed remedy, we have considered the timescale over which the Microbusiness Weak Customer Response AEC is expected to endure, and the timescale over which the proposed remedy would be likely to take effect.
- 9.167 As regards the Microbusiness Weak Customer Response AEC, our view is that, absent the proposed remedy (and the other proposed remedies we have provisionally decided upon concerning this provisional AEC), the detriment would persist. We note that not all suppliers currently include in their contracts with microbusinesses the particular clauses with which we have concerns (see paragraphs 9.146, 9.148 and 9.150 above). Furthermore, we have seen no evidence that the suppliers currently using such clauses have future intentions to remove them (absent our proposed remedy). We also note that there is no current licence condition that prevents any supplier from re-introducing such clauses in the future. Therefore we have provisionally decided that the proposed remedy would not be subject to a sunset provision.
- 9.168 As regards the timescales for implementation, we note that many suppliers (principally the Six Large Energy Firms, and certain other suppliers) already comply with the key components of this proposed remedy. Therefore, the timescale for the implementation of this proposed remedy principally concerns the other suppliers that would be required to change their practices to comply with the CMA order.
- 9.169 As regards the future auto-rollover contracts, our proposed order would take effect immediately upon publication of the CMA's order. As regards the existing auto-rollover contracts, we propose to set a deadline for implementation by suppliers within 12 months of the publication of the final report. We believe this would give suppliers adequate time to adjust their forward purchasing strategies in the wholesale energy markets¹²⁰² concerning the Roll-over Periods to which they were already contractually committed. For example, we understand that the furthest period ahead that a supplier typically purchases energy for Roll-over Periods is 12 months ahead.¹²⁰³ As a result, any suppliers that had purchased energy on the forward markets in this way would, from the date of the final report, be given

¹²⁰² SLC 7A.13A(c) permits a fixed-term Roll-over Period up to 12 months. In its response to the Remedies Notice (remedy 8 on p6), Ofgem said that a fixed-term contract (including a 12-month fixed-term auto-rollover contract) allowed a supplier to hedge the risk of short-term changes in wholesale electricity and gas prices.

¹²⁰³ For its microbusiness customers on a fixed-term Roll-over Period of 12 months, which is permitted under SLC 7A.13A(c).

enough time to manage their risks in relation to the forward purchasing of energy.

- *Consistency and compliance with existing or expected laws or regulations*

- 9.170 We have considered whether any elements of the remedy would be inconsistent with other relevant laws and regulations.
- 9.171 A particular focus of our assessment was the scope of the remedy (as laid out in paragraph 9.154 above) ie the proposed remedy would be applicable to all microbusiness customers on auto-rollover contracts including those on auto-rollover contracts when the remedy is implemented. However, as noted in paragraph 9.169 above, we would be setting an implementation deadline of 12 months with the publication of the final report, specifically concerning existing auto-rollover contracts. Suppliers would therefore have 12 months to amend their contractual terms and forward purchasing strategies.

Assessment of proportionality of the auto-rollover remedy

- 9.172 In this section we set out our assessment of whether the proposed remedy would be a proportionate remedy to address one of the three features that we identified in the microbusiness segments. We have done so by considering whether the proposed remedy would:
- (a) be effective in achieving its legitimate aim;
 - (b) be no more onerous than needed to achieve its aim;
 - (c) be the least onerous if there were a choice between several effective measures; and
 - (d) not produce disadvantages that are disproportionate to the aim.¹²⁰⁴

- *Effective in achieving its aim*

- 9.173 For the reasons set out in paragraphs 9.133 to 9.136 above, our provisional view is that this proposed remedy would be effective in achieving its aim of increasing the ability of microbusiness customers on auto-rollover contracts to engage in the microbusiness segments of the SME retail energy markets. Accordingly, it would be effective in addressing one of the underlying

¹²⁰⁴ CC3, paragraph 344, citing the principles established in the Fedesa case, Case C-331/88, the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others, [1990] ECR I-4023, paragraph 13.

features contributing to the provisional Microbusiness Weak Customer Response AEC, and the resulting customer detriment.

- *No more onerous than needed to achieve its aim*

9.174 We also consider that this proposed remedy would be no more onerous than needed to achieve its aim. The proposed remedy would not impose any upfront costs on energy suppliers. In addition, we have also provisionally decided on setting a 12 months implementation deadline, after the publication of the final report, which would give suppliers adequate time to adjust their contracts and forward purchasing of energy in relation to existing auto-rollover contracts (see paragraph 9.179 to 9.183 below).

- *Least onerous if there were a choice between several effective measures*

9.175 As noted above, we have considered whether there may be alternative means that would achieve the same aim. However, we provisionally consider that the proposed remedy is the only effective means of addressing the concerns we have provisionally identified, for the reasons discussed in paragraph 9.160 above.

- *Would not produce disadvantages disproportionate to the aim*

9.176 We estimated the profits of the Six Large Energy Firms in excess of the cost of capital at approximately £230 million per year (see paragraph 9.16 above). We have not quantified the amount by which the detriment from the independent suppliers would be reduced solely as a result of the proposed auto-rollover remedy. However we note the beneficial impact on engagement levels of microbusiness customers of the Six Large Energy Firms that have already ceased entering into contracts containing the restrictive clauses with which we have concerns (see paragraphs 9.137 and 9.139 above). For the reasons noted above, we believe that the proposed remedy would have a positive impact on engagement levels and competition in the microbusiness segments that would overall lead to lower prices.

9.177 As noted above, we consider that no upfront costs would be imposed on suppliers as a result of this remedy, and we are therefore confident that this proposed remedy would have greater benefits than costs and would be proportionate to its aims.

9.178 Certain parties told us that the prohibition of termination fees and no-exit clauses could lead to greater risks for suppliers, which could compel suppliers to raise their prices to microbusiness customers on auto-rollover contracts. However, we consider that customers would be unlikely to be

charged a higher price solely because of the implementation of our proposed remedy. We note that suppliers could take a number of mitigating actions to manage any potential risk arising from the proposed remedy without having to resort to price increases.

- 9.179 First, there would be no increased risk (for suppliers) with regards to the effect of our proposed remedy on future contracts (on the date the CMA's order becomes effective) with a Roll-over Period. Our proposed remedy would bring into line certain independent suppliers' practices with the current practices of the Six Large Energy Firms and other suppliers. Hence, we believe that such suppliers would be able to adjust their risk and pricing strategies so as to remain (or to become) competitive with the Six Large Energy Firms and other suppliers, which are already conducting their business in line with our proposed remedy.
- 9.180 Second, for microbusiness customers in the Initial Period (on the date the remedy becomes effective), we note that a supplier would have enough time to adjust its purchasing strategy concerning the Roll-over Period so as to accommodate the new exit provisions. For example, a supplier that previously bought energy 12 months ahead (usually during the last 30 days of the Initial Period) for its customer on a 12-month fixed-term Roll-over Period could adjust its purchasing strategy by purchasing 30 days ahead or any other strategy it considered appropriate.
- 9.181 Third, for microbusiness customers in the Roll-over Period (on the date the remedy becomes effective), we note that (for the reasons noted above) the proposed implementation period of 12 months would allow a supplier adequate time to adjust its purchasing strategy to take into account its risks. Such a supplier would have 12 months to adjust its purchasing strategy for a microbusiness customer on the Roll-over Period, which in itself cannot exceed 12 months.
- 9.182 To the extent that any adjusted purchasing strategy might lead to a higher price to microbusiness customers on the Roll-over Period (at the time the remedy becomes effective), we note that suppliers could contact their existing microbusiness customers that are on non-fixed Roll-over Periods and offer them a fixed-term retention contract. However, if such a microbusiness customer did not engage, and the supplier considered that it was unable to manage its risks, then that supplier could choose to terminate the Roll-over Period or offer a variable priced contract that tracked a wholesale energy cost index. Our proposed remedy would not prohibit a supplier from offering acquisition or retention contracts to that, or other, microbusiness customers.

9.183 In addition, suppliers could form a reasonable view on the overall customer demand profile for microbusiness customers on Roll-over Periods. This would be possible because such customers would have been with the supplier for more than one year, and the supplier would have been able to collate and analyse the necessary data to form a view on the overall demand profile for all such customers. This would allow the supplier to broadly purchase the correct volumes of energy to match actual demand. Also, the supplier could choose to manage its risks by purchasing ahead only 30 days based on the knowledge that the termination notice period would be 30 days, and it would also have the option to change its prices every 30 days on auto-rollover contracts with variable prices during the Roll-over Period.

- *Ofgem's statutory duties*

9.184 As stated above, where the CMA is considering whether to modify one or more of the conditions of a retail gas or electricity supplier's licence, in deciding whether such action would be reasonable and practicable, the CMA must 'have regard' to the relevant statutory functions of Ofgem.

9.185 In reaching our provisional decision to introduce a new licence condition concerning gas and electricity supply that prohibits suppliers from entering into (a) auto-rollover contracts with certain restrictions (as laid out in paragraphs 9.146 to 9.153 above), and (b) OOC and evergreen contracts with termination fees; we have, as part of our own application of the legal framework requiring us to decide upon proposed remedies that are effective and proportionate,¹²⁰⁵ explicitly taken into account many of the above factors to which Ofgem must have regard when carrying out its functions. We have therefore concentrated below on the considerations not explicitly taken into account elsewhere in this section of the provisional decision on remedies.

9.186 In particular, we do not consider that this proposed remedy would have an adverse impact on suppliers' ability to meet all reasonable demands for gas and electricity supply, achieving sustainable development, the interests of vulnerable customers, security of supply or environmental concerns. In this regard, the proposed remedy would only impact the 'efficiency' limb of the trilemma considerations built into Ofgem's statutory duties and functions.

9.187 We note that the proposed remedy will also provide some protection to microbusiness customers from becoming locked in to contractual terms that they may not have been fully aware of (or may consider that they did not agree to) at the time of entering into the contract. In this context, the

¹²⁰⁵ CC3, paragraph 329.

proposed remedy directly engages Ofgem's principal objective of protecting the interests of existing and future customers.

- 9.188 The proposed remedy may also enhance transparency by removing terms and conditions that customers may not be fully aware of, or those that may create confusion (for example, the prohibition of termination fees and no-exit clauses on auto-rollover contracts). Additionally, the removal of termination fees on all OOC and evergreen contracts would result in a consistent approach of no termination fees being charged on all default contracts.
- 9.189 Not all suppliers have taken action themselves voluntarily to remove termination fees concerning Roll-over Periods from their contracts with microbusiness customers or to stop offering contracts with such termination fees altogether, and so we consider that the introduction of a new SLC in the terms proposed is a necessary measure, and therefore consistent with best regulatory practice.
- 9.190 In light of the above, we consider that the proposed remedy is consistent with Ofgem's principal objective of promoting the interests of existing and future customers.

Ofgem programme to promote microbusiness customers' engagement

- 9.191 In our provisional findings report, we identified three features giving rise to the Microbusiness Weak Customer Response AEC, two of which were that microbusiness customers face actual and perceived barriers to accessing and assessing information; and that microbusiness customers have limited awareness of, and interest in, their ability to switch.¹²⁰⁶
- 9.192 As discussed in Section 6, clear information is important to facilitate customer engagement. However, there are many potentially plausible but divergent arguments about the way in which information should be provided to microbusiness customers in order to facilitate their understanding and engagement. Without adequate testing, it is not possible to know which approach will work best in practice.
- 9.193 According to Ofgem's most recent data, a little less than half¹²⁰⁷ of microbusiness customers were on default¹²⁰⁸ contracts in 2013. These customers would benefit from additional or different information, and/or from messaging to prompt them to switch to lower priced acquisition and retention

¹²⁰⁶ Remedies Notice, paragraph 53.

¹²⁰⁷ Electricity (45%) and gas (49%).

¹²⁰⁸ Default contracts comprise: Auto-rollover, deemed, OOC and evergreen contracts.

contracts. The proportion of microbusiness customers on default contracts may have decreased recently, due to the implementation of the RMR rules and the ending of fixed-term Roll-over Periods by the Six Large Energy Firms and other suppliers. However, they still constitute a significant proportion of the overall microbusiness customer base. Ofgem also told us that the median term of the default contract was greater than one year. This could suggest some degree of disengagement among these customers.

- 9.194 We have also observed that the Six Large Energy Firms have earned the highest average revenues and gross margins on deemed and OOC contracts, which were substantially higher than those relating to acquisition and retention contracts.¹²⁰⁹ We provisionally concluded that this implied that most microbusiness customers on default contracts could benefit from switching to acquisition and retention contracts.¹²¹⁰ We consider that switching would be a positive development in the market, considering that prices of default contracts to non-domestic customers (including microbusiness customers) are significantly higher than those for fixed-term acquisition and retention contracts.¹²¹¹
- 9.195 Accordingly, we propose to recommend to Ofgem that it establish an ongoing programme to identify, test (through randomised controlled trials (RCTs), where appropriate) and implement (for example, through appropriate changes to standard licence conditions) measures to provide microbusiness customers with different or additional information to prompt them to engage in the SME retail energy markets.
- 9.196 This proposed remedy would be similar to the Ofgem-led programme remedy proposed in Section 6 for domestic customers (the 'Domestic Ofgem-led Programme Remedy').

Aim of the proposed remedy

- 9.197 The overall aim of this proposed remedy would be to:
- (a) identify the most appropriate form of information that should be included in routine communications from suppliers (eg bills);
 - (b) reduce or minimise the complexity of those communications; and

¹²⁰⁹ Provisional findings report, [Appendix 9.1](#), paragraph 172.

¹²¹⁰ Provisional findings report, [Appendix 9.1](#), paragraph 172.

¹²¹¹ For example, in response to the Remedies Notice, on remedy 8 (the auto-rollover remedy), Ofgem told us that its April 2013 study had shown that electricity prices for micro-businesses with a non-fixed-term contract (such as OOC and deemed) were on average 80% higher than negotiated contracts such as the acquisition and retention contracts.

(c) provide microbusiness customers with different or additional information or messaging that would prompt them to switch contract or supplier.

9.198 Accordingly, the ultimate aim of this proposed remedy is to address (in whole, or in part) the feature that microbusiness customers face actual and perceived barriers to accessing and assessing information. The proposed remedy will also address, in part, the feature that microbusiness customers have limited awareness of, and interest in, their ability to switch. Hence, this remedy would work alongside the other remedies to address the Microbusiness Weak Customer Response AEC (and the resulting detriment).

Parties' views on the proposed remedy

9.199 In the Remedies Notice, we invited parties' comments on a remedy that would involve measures to provide microbusiness customers with different or additional information to reduce actual or perceived barriers to accessing and assessing information to help them engage.

9.200 In their responses to the Remedies Notice, parties said that they had noticed increased engagement in microbusiness segments recently. They also pointed out to the voluntary steps that had been taken by certain suppliers that had also increased customer engagement. We note that one of the most important of these voluntary steps was that certain suppliers stopped the practice of fixed-term auto-rollover contracts (see paragraphs 9.137 and 9.139 above).

9.201 Nevertheless, parties were also supportive of the proposed remedy to test measures to improve engagement before implementation.¹²¹²

Design considerations

9.202 The key elements that we have considered to design the proposed remedy are set out below. We note that some of these elements are similar to those of the Domestic Ofgem-led Programme Remedy and, accordingly, we cross-refer to these elements where relevant.

9.203 We have considered the following elements in the design of this proposed remedy:

(a) what approach should be taken to identify and test the measures concerning the information to be provided to microbusiness customers;

¹²¹² See Appendix 9.3 for parties' views on prompts and what engagement measures are mandated by the standard licence conditions.

- (b) whether the identification and testing of those measures should be Ofgem or supplier led;
- (c) whether we should identify a shortlist of proposed measures for testing; and
- (d) how the proposed remedy should be implemented.

- *What approach should be taken*

9.204 Under the proposed remedy, Ofgem would have discretion to specify the criteria to identify, test and review the measures concerning what, how and when information would be presented to microbusiness customers.

9.205 However, regardless of the specific steps taken by Ofgem to identify and test those measures, our view is that the overall approach of the Ofgem-led programme would provide for:

- (a) the specification of potential forms of information that microbusiness customers should receive from suppliers in their routine communications (eg bills, annual statements, price increase notices and fixed-term notices) and messaging aimed at prompting customers to engage (referred to below as ‘the measures’);
- (b) rigorous testing (through RCTs, where appropriate) of the impact of the measures identified prior to segment-wide implementation;
- (c) the implementation of the measures considered most appropriate following testing (for instance, through appropriate changes to the standard licence conditions);
- (d) ongoing monitoring of the impact of the implemented measures; and
- (e) adjustments as appropriate, where measures may no longer have the desired effect.

- *Whether the programme should be led by Ofgem or suppliers*

9.206 Our provisional view is that Ofgem would be better placed than suppliers to take the lead in a programme to identify measures aimed at promoting microbusiness customers’ engagement, for the same reasons as those concerning the Domestic Ofgem-led Programme (see Section 6).

- *Whether we should identify a shortlist of proposed measures for testing*

9.207 Contrary to our approach on the Domestic Ofgem-led Programme, we do not consider it necessary to recommend (to Ofgem) a shortlist of measures to be tested through RCTs.

9.208 In the domestic retail energy markets, we found some evidence regarding the complexity of information provided in certain routine communications between customers and suppliers, and evidence that Ofgem's research on the 'clearer information' component of the RMR rules has been inadequate to date. However, in the microbusiness segments it has not been possible to ascertain what routine communications from suppliers should be targeted by this Ofgem-led programme. Based on this uncertainty as to which routine communications Ofgem should look at, and how best to look at them, we have not identified a shortlist of proposed measures for testing in the context of the proposed remedy for microbusiness customers.

- *How the remedy should be implemented*

9.209 We propose to implement this remedy through a recommendation to Ofgem to establish an ongoing programme to identify, test (through RCTs, where appropriate) and implement (for example, through appropriate changes to gas and electricity suppliers' standard licence conditions) measures to provide microbusiness customers with different or additional information with the aim of prompting engagement in the SME retail energy markets.

9.210 Contrary to our approach on the Domestic Ofgem-led Programme, we do not propose to mandate suppliers to participate in the Ofgem-led programme concerning the microbusiness segments for a number of reasons, including the following:

- (a) RCTs are less well established as a testing tool among microbusinesses, as compared with domestic customers.
- (b) We have less evidence that ineffective microbusiness information is as big a problem as it is in the domestic retail markets.
- (c) Our other proposed remedies go some way to addressing the feature that microbusiness customers face actual or perceived barriers to accessing and assessing information. Accordingly, we do not consider the proposed remedy to be critical to the success of the package of proposed remedies aimed at promoting engagement in the microbusiness segments, and therefore to address (in part) the

overarching Microbusiness Weak Customer Response AEC (and the resulting detriment).

Assessment of effectiveness of the proposed remedy

9.211 As we explain below, our provisional view is that the proposed remedy would be effective in achieving its aim of (a) identifying the most appropriate form of information to be included in routine communications from suppliers, (b) reducing or minimising the complexity of those communications, and (c) providing microbusiness customers with different or additional information or messaging that would prompt them to switch tariff or supplier.

9.212 Accordingly, our provisional view is that the proposed remedy would be effective in addressing (in whole or in part) the feature that microbusiness customers face actual and perceived barriers to accessing and assessing information that (among other features) gives rise to the Microbusiness Weak Customer Response AEC (and the resulting detriment). It will also address, in part, the feature that microbusiness customers have limited awareness of, and interest in, their ability to switch.

9.213 In assessing the effectiveness of the proposed remedy, we have considered the following factors:

- (a) The effectiveness of the key design elements of the proposed remedy.
- (b) The extent to which the proposed remedy would be capable of effective implementation, monitoring and enforcement.
- (c) The timescale over which the proposed remedy would be expected to take effect.

- *Effectiveness of the key design elements*

9.214 We consider that the key design elements of the proposed remedy would be effective in achieving its aim, for the following main reasons:

- (a) The proposed remedy would provide for testing of the impact of the measures prior to market wide implementation. It would also provide for ongoing monitoring of the impacts of the various measures (see paragraphs 9.204 to 9.211 above). Accordingly, Ofgem would be able to identify the most effective measures to promote engagement.
- (b) Ofgem would be better placed than suppliers to take the lead in a programme to identify and test measures aimed at promoting customer engagement (see paragraph 9.207 above).

9.215 We also consider that the Ofgem-led programme would be responsive to future developments in the markets. For example, the introduction of smart metering has the potential to change how microbusiness customers engage in the markets.

- *Implementation, monitoring compliance and enforcement of the proposed remedy*

9.216 In determining whether a proposed remedy is effective, we have had regard to how it would be expected to operate. We have also had regard for the proposed remedy to be clear to whom it is directed, such as Ofgem and suppliers.

9.217 As regards the implementation of the proposed remedy, we would expect Ofgem to put in place a governance structure to ensure that there would be effective oversight of the design and implementation of the programme.

- *Timescale for the proposed remedy*

9.218 In evaluating the effectiveness of the proposed remedy, we have considered the timescale over which the Microbusiness Weak Customer Response AEC is expected to endure, and the timescale over which the proposed remedy would be likely to take effect. We consider that the detriment would persist absent the proposed remedy, and notwithstanding that the impact of future market developments, including the roll-out of smart meters, is somewhat uncertain.

9.219 Moreover, we consider that the need for significant changes to suppliers' communications to microbusiness customers to be made only after rigorous testing to be an ongoing need, notwithstanding any market developments. Therefore, we have provisionally decided that the proposed remedy would not be subject to a sunset provision.

9.220 As regards the timescales for implementation, we note that Ofgem has a research team that could take forward the proposed programme.¹²¹³ We would expect Ofgem to begin developing initial plans for the programme immediately following the CMA's final report. We note that, as regards the Domestic Ofgem-led Programme Remedy, we would expect that the first trials could start by mid-2017. Ofgem could conduct evaluations of the trials from late 2017 onwards and where the trials proved successful, the interventions could be implemented from late-2018 onwards. However, as

¹²¹³ Ofgem's Monitoring and Consumer Research Team.

regards this programme concerning microbusinesses, Ofgem would have greater flexibility in choosing what to test and how to conduct trials and we would expect that trials could be commenced sooner. Subsequently we would expect Ofgem to monitor the effectiveness of the interventions and continue to update the programme on an ongoing basis. We would therefore expect the remedy to start having an effect in addressing aspects of the features identified in the provisional findings report, including the actual and perceived barriers in accessing and assessing information, and customers' lack of awareness of their ability to switch from the beginning of 2019.

Assessment of proportionality

9.221 In this section, we set out our assessment of whether the proposed remedy would be proportionate to achieve its aim. We have done so by considering whether the proposed remedy would:

- (a) be effective in achieving its legitimate aim;
- (b) not be more onerous than needed to achieve its aim;
- (c) be the least onerous if there were a choice between several effective measures; and
- (d) not produce disadvantages that are disproportionate to the aim.¹²¹⁴

- *Effective in achieving its aim*

9.222 For the reasons set out in paragraphs 9.197 to 9.198 above, we consider that a programme of rigorous testing (involving RCTs where appropriate) would be effective in achieving its aim of reducing the complexity of the information included in routine communications from suppliers and to provide microbusiness customers with different or additional information or messaging that would prompt them to switch contract or supplier. Accordingly, it would be effective in partly addressing (in whole, or in part) two of the features that gives rise to the Microbusiness Weak Customer Response AEC, and the resulting customer detriment.

¹²¹⁴ CC3, paragraph 344, citing the principles established in the Fedesa case, Case C-331/88, the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others, [1990] ECR I-4023, paragraph 13.

- *No more onerous than needed to achieve its aim*

9.223 We also consider that this proposed remedy would be no more onerous than needed to achieve its aim.

9.224 Given the need for an ongoing programme of rigorous testing, Ofgem is best placed to identify, develop, test and implement measures to provide microbusiness customers with different or additional information or messaging to prompt them to engage in the markets. In designing the programme, Ofgem would be required to assess the proportionality of the various stages involved in the programme, including the testing involved in each specific measure identified. In this regard, we would expect Ofgem to take into account issues, such as the potential costs incurred by suppliers, the duration of the testing process and for how long it will impose costs on suppliers, as part of its proportionality assessment.

9.225 In addition, as explained above, we are not proposing to require suppliers to participate in the Ofgem-led programme. Accordingly, we have chosen the least onerous option. We consider that a programme within the proposed parameters would be proportionate.

- *Least onerous if there were a choice between several effective measures*

9.226 We have considered whether there may be alternative remedies that could achieve the same aim. However, we consider that there is no substantive alternative to the proposed remedy that would be effective.

- *Would not produce disadvantages disproportionate to the aim*

9.227 We have provisionally concluded that the proposed remedy would not produce adverse effects that would be disproportionate to its aim. We estimate that the costs of extending the Ofgem-led programme remedy to the microbusiness segments would be similar in nature and scale to those identified in Section 6 for the domestic markets. We note that the Ofgem-led programme would be proportionate given the scale of the detriment, and any potential costs to suppliers would be subject to Ofgem's obligation to consider the proportionality of any testing.

- *Relevant customer benefits*

9.228 We do not consider that any relevant customer benefits will be lost as a result of the Ofgem-led programme. No changes would be made to information for microbusiness customers unless prior testing proves they would be effective. The programme therefore provides for the identification

and implementation of measures that will be proven to help microbusiness customers engage in the market. In turn, this greater customer engagement will help to promote competition.

The Database remedy

- 9.229 In the provisional findings report, we identified three features that give rise to the Microbusiness Weak Customer Response AEC. Two of these features were that microbusiness customers have limited awareness of, and interest in, their ability to switch energy supplier; and that microbusiness customers face actual and perceived barriers to accessing and assessing information arising from certain aspects of the SME retail energy markets.¹²¹⁵
- 9.230 In the Remedies Notice and Supplementary Remedies Notice, we sought views on possible remedies aimed at prompting customers that were on default contracts that they had not actively chosen. Specifically, we consulted on providing such customers with the information that they would need so that they would be able to identify relevant options and make informed choices.
- 9.231 A little less than half of microbusiness customers were on default contracts in 2013 (see paragraph 9.193 above). These customers would benefit from additional information or messaging to prompt them to switch to lower priced acquisition and retention contracts. Ofgem also told us that the median term of the default contract was greater than one year. This could suggest some degree of disengagement among these customers.
- 9.232 In order to enable suppliers to prompt microbusiness customers of rival suppliers on default contracts, the proposed remedy would require energy suppliers to disclose certain details of their microbusiness customers that have been on a default contract (eg auto-rollover, evergreen, deemed and/or OOC contract) for three or more years (the 'Disengaged Microbusiness Customers') to Ofgem, and would recommend to Ofgem that it retain, use, and disclose this data (via a centrally managed database) to rival suppliers. We are proposing a similar remedy for domestic customers who have been on an SVT, or other default tariff, with the same supplier for three or more years (see details in Section 6).

¹²¹⁵ Remedies Notice, paragraph 53.

Aim of the proposed remedy

- 9.233 The aim of the proposed remedy would be to enable rival retail energy suppliers to identify Disengaged Microbusiness Customers and prompt these customers to engage in the markets. The ultimate aim of this proposed remedy would be to partly address two of the features identified in the provisional findings report giving rise to the Microbusiness Weak Customer Response AEC (and the resulting detriment), ie that customers have limited awareness of, and interest in, their ability to switch energy supplier and that customers face actual and perceived barriers to accessing and assessing information.

Parties' views on the prompts to microbusiness customers on default contracts remedy

- 9.234 We consider the core issues concerning the proposed remedy and its design are similar between the microbusiness segments and the domestic retail energy markets. Therefore, for the purposes of this proposed remedy, we have taken into consideration the parties' views in relation to a similar remedy proposed for the domestic retail markets (see details in Section 6) (including parties' views concerning the application of the remedy to prepayment customers) and applied their views to the microbusiness segments.
- 9.235 We also note that in their responses to the Remedies Notice, and subsequent submissions,¹²¹⁶ parties were generally supportive of measures to promote engagement among microbusiness customers.

Design considerations

- 9.236 The key elements of the design of this proposed remedy are set out below. We note that some of these elements would be similar to those of the equivalent remedy proposed for domestic customers and, accordingly, we cross-refer to these elements where relevant.
- 9.237 We have considered the following matters in the design of this proposed remedy:
- (a) what approach should be taken to prompt engagement;
 - (b) who should the proposed remedy target;

¹²¹⁶ See Appendix 9.4.

(c) what should be the role of Ofgem and suppliers in implementing the proposed remedy;

(d) how the proposed remedy should be implemented.

- *What approach should be taken to prompt engagement*

9.238 We recognise that microbusiness customers on default contracts already receive certain information from suppliers.¹²¹⁷ However, as noted for the equivalent remedy proposed for domestic customers, the incentives of a supplier contacting its own Disengaged Microbusiness Customers and alerting them of their ability to switch are quite different from rival suppliers contacting such customers. As discussed above, we also propose to recommend an Ofgem-led programme for identifying, testing and implementing measures for promoting engagement.

9.239 We consider that the proposed disclosure to rival retail energy suppliers of the details of the Disengaged Microbusiness Customers would further contribute to prompting engagement. In particular, we consider that rival suppliers would have an incentive to contact these customers to try to win their custom. Hence, the proposed remedy would encourage existing suppliers and/or new entrants to compete more intensively for the Disengaged Microbusiness Customers.

- *Who should be targeted by the proposed remedy*

9.240 As explained in paragraphs 9.193 above, a little under half of microbusiness customers are on default contracts.

9.241 We consider that instances when microbusiness customers roll on to default contracts and choose not to move contract immediately could be explained by a number of factors other than pure disengagement with the markets. However, we also consider microbusiness customers on default contracts for three or more years (with the same supplier) are more likely to be on such contracts due to a certain level of disengagement. We are therefore of the provisional view that the proposed remedy should apply to all microbusiness customers on default contracts for three or more years.

¹²¹⁷ SLC 7A.

- *What should be the roles of Ofgem and suppliers in implementation*

- 9.242 Under the proposed remedy, suppliers would be required to disclose certain details of the Disengaged Microbusiness Customers to Ofgem. These details would include the microbusiness customer's full name, billing (or registered) address, consumption address, fixed telephone number, current supplier, name of their current contract, annual energy consumption, and MPAN/MPRN) (the 'Microbusiness Customer Data').
- 9.243 We propose to recommend that Ofgem develops, operates and maintains a secure cloud database to hold the Microbusiness Customer Data (in an accessible format). Ofgem could use external IT/database experts to develop this database. However, once the database is created, Ofgem would operate, control and maintain it.
- 9.244 We consider that Ofgem, as the industry regulator, would be best placed to collect and disclose the Microbusiness Customer Data to rival suppliers. This is because we believe Ofgem would be able to represent the interests of the Disengaged Microbusiness Customers fairly. In this regard, the incentives of energy suppliers to control and share the Microbusiness Customer Data with each other may not align with the interests of the Disengaged Microbusiness Customers.
- 9.245 The database would also need to be updated regularly. Accordingly we propose, as part of our order, to require suppliers to provide Ofgem with updated information of any (new or existing) Disengaged Microbusiness Customers every six months to enable Ofgem to remove the details of microbusiness customers that have moved off default contracts, and to include the details of microbusiness customers that have become eligible to be on the database because they have been on a default contract with the same supplier for a total of three or more years.
- 9.246 We also propose to recommend that Ofgem enters into agreements with those suppliers that request access to the Microbusiness Customer Data. These agreements would include restrictions on how the data would be used by Ofgem and rival suppliers (the 'Use Restrictions'), and any other restriction concerning access to the Microbusiness Customer Data that Ofgem considers appropriate (see further Section 6).
- 9.247 Rival suppliers would be allowed to prompt the Disengaged Microbusiness Customers by sending them marketing correspondence by letter (see further Section 6).

- *How the proposed remedy should be implemented*

9.248 We propose to implement this proposed remedy through:

(a) a CMA order that would require suppliers to:

- (i) disclose the Microbusiness Customer Data to Ofgem; and
- (ii) provide Ofgem with updated Microbusiness Customer Data every six months; and

(b) a recommendation to Ofgem to:

- (i) create, operate and maintain a secure cloud database for the purposes of holding the Microbusiness Customer Data;
- (ii) hold the Microbusiness Customer Data;
- (iii) enter into agreements with suppliers including the Use Restrictions, and any restrictions concerning the access to the Microbusiness Customer Data; and
- (iv) provide access to the Microbusiness Customer Data by any rival supplier that has entered into such an agreement.

9.249 We also propose that our order would expire after the sooner of five years, or upon substantial completion of the smart meter roll-out (due by the end of 2020). We note that smart meters are expected to change the competitive dynamic in the retail markets, and the way that microbusiness customers and suppliers interact. Hence the database may no longer be required once smart meter roll-out has been concluded.

Assessment of effectiveness of the proposed remedy

9.250 As we explain below, our provisional view is that the proposed remedy would be effective in achieving its aims of enabling rival energy suppliers to identify and market to the Disengaged Microbusiness Customers, and prompt them to engage. Accordingly, the proposed remedy would be effective in partly addressing two of the features giving rise to the Microbusiness Weak Customer Response AEC. These two features are that customers have limited awareness of, and interest in, their ability to switch supplier; and that customers face actual and perceived barriers to assessing and accessing information.

9.251 In evaluating the effectiveness of the proposed remedy, we have considered the following factors:

- (a) The effectiveness of the key design elements of the proposed remedy.
- (b) The extent to which the proposed remedy would be capable of effective implementation, monitoring and enforcement.
- (c) The timescale over which the proposed remedy would be expected to take effect.
- (d) Compliance with existing or expected laws or regulations.

- *Effectiveness of the key design elements*

9.252 We consider that the following key design elements of the proposed remedy would be effective in achieving its aim. In particular:

- (a) Rival suppliers would be able to easily identify the Disengaged Microbusiness Domestic Customers.
- (b) Ofgem's role in operating, controlling, maintaining the database, and providing access to it would ensure that it was set up and administered fairly in the interests of microbusiness customers.
- (c) The database would be readily accessible to rival suppliers upon request (subject to entering into agreements with Ofgem containing the Use Restrictions and any other access terms) and would include data that was accurate and up-to-date. The proposed remedy provides for the information to be updated every six months.
- (d) Rival suppliers that have an incentive to compete for the Disengaged Microbusiness Customers would have access to certain of their details.
- (e) Rival suppliers would be able to provide the Disengaged Microbusiness Customers with personalised information as they would know their current supplier, contract and annual consumption.

- *Implementation, monitoring compliance and enforcement*

9.253 In determining whether the proposed remedy would be effective, we have considered the operation and implications of the proposed remedy.

9.254 As regards the implementation of the proposed remedy, we have set out a number of detailed specifications so that it would not only be clear to Ofgem and suppliers to understand, but also be straightforward for Ofgem to

implement (as the addressees of our proposed remedy). We note Ofgem has already expressed broad support for the proposed remedy.¹²¹⁸

9.255 As regards monitoring compliance with the proposed remedy, we note that this should also be straight forward. If any supplier failed to comply with the order, Ofgem (as the recipient of the Microbusiness Customer Data) could report this breach to the CMA. In addition, as sector regulator, Ofgem would be well placed to receive any allegations of mistreatment of the Microbusiness Customer Data by a rival supplier and would be able to take action under the agreements (put in place concerning access to and use of the Microbusiness Customer Data, or under a supplier's licence).

- *Timescales for the proposed remedy*

9.256 As regards the timescales for implementation, following the publication of the final report we would expect Ofgem to begin developing the database and associated agreements. We would require suppliers to pass the Microbusiness Customer Data to Ofgem by the end of 2017 at the latest. We would therefore expect rival suppliers to start accessing the database, and contacting the Disengaged Microbusiness Customers by the end of 2017. The database would then be updated every six months from the beginning of 2018 onwards.

9.257 In evaluating the effectiveness of the proposed remedy, we have also considered the timescale over which the Microbusiness Weak Customer Response AEC would be expected to endure, and the timescale over which the proposed remedy would be likely to take effect. We would propose our order would expire after the sooner of five years or upon substantial completion of the smart-meter roll out (due by the end of 2020). Smart meters are expected to change the competitive dynamic in the retail markets, and the way that customers and suppliers interact so the database may no longer be required once smart meter rollout has been concluded.

- *Consistency and compliance with existing or expected laws or regulations*

9.258 As part of our consideration of the effectiveness of the proposed remedy, we have considered whether any elements of the proposed remedy would be consistent with other relevant laws and regulations. As the Microbusiness Customer Data does not involve personal data, we consider that the

¹²¹⁸ Ofgem response to second supplemental notice of possible remedies, pp1–2.

proposed remedy would be in compliance with UK and EU data protection legislation.

Assessment of proportionality of the proposed remedy

9.259 In this section we set out our assessment of whether the proposed remedy would be proportionate.

- *Effective in achieving its aim*

9.260 For the reasons set out above, we consider that the proposed remedy would be effective in achieving its aim of enabling rival retail energy suppliers to identify Disengaged Microbusiness Customers. Accordingly, it would be effective in partly addressing two of the features giving rise to the Microbusiness Weak Customer Response AEC (and the resulting detriment).

- *No more onerous than needed to achieve its aim*

9.261 Consistent with our approach in the domestic markets, we consider that the proposed remedy would be no more onerous than needed to achieve its aim. In particular, we have considered very carefully the requirements in relation to the data suppliers would be required to disclose, the microbusiness customers for whom suppliers would be required to disclose data, the frequency with which suppliers would be required to update the database, and the procedures providing for the disclosure and access to the database, and consider that we have designed the proposed remedy so that it would be no more onerous than needed to achieve its aim.

9.262 With regard to the data that suppliers would be required to disclose, it is our view that the Microbusiness Customer Data would be sufficient for rival suppliers to be able to identify and contact the Disengaged Microbusiness Customers and to provide potential customers with personalised information on the savings they could make by switching.

9.263 With regard to the microbusiness customers for whom suppliers would be required to disclose information, we consider that an approach targeted specifically at the Disengaged Microbusiness Customers would be more proportionate than a similar remedy directed at all microbusiness customers on default contracts or those that have been on default contracts for a shorter duration than three years. In particular, our judgement is that if microbusiness customers were to actively engage in the market every three years, it is likely that would be sufficient for microbusiness customers to exert an effective competitive constraint on suppliers.

9.264 Finally, with regard to the frequency with which suppliers would be required to update the database, we considered whether suppliers should be required to do so more regularly than every six months. Our provisional view is that six months is proportionate in the expectation that the process of extracting, formatting and disclosing the Microbusiness Customer Data would be moderately costly for suppliers. Otherwise we would consider whether a requirement to update the database more frequently would be more proportionate to the aims of the remedy. In particular, more frequent updating would reduce the risk of rival suppliers contacting microbusiness customers who had recently switched away from a default contract, based on out-of-date information, causing annoyance and confusion.

- *Least onerous if there were a choice between several effective measures*

9.265 We have also considered whether there may be alternative designs of this proposed remedy to achieve the same aim that are less onerous. For the reasons noted above, we consider that the proposed remedy, as designed, appropriately balances the need for the proposed remedy to be effective, and proportionate, in terms of the proportion of suppliers' existing customer base to which the proposed remedy will apply (ie customers on a default tariff for three or more years).

- *Would not produce disadvantages disproportionate to the aim*

9.266 Consistent with our approach in the domestic markets, we have provisionally concluded that the proposed remedy would not produce adverse effects that would be disproportionate to its aim. In this regard, we estimate that the costs of extending the database remedy concerning domestic customers to disengaged customers in the microbusiness segments would be similar in nature and in scale to those identified in Section 6 for the domestic markets.

Any relevant customer benefits that may be lost

9.267 We do not consider any relevant customer benefits would be lost as a result of the disclosure of details of the Disengaged Microbusiness Customers to Ofgem and rival suppliers subject to the Use Restrictions. As noted above, the proposed remedy would have several detailed design mechanisms to mitigate the risk of customers receiving unwanted correspondence that could disengage them further. Instead, the proposed remedy would provide Disengaged Microbusiness Customers with relevant information, encourage them to engage and switch to cheaper acquisition and retention contracts.

Remedies relating to the Microbusiness Weak Customer Response AEC not being pursued

TPI information disclosure remedy

- 9.268 One of the features of the retail energy markets identified in the provisional findings report giving rise to the Microbusiness Weak Customer Response AEC was that customers faced actual and perceived barriers to accessing and assessing information arising from certain aspects of these markets. The aspects contributing to the feature were a general lack of price transparency and the role of TPIs.¹²¹⁹
- 9.269 In relation to the role of TPIs, we have observed that trust in TPIs was likely to have been reduced in the microbusiness segments due to:
- (a) alleged TPI malpractice; and
 - (b) customers not necessarily being aware of TPIs' incentives (for example, commissions that TPIs receive) not to give customers the best possible deal.¹²²⁰
- 9.270 In the Remedies Notice, we proposed certain measures that would require the introduction of rules regarding the information that TPIs would have to provide to microbusiness customers. The possible remedy would have required TPIs to disclose the following information to microbusiness customers:
- (a) The extent to which they cover the whole of the market, eg by highlighting those suppliers with which they have and do not have agreements.
 - (b) How they are paid for their services, eg by commission from energy suppliers.
 - (c) Whether they will provide the customer with the cheapest quote (or cheapest quotes) among those firms with which the TPI has an agreement to supply customers, or whether only a selection of quotes will be provided.¹²²¹

¹²¹⁹ TPIs are intermediaries in the supply chain between the energy supplier and the retail microbusiness customer. However, in some circumstances, these can include online TPIs (eg PCWs) and offline TPIs (eg brokers). References to TPIs in this section relate specifically to brokers.

¹²²⁰ Provisional findings report, paragraph 12.9.

¹²²¹ [Remedies Notice](#), paragraph 77.

Parties' views on the TPI information disclosure remedy

- 9.271 In the Remedies Notice, we invited views on a number of questions on the possible remedy. The key questions that we asked were whether this possible remedy could be effective in improving transparency over TPI incentives; and whether this possible remedy should be implemented in addition to Ofgem's draft Code of Practice (CoP).¹²²²
- 9.272 In their responses to the Remedies Notice, all of the Six Large Energy Firms and certain of the independent suppliers welcomed a remedy to improve transparency over TPI and they supported Ofgem's draft CoP. However, some suppliers such as EDF Energy and RWE were in favour of direct regulation of TPIs via a licensing regime.¹²²³ The FSB also supported Ofgem's draft CoP, and said that the CMA should consider Ofgem's draft CoP when designing the remedy. The FSB supported greater transparency regarding TPIs. All TPIs, which responded to the Remedies Notice, were also in favour of Ofgem's draft CoP, except for the UIA, a TPI, which has its own code of practice. In relation to whether the TPI information disclosure remedy should be implemented in addition to Ofgem's draft CoP, most parties said that either one or the other (but not both) should be implemented, with most favouring Ofgem's draft CoP.¹²²⁴

Our position on the TPI information disclosure remedy

- 9.273 We have provisionally decided not to pursue the TPI information disclosure remedy. Our provisional view is that the proposed price transparency remedy would address in part, aspects of the feature of actual and perceived barriers to accessing and assessing information that we have provisionally found gives rise to the Microbusiness Weak Customer Response AEC in particular, concerning the general lack of price transparency. It will also enhance TPIs' roles (in particular PCWs' roles) in helping microbusiness customers to access and assess information to help them engage (see paragraphs 9.43 to 9.47 above). In addition, we note that we have received inconclusive evidence regarding alleged TPI malpractice, in particular as regards microbusinesses, in relation to which Ofgem is considering implementing its draft CoP, which seeks to address similar areas to those proposed under this possible remedy.

¹²²² Remedies Notice, paragraph 80.

¹²²³ EDF Energy said that even though it supported Ofgem's CoP, it saw it as an interim measure until a direct licensing regime was established.

¹²²⁴ See Appendix 9.4 for further details on parties' views.

- *The price transparency remedy*

9.274 We also note that the price transparency remedy would also constrain TPI conduct (ie potential or alleged malpractice), which was the second aspect that contributed to the feature. The price transparency remedy would reduce search costs and would facilitate the development of PCWs (see paragraphs 9.43 to 9.47 above). This would enable microbusiness customers to effectively assess and verify online whether the prices they were quoted by TPIs were reasonable. This would act as a competitive constraint on TPIs, which would be incentivised to offer competitive quotes to microbusiness customers.

- *Evidence base for alleged TPI malpractice*

9.275 We have received inconclusive evidence regarding alleged TPI malpractice in the supply of energy to SMEs and in particular microbusiness customers. It is therefore unclear whether (and if so, how much) this is a significant concern for microbusiness customers.

9.276 The evidence we received was primarily drawn from Ofgem surveys on SMEs' concerns with TPIs, which showed mixed and inconclusive results:

- (a) Ofgem's survey results showed overall negative perceptions of TPIs among SME customers. However, the majority (81%) of customers (SMEs including microbusiness customers), which used brokers, were satisfied with them.¹²²⁵
- (b) The same survey showed that just 5% of SMEs that have used a broker reported that they were charged for the broker's services. However, of those aware of the commission, most (92%) considered the fee to have been at the right level.¹²²⁶
- (c) A Cornwall Energy Report (2011) pointed out that TPIs might be presenting not the most advantageous offers to SMEs because suppliers were skewing commission payments towards the deals they wanted to sell.¹²²⁷ This suggests that the root cause of alleged TPI malpractice may not be TPIs, which may simply be responding to incentives set by suppliers.

¹²²⁵ BMG Research (2015), Micro and Small Business Engagement in Energy Markets (report for Ofgem).

¹²²⁶ BMG Research (2015), Micro and Small Business Engagement in Energy Markets (report for Ofgem).

¹²²⁷ Cornwall Energy (2011), Brokerage services for micro-business energy consumers, report for Consumer Focus, p14.

9.277 In their responses to the Remedies Notice, some parties stated that alleged TPI malpractice was an issue with a few TPIs and that this did not represent most TPIs, which performed a useful function in the markets. For example, Energy UK told us that concerns regarding TPI malpractice applied to a minority of TPIs. Furthermore, surveys for Ofgem such as those conducted by BMG indicated issues (eg sales pressure tactics) among some TPIs, not most TPIs.¹²²⁸

9.278 Third, a recent survey done for Ofgem showed that only 11% of microbusiness customers procured their current energy contract with the help of a broker,¹²²⁹ thus demonstrating limited TPI penetration in the microbusiness segments. The survey noted that microbusiness customers were more likely to contact suppliers directly to procure energy, rather than procure energy through a TPI.¹²³⁰ In the provisional findings report, we noted that low TPI penetration among microbusiness customers could partly be driven by the financial incentives of TPIs, which may prefer to focus on larger businesses from which they can earn more commission.¹²³¹

- *Ofgem's draft CoP*

9.279 We have also observed that Ofgem is considering implementing its draft CoP. Having discussed further with Ofgem its intentions concerning its draft CoP, we consider that it has a clear intention to take its draft CoP forward and introduce it, following a consultation process with the industry.¹²³²

9.280 In its response to the Remedies Notice, Ofgem told us that the measures described in the TPI information disclosure remedy (see above) were currently included in its draft CoP. However, Ofgem considered it would not be appropriate for it to duplicate regulation by implementing these aspects of the CoP alongside a remedy which addresses the same areas.¹²³³

9.281 We also note that Ofgem's draft CoP applies across retail supply to SMEs. Hence, to the extent its draft CoP were to address concerns pertaining to the

¹²²⁸ BMG Research (2015), *Micro and Small Business Engagement in Energy Markets* (report for Ofgem).

¹²²⁹ Provisional findings report, [Appendix 9.1](#), sourced from *The Research Perspective and Element Energy (2013), Quantitative research into non-domestic consumer engagement in, and experience of, the energy market (report for Ofgem)*, p31.

¹²³⁰ Provisional findings report, [Appendix 9.1](#), sourced from *The Research Perspective and Element Energy (2013), Quantitative research into non-domestic consumer engagement in, and experience of, the energy market (report for Ofgem)*, p31.

¹²³¹ Provisional findings report, [Appendix 9.1](#), paragraph 102.

¹²³² Discussed with Ofgem on 24 November 2015.

¹²³³ Ofgem response to Remedies Notice.

SME markets, we are of the provisional view that Ofgem's draft CoP may effectively target such concerns.

- 9.282 Given the inconclusive evidence and the extent to which any concerns regarding TPI malpractice or mistrust are specific to the microbusiness segments, we consider that such concerns would more effectively be monitored¹²³⁴ and addressed by an Ofgem CoP concerning all SMEs.

Price cap remedy – protecting customers that are unable to engage to exploit the benefits of competition

- 9.283 We have considered whether a price cap would be an appropriate remedy to protect microbusiness that are unable to engage. Our provisional decision is not to implement a price cap on the grounds that it would be a disproportionate measure on the basis that we provisionally consider that the package of remedies (see paragraphs 9.291 to 9.302 below) would adequately address the Microbusiness Weak Customer Response AEC and/or associated detriment. We also note that the microbusiness segments are heterogeneous (see paragraph 9.12 above) and there is considerable variation in consumption levels among different microbusinesses. These factors would significantly increase the complexity of implementing, monitoring and enforcing any price cap remedy in the microbusiness segments and its associated costs to suppliers from doing so.

Creating the framework for effective competition

Settlement reform remedy

- 9.284 The remedies relating to gas and electricity settlement, discussed in Section 5 above in relation to domestic customers, will also apply to microbusiness customers.
- 9.285 The remedy concerning electricity settlement would move microbusiness customers in profile classes 1 to 4¹²³⁵ into half-hourly settlement. These changes would affect almost all (90% or more) microbusiness electricity customers. In particular, Ofgem told us that its data suggested that the vast

¹²³⁴ In its response to the Remedies Notice, Ofgem told us that there were approximately 1,200 TPIs engaged with suppliers and considerably more that operated through aggregators. According to Ofgem, many TPIs operating in the microbusiness space were 'one man bands'.

¹²³⁵ Profile class 1 – domestic unrestricted customers. Profile class 2 – domestic Economy 7 customers. Profile class 3 – non-domestic unrestricted customers. Profile class 4 – non-domestic Economy 7 customers. For more information of the use of profile classes in settlement see Elexon (2013), [Load Profiles and their use in Electricity Settlement](#).

majority (88%¹²³⁶) of non-domestic electricity customers would be covered by looking at profile classes 3 and 4. It estimated also that 6% of non-domestic customers were in profile classes 5 to 8, though there were also a small number of microbusiness customers in profile classes 1 and 2.¹²³⁷

9.286 In Section 5, we reported evidence on the potential for demand-side response in the domestic retail markets and in particular we noted that according to one study shiftable electricity demand (see Section 5) could be as high as 10 GW in 2025. Similar studies have been conducted for the SMEs sector.¹²³⁸ They tend to suggest that the potential for demand-side responses might be of the order of 2 GW.¹²³⁹

9.287 We discuss our provisional decision on remedies in relation to both gas and electricity settlement, including aims, parties' views, design, effectiveness and proportionality of the remedy in Section 5.

Proposed package of remedies to address the Microbusiness Weak Customer Response AEC: effectiveness and proportionality

9.288 We have discussed the rationale for each element of the proposed package of remedies in the subsections above. In this subsection, we explain how the elements in the proposed package of remedies would work together to be effective and proportionate in addressing the Microbusiness Weak Customer Response AEC and/or the resulting customer detriment.

Effectiveness of the package of remedies

- *How the package of remedies would address the Microbusiness Weak Customer Response AEC and/or resulting customer detriment*

9.289 We provisionally conclude that the proposed package of remedies would be effective in addressing the features giving rise to the Microbusiness Weak Customer Response AEC and associated detriment.

9.290 As regards the first feature regarding microbusiness customers facing actual and perceived barriers to accessing and assessing information, the price transparency remedy would require suppliers to disclose online the prices of

¹²³⁶ This would suggest the proportion of microbusiness customers affected by the changes would be higher than 88%, which affects all non-domestic customers.

¹²³⁷ Email from Ofgem dated 15 September 2015. Note that Ofgem cited these proportions using Elexon and Xoserve, June 2015 data.

¹²³⁸ See Baringa (2013), Smart Metering Load Shift Analysis; and Baringa and Element Energy (2012), [Electricity System Analysis – future system benefits from selected DSR scenarios, Final report pack](#).

¹²³⁹ See Baringa and Element Energy (2012), [Electricity System Analysis – future system benefits from selected DSR scenarios, Final report pack](#), p43.

all their available acquisition and retention contracts to those microbusiness customers suffering detriment more significantly from the lack of price transparency, namely those in the Proposed Segment. This proposed remedy would contrast with the current practice, where most contracts are individually negotiated between microbusiness customers and suppliers, in the context of many prices not being disclosed online.

- 9.291 Whilst our proposed remedy does not prohibit the individual negotiation of contracts, we acknowledge that it may discourage that process by reducing microbusiness customers' search costs, and increasing the efficiency of switching. Also, this proposed remedy would facilitate the development of PCWs in the microbusiness segments thereby addressing the second aspect of this feature identified in our provisional findings report concerning the role of TPIs. These changes would reduce the search costs, increase price transparency and as a result reduce the actual and perceived barriers that microbusiness customers currently face in accessing information regarding contract prices.
- 9.292 This feature will be further addressed in general, by the proposed remedies involving the Ofgem-led programme concerning the information provided to microbusiness customers and the proposed remedy requiring suppliers to disclose details of certain microbusiness customers, via Ofgem, to rival suppliers, would also address the actual and perceived barriers to accessing and assessing information. Specifically, these proposed remedies would reduce the barriers to accessing and assessing information, and hence enable microbusiness customers to switch from default contracts onto lower-priced acquisition and retention contracts.
- 9.293 We also consider that the proposed remedy requiring suppliers to disclose the details of their disengaged microbusiness customers (the Database remedy) would address, in part, the feature that microbusiness customers have limited awareness of, and interest in, their ability to switch energy supplier.
- 9.294 As regards the third feature concerning microbusiness customers on auto-rollover contracts, the auto-rollover remedy would address this feature so that microbusiness customers would no longer face certain restrictions that constrain their ability to switch contract or supplier. In addition, we consider that the inclusion of termination fees in OOC and deemed contracts also acts as a barrier to switching. We therefore consider the proposed removal of termination fees for OOC and evergreen contracts would increase the ability of those microbusiness customers to switch supplier or contract.

- 9.295 By addressing each of the three features, we believe that our proposed package of remedies would be effective in addressing the Microbusiness Weak Customer Response AEC, and would also address the customer detriment by reducing the energy costs for microbusiness customers that switch from relatively higher priced default contracts on to acquisition and retention contracts.
- 9.296 We have therefore provisionally concluded that our proposed package of remedies would be effective in addressing, in large part, the Microbusiness Weak Customer Response AEC, and the resulting customer detriment.
- *Other aspects of the effectiveness of our proposed package of remedies*
- 9.297 Based on our assessment of the effectiveness of each proposed remedy contained within our package of remedies, we consider that the proposed package of the four remedies as a whole (see paragraphs 9.22 above) would be capable of effective implementation, monitoring compliance and enforcement within reasonable timescales).
- 9.298 As regards monitoring compliance with the proposed remedies package, we note that amendments to the licence condition in the context of the price transparency and the auto-rollover remedies would place Ofgem under a duty to perform a monitoring role. We also note that monitoring compliance with the remedies concerning the Ofgem-led programme and the disclosure of details of certain microbusiness customers to rival suppliers should be straight forward since Ofgem would assist the CMA in monitoring compliance with the requirement of suppliers to participate in the programme and the requirement of suppliers to disclose the Microbusiness Customer Data to Ofgem.
- 9.299 As regards enforcement, the CMA would be able to directly enforce against any breach of order and Ofgem would be able to enforce against any breach of new licence conditions, without making an application to the court (as compared to a breach of the order, for which a court application is required).
- *Timescale for the proposed remedies package*
- 9.300 In evaluating the effectiveness of the proposed remedies package, we have considered the timescale over which the proposed remedies would be likely to take effect.
- 9.301 We also provisionally concluded that the package of remedies would have a beneficial impact in addressing the Microbusiness Weak Customer Response AEC, soon after its implementation. However, the success over

the medium to long term of the price transparency and auto-rollover remedies would depend upon increased microbusiness customer awareness that all prices are being disclosed and that customers no longer face restrictions on auto-rollover contracts. To this effect, we note that microbusiness customers could be made aware of the benefits of these remedies through the remedies to prompt microbusiness customers on default contracts, and also through the outcome of the Ofgem-led programme. Additionally, PCWs would have a greater incentive to advertise their services to microbusiness customers, which would in turn increase customer awareness.

9.302 In addition, we have ensured that the design of our proposed package of remedies, and the elements within it, would be consistent with current and expected laws and regulations that are applicable to the supply of electricity and gas to the microbusiness segments.

9.303 Therefore, we have provisionally concluded that the proposed package of remedies would be capable of effective implementation within a reasonable timescale.

- *Coherence of the package of remedies*

9.304 We have considered whether there would be synergies between the various remedies contained within our proposed package of remedies. We note that none of the individual proposed remedies would work against the aims of the other remedies or the features that give rise to the Microbusiness Weak Customer Response AEC.

9.305 For example, the proposed remedies to prompt microbusiness customers on default contracts would remind them to switch; the price transparency remedy would facilitate switching by allowing them to discover competitive prices more easily; as would the Ofgem-led programme which would also enable them to switch; and the auto-rollover remedy would no longer constrain them from switching. We therefore consider that these individual remedies would mutually reinforce each other.

9.306 We have therefore provisionally concluded that our remedies represent a coherent package, whose elements would be mutually reinforcing.

Proportionality of the package of remedies

9.307 We note that the proportionality of the package of remedies has been built into its design. We have considered issues such as less onerous

alternatives, costs (that do not outweigh benefits) and also the adverse consequences of the package of remedies.

9.308 We discussed the proportionality of each individual proposed remedy above. In this subsection, we explain how the proposed package of remedies would be proportionate to address the Microbusiness Weak Customer Response AEC and/or associated detriment. We have done so by considering whether the proposed remedies package would:¹²⁴⁰

- (a) be effective in achieving its legitimate aim;
- (b) be no more onerous than needed to achieve its aim;
- (c) be the least onerous if there is a choice between several effective remedies; and
- (d) not produce disadvantages that are disproportionate to the aim.

- *Effective in achieving its aim*

9.309 We provisionally conclude that our proposed package of remedies would be effective in directly addressing aspects of the features that give rise to the Microbusiness Weak Customer Response AEC or the AEC itself and/or its resulting customer detriment (see paragraphs 9.289 to 9.303 above).

- *No more onerous than necessary to achieve its aim*

9.310 In order to assess whether the proposed package would be no more onerous than necessary, we have considered:

- (a) whether each of the remedies within the proposed package of remedies would be required to remedy the Microbusiness Weak Customer Response AEC and/or associated detriment; and
- (b) whether the design of each remedy within the package of remedies would be no more onerous than it needed to be.

9.311 Based on our assessment of how the various remedies within the package would contribute to addressing the Microbusiness Weak Customer Response AEC and/or associated detriment, it is our provisional view that each proposed remedy would make a distinct and material contribution to

¹²⁴⁰ CC3, paragraph 344, citing the principles established in the Fedesa case, Case C-331/88, the Queen v Minister of Agriculture, Fisheries and Food and Secretary of State for Health, ex parte: Fedesa and others, [1990] ECR I-4023, paragraph 13.

the overall effectiveness of the proposed remedies package. Even though some of the proposed remedies would have overlapping aims/purposes, no single proposed remedy would be a substitute for any other.

- 9.312 Whilst we believe that each proposed remedy would play an important role in addressing the Microbusiness Weak Customer Response AEC and/or associated detriment, we would expect each remedy's contribution to the overall impact of the package to vary. For example, the proposed price transparency remedy would be key to unlocking competition on price, and the other proposed remedies would be helpful in making sure that microbusiness customers would then be aware, willing and able to take advantage of that increased price transparency by finding cheaper available contracts, and therefore enabling them to switch to those contracts.
- 9.313 This is because the proposed price remedy in our view, has the potential to transform the microbusiness segments of the retail supply markets from individually negotiated contracts with opaque prices into one with transparent price disclosures (although individually negotiated contracts could still prevail).
- 9.314 Based on our assessment above, we provisionally conclude that it would be necessary to include each of the remedies in our proposed package in order to achieve a comprehensive solution to the Microbusiness Weak Customer Response AEC and/or associated detriment.
- 9.315 When reaching our provisional decision on remedy design, we have sought to avoid imposing costs and restrictions on parties that go beyond what would be needed to achieve an effective remedy. For example, in relation to the proposed price transparency remedy, our approach to the Proposed Segment would rule out the requirement for suppliers to develop complex and costly online quotation tools concerning the largest microbusiness customers. Similarly, the option to disclose prices via online quotation tools would present a cost effective option for smaller suppliers. In relation to the proposed auto-rollover remedy concerning existing auto-rollover contracts, we have provisionally decided that an implementation period of up to 12 months (following the publication of the final report) would be reasonable to allow suppliers adequate time to adjust their business practices and manage risks.
- 9.316 Based on the above, we have provisionally concluded that our proposed package of remedies would be no more onerous than necessary in order to address the Microbusiness Weak Customer Response AEC and/or resulting customer detriment.

- *Least onerous if there were a choice of effective remedies*

- 9.317 For the reasons given above, we do not consider that there are other less onerous remedies that would be effective in remedying the AEC and/or associated detriment we have provisionally identified.
- 9.318 First, we consider that the online means of price disclosure proposed under the proposed price transparency remedy is likely to be the most cost effective and least restrictive way of reaching the target microbusiness customer audience, compared to other means such as online price lists or letters. In addition, we note that our concerns regarding termination fees on fixed-term auto-rollover contracts, could not be addressed in any way, other than how we have proposed in the remedy.
- 9.319 We have also considered whether other possible remedies not within our package of remedies could address the Microbusiness Weak Customer Response AEC and/or associated detriment. These included remedies that were put to us by parties in response to the Remedies Notice such as certain parties' preferences for no action over the auto-rollover remedy. We note that such alternative remedies would be of limited or no effectiveness, and would not address the Microbusiness Weak Customer Response AEC or associated detriment. We were not able to identify an alternative package of remedies that would be both less onerous and effective in addressing the Microbusiness Weak Customer Response AEC and/or associated detriment.
- 9.320 We therefore provisionally conclude that our proposed package of remedies would be the least costly and least restrictive solution.
- *Does not produce adverse effects and costs that are disproportionate to the aim*
- 9.321 We have considered whether the proposed package of remedies – or any specific remedy within it – would likely produce adverse effects that would be disproportionate to their individual aims of remedying the Microbusiness Weak Customer Response AEC and/or associated detriment. Specifically, we considered whether the benefits of the remedies package as a whole would be likely to exceed the overall costs of the package. We summarise below our estimates of the cost of each remedy in the package:
- (a) We estimate that the price transparency remedy would be likely to impose costs on the Six Large Energy Firms of approximately £750,000; and on all 30 suppliers (including the Six Large Energy Firms) these costs could amount to approximately £4.5 million if they all opted for the

more expensive online quotation tool option (see paragraph 9.115 above).

- (b) We do not expect the auto-rollover remedy to impose any consequential costs on suppliers, as we expect them to be able to change their risk management (see paragraphs 9.176 to 9.183 above).
- (c) We estimate that the costs of extending the Ofgem-led programme remedy to the microbusiness segments would be similar in nature and scale to those identified in Section 6 for the domestic markets. We note that the Ofgem-led programme would be proportionate given the scale of the detriment, and any potential costs to suppliers would be subject to Ofgem's obligation to consider the proportionality of any testing.
- (d) We note that the costs of extending the Database remedy to the microbusiness segments would be similar in nature and scale to those identified in Section 6 for the domestic markets.¹²⁴¹

- 9.322 In light of the above, we consider that the total costs associated with the remedies package as a whole are unlikely to exceed around £750,000 for the Six Large Energy Firms. For the approximately 30 suppliers in the market, the costs of this remedy on suppliers are unlikely to exceed £4.5 million. However, we note that these figures are likely to be an upper bound of the cost estimates because we would expect several suppliers to choose the third party online platform option (eg PCWs), which would be significantly more cost effective, to comply with the price transparency remedy.
- 9.323 By comparison we consider that there is substantial scope for price reductions and that the remedies would still be proportionate (even if more costly to implement than we have estimated) if they lead to a reduction in prices for microbusiness customers, even if small (we have estimated that the Six Large Energy Firms generated profits in excess of the cost of capital from microbusiness customers of £230 million).
- 9.324 With regards to the Six Large Energy Firms, the package of remedies would need to result in a very small 0.03%¹²⁴² reduction in prices for the benefits to customers to exceed the costs of the package. By comparison, we consider that prices for the microbusiness customers of the Six Large Energy Firms

¹²⁴¹ This position is consistent with the domestic retail markets, which contributes a far greater share of revenues than the microbusiness segments.

¹²⁴² This is the same calculation as used to assess the proportionality for the price transparency remedy and relates to the microbusiness customers of the Six Large Energy Firms.

could have been on average 6% lower between FY 2007 to FY 2014 in a better-functioning market (see paragraph 9.19 above).

- 9.325 We have therefore concluded that the benefits of the remedies package for all microbusiness customers are likely to substantially exceed the costs that it would impose on all suppliers in the microbusiness segments. Consequently, the proposed remedies package would be unlikely give rise to adverse effects that were disproportionate to its legitimate aim.

10. Governance of the regulatory framework

Introduction

- 10.1 Efficient and robust rules and regulations are fundamental to the well-functioning of energy markets. Because of the technical reality of electricity and gas consumption and production, energy markets are highly regulated, and the nature of competition in these markets is shaped by the design of the regulatory regime to a much greater extent than in most other markets.
- 10.2 Government policies – particularly those designed to reduce harmful greenhouse gas emissions – are also having an increasing impact on energy prices and bills. On the basis of current announced plans, climate and energy policies as a whole are expected to add 37% to the retail price of electricity paid by households in 2020. Further, some policies – such as the roll-out of smart meters – are expected to improve energy efficiency and hence reduce energy bills. Given the central role that government policies are expected to play in determining energy bills in the future, we believe it is vital that policy decisions are robust, and informed by a transparent analysis of their impacts on consumers.
- 10.3 In this section, we set out a package of proposed remedies which, by addressing the provisional AECs we have identified, will help to ensure that regulatory and policy decisions in the future are robust, efficient and timely, and driven by a concern for the interests of current and future consumers, wherever appropriate through competition. Our package is based on a ‘reset’ of the current regulatory framework, involving a recalibration of the roles and responsibilities of Ofgem, DECC and industry participants.
- 10.4 Ofgem will be at the heart of this new regulatory framework, with a simpler and clearer focus on competition and the interests of consumers, an additional role to scrutinise and comment on government policies, greater access to relevant financial information from industry and greater powers to drive through changes to industry codes when these are needed to meet broader policy objectives and are in the interests of consumers and competition.

Summary of AECs and features

- 10.5 In our provisional findings, we noted past regulatory interventions that we consider are likely to have led to detrimental outcomes for competition and consumers. We have also identified changes to regulations and policies that we consider would have improved competition and consumer welfare, and yet were not implemented.

- 10.6 We provisionally concluded that a combination of features relating to the overall governance of the GB energy markets, and a combination of features specific to industry code governance, each gives rise to an AEC. This is because these features are likely to increase the risk of policies being developed in the future that are not in consumers' interests, or inhibit the development of policies that are in their interests.
- 10.7 As regards the overall governance of the GB energy markets, we have provisionally found that a combination of features of these markets give rise to an AEC through an overarching feature of a lack of robustness and transparency in regulatory decision-making which, in turn, increases the risk of poor policy decisions which have an adverse impact on competition (the Governance AEC). More particularly, these features are as follows:
- (a) the lack of a regulatory requirement for clear and relevant financial reporting concerning generation and retail profitability;
 - (b) the lack of effective communication on the forecasted and actual impact of government and regulatory policies over energy prices and bills;
 - (c) Ofgem's statutory objectives and duties which, in certain circumstances, may constrain its ability to promote effective competition; and
 - (d) the absence of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making and implementation can be addressed transparently.
- 10.8 As regards industry code governance, we have provisionally found that a combination of features of the GB energy markets give rise to an AEC through limiting innovation and causing the GB energy markets to fail to keep pace with regulatory developments and other policy objectives (the Codes AEC). In particular, we are concerned that the Codes AEC has the impact of limiting pro-competitive change. These features are as follows:
- (a) parties' conflicting interests and/or limited incentives to promote and deliver policy changes; and
 - (b) Ofgem's insufficient ability to influence the development and implementation phases of a code modification process.
- 10.9 Both provisional findings have highlighted what we consider to be inefficiencies in the structure and governance of the regulatory framework for the GB energy markets.

Structure of this section

10.10 The rest of this section sets out:

- (a) our updated assessment of the detriment arising from the provisional AECs we have identified;
- (b) our strategic approach to designing remedies to address these provisional AECs;
- (c) a detailed assessment of the remedies that we are proposing to implement in relation to the governance of the regulatory framework;
- (d) a detailed assessment of the remedies that we are proposing to implement in relation to the governance of industry codes; and
- (e) an assessment of the effectiveness and proportionality of these remedies as a package.

Updated analysis of detriment arising from provisional AECs

10.11 The provisional AECs we seek to address in this section relate to the processes, structures and institutions involved in regulatory decision-making in the energy sector. They – and the features contributing to them – are systemic in nature, having an impact across all of the energy markets that we have investigated. Further, given rapid changes in the regulatory and technological environment, their effects are likely to be felt not just in past regulatory decisions that have harmed customers but in the risk of future decisions that are not in customers' best interests. It is our provisional view, therefore, that, while the detriment arising from these provisional AECs is, by its nature, difficult to quantify, it is likely to be very substantial.

10.12 First, the costs of energy policies – the transfers and subsidies put in place to achieve government policy objectives such as reducing greenhouse gas emissions – will comprise an increasing proportion of customers' energy bills. On the basis of current announced plans, DECC estimates that climate and energy policies will add 37% to the retail price of electricity paid by households in 2020.¹²⁴³

10.13 To take one example of policies that are expected to add to energy prices, the government is set to invest billions of pounds in decarbonising electricity generation over the next few years. The spending cap under the Levy

¹²⁴³ 2014 prices. Source: DECC (November 2014), [Estimated impact of energy and climate change policies on energy prices and bills](#).

Control Framework – which covers the Renewables Obligation, feed-in tariffs and CfDs – began at £3.3 billion for the period 2014/15 and will rise to £7.6 billion for the period 2020/21.¹²⁴⁴ With such large sums of money at stake, suboptimal regulatory design can lead to substantial consumer detriment.

- 10.14 For instance, we provisionally found that the cost of supporting an early form of CfDs (under the FIDeR framework) allocated outside the context of a competitive auction is £250–£310 million per year higher than it likely would have been had the FIDeR projects been awarded CfDs at the auction clearing price – a detriment equivalent to 1% of all customers’ electricity bills (see paragraphs 5.197 to 5.209, in particular 5.201 of our provisional findings report and Section 2 of the present document).
- 10.15 Second, because of the technical reality of electricity and gas consumption and production, energy markets are highly regulated, and the nature of competition in these markets is shaped by the design of the regulatory regime to a much greater extent than in most other markets.
- 10.16 This is particularly the case for wholesale markets, which currently comprise around 50% of the costs faced by electricity and gas customers. In our provisional findings, in addition to our findings on CfDs, we noted evidence of a detriment arising from the absence of charges for transmission losses. Our updated analysis of this detriment, based on NERA’s ongoing work for the CMA (see above in Section 2), supports our provisional finding, and indicates that the absence of locational charges for transmission losses will lead to a cost of between £134 million and £190 million over the period 2017 to 2026.
- 10.17 While in other respects we provisionally found the wholesale gas and electricity markets to be operating at a broadly efficient level, the nature and size of technological and regulatory changes expected over the next few years is such that it is vital that the regulatory framework is sufficiently robust to ensure that competition and customers’ interests are protected in the future. And in retail energy markets, many of the competition problems that we have identified – the settlement systems for gas and electricity, which fail to give suppliers the right incentives and the introduction of the simpler choices component of the RMR rules, which has stifled innovation – are regulatory in nature, reflecting specific provisions in legislation, licence conditions and industry codes.

¹²⁴⁴ National Audit Office (27 November 2013), [The Levy Control Framework](#).

10.18 Within this context, we have noted that a lack of robust evidence and the fragmentation of responsibility between stakeholders (DECC, Ofgem and industry) have led to suboptimal outcomes. Our concern is that the existing institutional and regulatory arrangements in the GB energy markets may lead to future decisions that themselves have adverse effects on competition. While it is not possible to quantify the potential detriment of future decisions which may arise as a result of the current institutional arrangements, the outcomes discussed above provide an indicator of the likelihood and substantial magnitude of this potential detriment.

Strategic approach to remedies design

Overarching aim and principles

10.19 The overarching aim of the remedies that we are considering is to improve the capacity of the regulatory framework to deliver good outcomes for all energy customers. These remedies seek to achieve that aim either by reducing the risk of policies being developed that are not in customers' best interests or by facilitating the development of policies that are in their best interests.

10.20 To meet this objective, we are proposing to implement a range of remedies relating to the roles of regulatory institutions and the relationships between them, the design of key regulatory processes and the provision of information to inform policy decision-making. While the proposed remedies are varied, affecting the full range of regulatory instruments and processes (legislation, licence conditions and industry codes), it is possible to group them under two overarching principles:

(a) well-defined powers, roles and objectives aligned with the best interests of customers; and

(b) robust analysis underpinning decision-making and improving transparency.

10.21 In the rest of this section, we explore aspects of our proposed remedies concerning the Governance AEC, or the Codes AEC, or both, under each of these principles before summarising our proposed revised regulatory framework.

Well-defined powers, responsibilities and objectives aligned with the interests of customers

- 10.22 The regulatory framework governing energy markets comprises a combination of regulatory instruments, each with different decision makers. Policy reforms may be implemented by measures taken by DECC (mainly through legislation), Ofgem (mainly through licence conditions) and the industry (through code self-regulation).
- 10.23 In principle, DECC is responsible for setting policy objectives. This includes for instance the responsibility for setting targets relating to the structure and pace of decarbonisation, for establishing acceptable parameters of security of supply, and for identifying social policy priorities. However, in view of its powers, duties and objectives, Ofgem inevitably also takes decisions which develop further these policy objectives, and go beyond mere implementation. And, as noted in our provisional findings, certain reforms that have substantial impacts on competition and the delivery of policy objectives are carried out through code changes (half-hourly settlement, transmission losses, cash-out reforms), in which industry has a key governance role.
- 10.24 This multi-layered structure of regulation in part reflects the complex nature of the sector and the need to leverage resources and expertise where they can be found. We also recognise that the role of industry in code governance arrangements is influenced by the desire to protect private investors' interests from regulatory instability. However, we are concerned that:
- (a) this fragmentation of responsibility increases the risk that a lack of coordination may lead to inconsistent or even conflicting decisions being made. It also increases the difficulty for both parties and stakeholders of navigating the regulatory framework; and
 - (b) the combination of roles and responsibilities leads to some parties – notably industry participants – having a role in decision-making but facing incentives that are not always aligned with those of consumers.
- 10.25 In relation to the incentives of industry participants, we note that these often differ between firms, leading to lengthy and costly regulatory processes and delays in decision-making. Examples of this include the long-running deliberations over whether to introduce locational charges for transmission losses over the past 25 years, which we documented in our provisional findings report.
- 10.26 We are also surprised to note some decisions that appear to us to be fundamental to ensuring effective competition appear to be loosely governed

under the industry codes, and not to have involved any formal role for Ofgem. For example, in relation to competition for customers on prepayment meters we understand, based on the relevant provisions set out in the Supply Point Administration Agreement,¹²⁴⁵ and parties' submissions,¹²⁴⁶ that there are no formal mechanisms in place to monitor the allocation of gas tariff pages and to govern the distribution of tariff pages between suppliers.¹²⁴⁷ This is of particular concern since the lack of access to gas tariff pages has been one of the factors inhibiting new entry into, and growth within, the prepayment segments, to the detriment of customers. Given the importance of gas tariff codes in entering, and growing within, both the gas and electricity prepayment segments, we consider it essential that Ofgem should control their allocation.¹²⁴⁸

10.27 We accept that each stakeholder has a role to play in designing and policing the regulatory framework of the energy markets, and that the delineation between these roles may not always be clear-cut. However, we believe that the current regime can be improved by ensuring that the roles, responsibilities and statutory duties of each stakeholder are clearly defined and aligned with the interests of customers.

10.28 Our proposed remedies seek to address these concerns through three related measures:

- (a) a recalibration of the current regulatory framework to create clear and consistent roles and objectives for decision makers at the various levels of regulation, aligned with the best interests of customers;
- (b) a reinforcement of the role of an independent and authoritative regulator; and
- (c) a clear assignment of responsibilities and transparent, coordinated implementation.

Clear and consistent objectives, aligned with the best interests of customers

10.29 In our provisional findings, we identified concerns relating to a lack of clear and consistent objectives that were aligned with the best interests of customers. In particular, with respect to the Codes AEC, our proposed remedies seek to address these features by giving greater power and

¹²⁴⁵ Specifically paragraph 2.14 of the Supply Point Administration Agreement.

¹²⁴⁶ In response to the addendum to provisional findings or to requests for information.

¹²⁴⁷ Siemens put to us that, in the absence of 'spare' tariff pages, a request for a tariff page could only be satisfied when another supplier released one of its tariff pages.

¹²⁴⁸ See further details in Section 3 and our proposed remedies in Section 5.

responsibility to Ofgem to influence the code modification process, to ensure that the decisions that are taken are fully aligned with the interests of customers. The remedies include (for more details see paragraphs 10.351 to 10.439):

- (a) new responsibilities for Ofgem to produce a strategic direction and a set of strategic work plans for code modifications;
- (b) new responsibilities for Ofgem and new powers for licensed code administrators to initiate and prioritise code changes for the purposes of delivering this strategic direction; and
- (c) the creation of a backstop executive power to allow Ofgem to ‘call in’ an ongoing strategically important code modification.

10.30 We also noted in our provisional findings that Ofgem’s objectives and duties could be considered to be unclear and in need of clarification (see paragraphs 11.54 and 11.63). It is one of the features that contributes to the Governance AEC that we have provisionally found. One of our proposed remedies (see paragraphs 10.51 to 10.79) seeks to address this feature by removing from Ofgem’s objectives and duties unnecessary constraints that may prevent it from pursuing its primary objective of meeting the needs of current and future consumers wherever appropriate by promoting competition.

An independent and authoritative regulator

- 10.31 As the above discussion suggests, our proposed remedies will give greater powers and responsibilities to Ofgem, particularly in relation to code governance. In light of this we consider it particularly important that Ofgem is both independent in practice and perceived to be independent from both government and industry.¹²⁴⁹ It is also key that Ofgem be regarded as authoritative, and able to answer the range of questions stakeholders may have about the effectiveness of competition in energy markets.
- 10.32 We noted in our provisional findings report that two of Ofgem’s most important decisions in recent years (neither of which we consider to be fully in customers’ best interests)¹²⁵⁰ were taken against a backdrop of DECC taking powers – or stating its readiness to take powers – to implement changes in primary legislation in the event that Ofgem did not act, and that

¹²⁴⁹ See below paragraph 10.88.

¹²⁵⁰ The introduction of the simpler choices component of the RMR reforms in 2013 and of SLC 25A in 2009, prohibiting regional price discrimination.

the coincidence of DECC and Ofgem's actions risked creating the perception of a lack of independence on the part of Ofgem.

- 10.33 To bolster the perception of Ofgem's independence, we propose to introduce a remedy concerning the Governance AEC that would empower and require Ofgem to comment transparently on DECC policy proposals, expressing its views publicly on the relative merits and potential impacts of such proposals. We believe that this would be in the interests both of transparency and of confidence in Ofgem as an independent body. We also consider that our proposed remedies to require Ofgem to publish periodic assessments of the impacts of government policies (discussed below) would bolster its perception by stakeholders as an independent, authoritative regulator.
- 10.34 We are aware that certain of Ofgem's decisions have been the subject of some criticism in recent years – and indeed we have provisionally found that some of its decisions give rise to AECs. However, we believe that, with the powers and responsibilities created by our proposed remedies and with the current leadership it has in place, it can reinforce its position as an independent, authoritative regulator, trusted by – but independent of – both government and industry and acting in the interests of current and future consumers.

Clear ownership of policies and transparent, coordinated implementation

- 10.35 We believe that the absence of mechanisms to coordinate government policy objectives, Ofgem's current objectives and duties, and the objectives and processes enshrined in industry codes are likely to lead to inconsistent approaches being taken to policy development.
- 10.36 The obvious risk of this fragmentation of decision-making power is a lack of coordination in decision-making and implementation, leading to incoherent outcomes. In our provisional findings report, we identified a few instances in which the implementation of policy goals was delayed or suboptimal due to a lack of coordination between DECC, Ofgem and the industry (see paragraphs 10.130 to 10.156). We therefore believe it is essential to improve the clarity of both the overarching policy objectives for the regulatory framework and to ensure that all stakeholders are given clear direction as to the implementation of these policy objectives.
- 10.37 We believe that policy objectives should be clearly stated by DECC (following consultation with Ofgem and the industry). In turn, mechanisms should be in place in order to ensure that these objectives are reflected in the decision-making processes, and that their achievement is regularly assessed. We acknowledge that steps have already been taken in this

respect (with DECC having now the power to designate a Strategy and Policy Statement), but believe that further actions need to be taken.

- 10.38 In particular, through our proposed remedies concerning both the Governance AEC and the Codes AEC, we seek to increase coordination and transparency of interactions between the different levels of powers. We expect DECC to take responsibility for the full implementation of its policy decisions, by ensuring that all the necessary analysis and implementation steps are being taken by the appropriate stakeholders (including modification to licences or industry codes where necessary). Similarly, Ofgem should actively and transparently make its expertise available to DECC, and should be held ultimately responsible for the outcomes arising from regulation through standard licence conditions and industry codes (including ensuring that the scope of industry-led regulation and the supervision of it is appropriate).
- 10.39 More specifically, our proposed remedies concerning both the Governance AEC or the Codes AEC, or both, provide, among other things, for:
- (a) mechanisms facilitating coordination (such as action plans and joint statements) where interventions from different stakeholders are required to achieve a particular objective, with a view to avoiding delayed or sub-optimal implementation;
 - (b) mechanisms empowering Ofgem to comment transparently on DECC policies, with a view to contributing their expertise; and
 - (c) an efficient process, for which Ofgem is ultimately responsible, to deliver in a timely manner industry codes changes which are in line with broader policy objectives.

Robust analysis underpinning decision-making and improving transparency

- 10.40 To ensure that energy regulations serve customers' needs, it is vital that policy decisions are informed by robust analyses of their likely impacts. We believe that, because of the magnitude of their impact and their complexity (as discussed above), interventions in the energy markets will require a particularly detailed level of analysis. Our provisional findings suggest that existing processes have on occasion been insufficient as we have identified a number of instances where regulatory interventions have led to poor outcomes for consumers (see our provisional findings report, paragraphs 11.39 to 11.44, and 11.51).
- 10.41 In particular, we believe that negative outcomes might have been caused by difficulties in assessing the impact of the regulatory framework on energy

prices and bills, ineffective collaboration between stakeholders in cases of disagreements, and a lack of relevant financial information. We believe that the risk of poor outcomes may be reduced (and the features giving rise to the Governance AEC addressed, in part) by setting up mechanisms that:

- (a) facilitate transparent exchanges between DECC and Ofgem over policy decision-making and implementation, so as to address disagreements and facilitate consultation with the industry;
- (b) ensure the performance of robust and authoritative analysis of the overall impact of the regulatory framework, taking into consideration the aggregate costs and impacts of policies on the various policy objectives; and
- (c) ensure that decision-making relies upon relevant financial information.

10.42 Through our proposed remedial action concerning the Governance AEC we also seek to ensure that mechanisms be put in place with a view to monitoring the markets on an ongoing basis, and in particular with a view to creating and/or communicating effectively:

- (a) robust and authoritative analysis of the overall impact of the energy regulatory framework on different policy objectives, notably decarbonisation, security of supply and affordable prices; and
- (b) a clear transparent understanding of key aspects of markets outcomes (we noted in paragraphs 11.8 to 11.21 of our provisional findings report that there has been in recent years a lack of shared understanding about key elements of the evidence base such as the price and bill impacts of policy objectives and of energy firms' profitability).

10.43 In addition, we believe that the ex post review of individual policies, as required by the *Better Regulation Framework Manual*¹²⁵¹ is essential in this area. These changes would allow DECC and Ofgem to identify areas where interventions are required, either by removing/amending previous interventions or by adjusting contemplated policies in order to prevent overlaps or conflicts between interventions.

10.44 In order to better understand the interaction between interventions taken by different stakeholders, and facilitate the assessment of their cumulative impacts, we also believe it is appropriate to ensure that the frameworks for analysis used over time and across decisions are consistent and easily

¹²⁵¹ See [Better Regulation Framework Manual: Practical Guidance for UK Government Officials](#) (latest version March 2015, currently being updated).

comparable. Transparent discussions between DECC, Ofgem and the industry would in our view facilitate such consistency. In particular, as discussed in more detail below, we have provisionally decided to recommend the following with a view to addressing, in part, the features giving rise to the Governance AEC:

- (a) Setting up a clear process for Ofgem to comment publicly on draft primary and secondary legislation that is relevant to its objectives and duties.
- (b) Pursuant to the principles set out in the *Better Regulatory Framework Manual*, DECC should review regularly the impact of its policies; the level of scrutiny should depend on the impact of each policy on business and consumers.
- (c) Ofgem should publish annually a state of the market report which would provide analysis regarding issues such as:
 - (i) the evolution of energy prices and bills over time;
 - (ii) the profitability of key players in the markets;¹²⁵²
 - (iii) the social costs and benefits of policies;
 - (iv) the impact of initiatives relating to decarbonisation and security of supply;
 - (v) the trade-offs between policy objectives resulting from the extant regulatory framework; and
 - (vi) the trends for the forthcoming year.

10.45 In order to support these three proposed remedies, we have provisionally decided to recommend Ofgem to:

- (a) enhance the existing regulatory reporting obligation pursuant to which certain firms must submit financial reports to Ofgem; and
- (b) create a new internal unit within Ofgem (eg an office of the chief economist), which would build expertise across the different areas of the energy markets with a view to performing some of the tasks above.

¹²⁵² Specifically those firms which are required to comply with the regulatory accounting reporting obligation (see paragraph 10.218).

Overview of the proposed new regulatory framework

- 10.46 Our proposed remedies concerning the Governance AEC and the Codes AEC are individually incremental but in combination represent a substantial reform package. They represent a ‘reset’ of the regulatory framework governing the energy sector, clarifying and recalibrating the roles and responsibilities of Ofgem, DECC and industry to help ensure that regulatory and policy decisions in the future are robust, efficient and timely, and driven by a concern for the interests of current and future consumers.
- 10.47 Ofgem will be at the heart of this new regulatory framework, with a simpler and clearer focus on the interests of consumers, an additional role to scrutinise and comment on government policies, greater access to relevant financial information from industry and greater responsibility to drive through changes to industry codes when these are needed to meet broader policy objectives and are in the interests of consumers and competition.
- 10.48 We believe that the two overarching principles informing our proposed remedies package are mutually reinforcing. For example, the roles given to Ofgem to comment on and scrutinise the impacts of government policies on the one hand, and undertake greater scrutiny of companies’ financial returns on the other, will help both to:
- (a) improve the robustness of the decision-making process, the quality of regulatory decisions and transparency in public debates about energy; and
 - (b) bolster the perception of Ofgem as an authoritative, trusted and independent regulator, consistent with the greater responsibilities it will have in relation to code governance and reform.
- 10.49 We also consider that our proposed reforms are fully consistent with the government’s *Principles for Economic Regulation*¹²⁵³ and its *Better Regulation Framework Manual*. In particular, our proposed remedies should ensure that new policy proposals and existing policies and regulations are subject to robust scrutiny in terms of their costs and benefits. Further, our proposed remedies to the code governance process and mechanisms to improve coordination between DECC and Ofgem should serve to streamline and rationalise the policymaking process.
- 10.50 We are aware that industry self-regulation is sometimes considered a ‘light-touch’ approach to regulation. However, in our provisional view, the existing

¹²⁵³ BIS (April 2011), [Principles for Economic Regulation](#).

model of industry-led code modifications has often led to burdensome and time-consuming processes that have served to impede pro-competitive change. We believe that by giving Ofgem greater responsibilities to proactively intervene where necessary to help deliver agreed policy goals and benefit consumers, our proposed reforms will substantially reduce regulatory burdens.

Governance of the overarching framework

Revision of Ofgem's statutory duties and objectives

- 10.51 We have noted that one of the features giving rise to a lack of robustness and transparency in regulatory decision-making is Ofgem's statutory objectives and duties which, in certain circumstances, may constrain its ability to promote effective competition. In particular, we noted that Ofgem considered that its duty to pursue its principal objective by 'wherever appropriate promoting effective competition' had been progressively downrated relative to other duties over the last ten years.
- 10.52 Ofgem's perception that its duty to promote competition has been downrated is a significant cause for concern, as it implies that Ofgem's ability to promote competition may be constrained. We noted that this view is supported by the amendment to Ofgem's principal objective and duties brought about by the Energy Act 2010 (EA10) (see Appendix 10.1), and by some interventions during the Parliamentary debate. This change qualified Ofgem's duty to promote competition in a way that may constrain Ofgem's margin of appreciation when deciding the best calculated manner to carry out its functions.
- 10.53 In our Remedies Notice, we proposed that Ofgem's statutory objectives and duties be revised.

Aim of the remedy

- 10.54 The aim of this proposed remedy is to clarify Ofgem's statutory objectives and duties in order to remove any constraint (actual or perceived) on Ofgem's ability to pursue its principal objective (protecting the interests of existing and future consumers) by promoting effective competition. The proposed change would increase the robustness and transparency of Ofgem's regulatory interventions and, in turn, contribute to remedying the Governance AEC that we have provisionally identified.

Parties' views

- 10.55 Most parties broadly agreed with our assessment that changes made by the EA10 to Ofgem's principal objective and duties may constrain Ofgem's ability to promote competition and to carry out efficient trade-offs between competing objectives, and that a revision of Ofgem's statutory objectives and duties is necessary (or at least they acknowledged that it would be beneficial) to assist Ofgem in regulating the market.¹²⁵⁴ Centrica said that it had observed a shift in Ofgem's regulatory approach, away from the promotion of effective competitive markets as the primary way of furthering the interests of consumers. Several respondents said that competition should be the principal mechanism by which Ofgem achieved its duties.
- 10.56 However, a few consumer bodies (ie Which?, National Energy Action) expressed concern in relation to the proposed remedy. In particular, Which? welcomed the proposed remedy but stated that a revision of Ofgem's objectives and duties should not lead to a 'downgrading of Ofgem's duty to protect consumers'. Citizens Advice/Citizens Advice Scotland said that no evidence had been presented to substantiate the argument that changes to Ofgem's statutory duties made in the EA10 had constrained its ability to promote competition and whether they had either positively or negatively affected subsequent regulatory decisions.
- 10.57 Some respondents argued that the role of promoting competition had not been materially diminished by the EA10, given that the current hierarchy of duties does not preclude Ofgem from promoting competition (Northern Powergrid, Ovo Energy) and therefore that statutory change was not necessary to enable Ofgem to promote competition. However, Ovo Energy stated that Ofgem should have 'a greater focus on competition matters from a principle-based approach'.
- 10.58 Those respondents that support a revision of Ofgem's statutory objectives and duties were broadly in favour of a revision that would increase the emphasis on Ofgem's duty to achieve its objective by promoting effective competition.
- 10.59 Various respondents (including EDF Energy, Centrica, E.ON and RWE) suggested that a reinstatement of the configuration of Ofgem's objectives and duties that existed prior to the EA10, as suggested by the CMA in the Remedies Notice, would be effective. EDF Energy noted that this would

¹²⁵⁴ See for instance ESB; Genserv; Good Energy; InterGen; Energy UK; First Utility; Spark Energy; EDF Energy; RWE; Centrica; SSE; Scottish Power.

(a) re-establish the promotion of competition as the principal objective, and (b) remove wording that diluted the emphasis on competition (in particular s16(3)(1C) EA10).¹²⁵⁵ Centrica went one step further, suggesting not only to remove Ofgem's current duty to consider means other than competition before proceeding with a course of action, but also to include in Ofgem's statutory objectives and duties a requirement to 'seek to further the Principal Objective wherever possible by promoting competition' (rather than 'wherever appropriate', as it is currently the case).

Design considerations

- 10.60 Ofgem's objectives and duties are set out in section 4AA of the GA86 and in section 3A of the EA89 (see our provisional findings report, Appendix 10.1). These sections are focused on the principal objective of protecting the interests of existing and future consumers, although recognising the existence of multiple subsidiary duties and objectives underpinning the principal objective.
- 10.61 It is up to Ofgem to decide how to pursue its principal objective, provided that, as currently set out in the GA86 and the EA89, its principal objective is achieved 'wherever appropriate by promoting effective competition'. As noted in paragraph 11.60 of our provisional findings report, this requirement gives Ofgem a wide margin of appreciation as to when it is appropriate to pursue its principal objective by promoting effective competition.
- 10.62 However, as noted in paragraphs 11.53 to 11.57 of our provisional findings report, Ofgem has expressed concerns with regard to its current objectives and duties, noting that its competition duty had been progressively downrated relative to other duties over the last ten years.
- 10.63 We noted in this respect that Ofgem's objectives and duties were amended by the EA10 (see Appendix 10.1) which, among other things, inserted in both current sections 4AA of the GA86 and 3A of the EA89 a new paragraph 1C as follows:

(1C) Before deciding to carry out functions under this Part in a particular manner with a view to promoting competition as mentioned in subsection (1B), the Secretary of State or the Authority shall consider—

¹²⁵⁵ See EDF Energy response to the Remedies Notice, August 2015, paragraph 16.6.

(a) to what extent the interests referred to in subsection (1) of consumers would be protected by that manner of carrying out those functions; and

(b) whether there is any other manner (whether or not it would promote competition as mentioned in subsection (1B)) in which the Secretary of State or the Authority (as the case may be) could carry out those functions which would better protect those interests.

10.64 The additional requirement set out by this paragraph in both the GA86 and the EA89, qualifies the words ‘wherever possible by promoting effective competition’ in a way that may constrain (or at least create the perception of constraining) Ofgem’s margin of appreciation. It imposes an additional procedural requirement on Ofgem when it decides to achieve its principal objective through competition, ie a duty to consider whether there is any other manner in which it could carry out its functions.

10.65 The Parliamentary debate shows that an underlying rationale of the EA10 reform to Ofgem objectives and duties was a concern that, in general, Ofgem pursued consumers’ interests exclusively through competition, and did not sufficiently consider whether other measures would have been more appropriate in the short term. For instance, Ed Miliband described the aim of the draft Bill as being to ‘change Ofgem’s remit to reflect the fact ... that relying on competition alone is insufficient to provide the consumer protection that we need.’¹²⁵⁶ In a similar vein, Lord Hunt interpreted the impact of this reform as making ‘it clear that, where consumer interests are threatened, Ofgem must consider measures other than the promotion of competition in order to rectify the situation.’¹²⁵⁷

10.66 We consider that Ofgem’s duty to pursue its principal objective by ‘wherever appropriate promoting effective competition’ grants it an appropriate level of discretion to determine on a case-by-case basis whether promoting consumers’ interests is best achieved through competition or by other means, and what procedural steps need to be taken for that purpose.

10.67 Therefore, in our view, it is appropriate to remove any unnecessary actual or perceived constraint on Ofgem’s discretion in this context. To this end, we propose to delete paragraph 1C from sections 4AA of the GA86 and 3A of the EA89.

¹²⁵⁶ House of Commons debate, 24 November 2009.

¹²⁵⁷ Second reading at the House of Lords, 23 March 2010.

- 10.68 For the avoidance of doubt, the purpose of this proposed remedy is not to constrain Ofgem's ability to carry out its functions in any manner which it considers is most likely to further the principal objective. We acknowledge that in certain circumstances the best way of protecting consumers' interests may be achieved by a means other than through competition. We therefore do not believe, as some parties have suggested, that competition should be given explicit priority as the preferred mechanism by which Ofgem should seek to achieve its principal objective, and this is reflected in our provisional decision to recommend a return to a form of wording closer to the one pre-EA10. It is our view that the wording 'wherever appropriate by promoting effective competition' puts sufficient emphasis on the role of competition within this context, and any further emphasis might unnecessarily constrain (or even preclude) Ofgem's ability to pursue its principal objective by means other than competition.
- 10.69 Most respondents to our provisional findings report and Remedies Notice have either supported this approach or at least acknowledged that there would be some benefits in clarifying the role of competition, relative to other types of regulatory interventions, in pursuing consumers' best interests.
- 10.70 As a consequence, subject to the deletion of paragraph 1C from sections 4AA of the GA86 and 3A of the EA89, we are not minded to recommend any further amendment to Ofgem's principal objective and duties (and in particular to the words 'wherever appropriate by promoting effective competition') which would seek to reinforce the emphasis on competition. Such an amendment is, in our view, not necessary and may, on the contrary, cause further confusion. As noted above, it is Ofgem's role to identify the best way in which to carry out its functions, and to decide which steps it needs to take in order to reach a view on this.
- 10.71 Therefore, we have provisionally decided to recommend that DECC initiate a legislative process in order to delete paragraph 1C from both sections 4AA of the GA86 and 3A of the EA89.
- 10.72 In practice, as this proposed remedy is not time sensitive, it is not necessary in our view to initiate a legislative process for the purpose of this remedy only. Instead, a provision to that end can be included within the next draft energy act (or any relevant omnibus bill).

Assessment of effectiveness

- 10.73 Pursuant to our guidelines, we assess below the effectiveness of this proposed remedy, and in particular:

- (a) whether this remedy is effective in contributing to the achievement of our remedial action;
 - (b) whether this remedy is capable of effective implementation; and
 - (c) the timescale over which the remedy measures will take effect.
- 10.74 By removing from Ofgem's principal objective and duties a requirement to consider, before promoting competition, whether there is any other manner in which it could carry out its functions, this remedy would be effective in removing unnecessary procedural and substantive constraints on Ofgem's ability to pursue its principal objective. The amended statutory objectives and duties, reverting to the balance set by the words 'wherever appropriate by promoting effective competition', would put an appropriate emphasis on Ofgem's duties to promote competition (see in particular paragraph 10.66 above). This, in turn, will address one of the features giving rise to the Governance AEC.
- 10.75 For the reasons set out in paragraph 10.72, we consider that this proposed remedy is capable of effective and timely implementation by way of a legislative change to be initiated by the government. In this respect, we note that the government has made a commitment to give a public response to any recommendation made to it within 90 days of the publication of a CMA report.¹²⁵⁸
- 10.76 This remedy would be implemented through a change in legislation.

Assessment of proportionality

- 10.77 For the reasons, set out above, we believe that this proposed remedy would be effective in achieving its aim.
- 10.78 For the reasons set out above (see in particular paragraph 10.68), we believe that this proposed remedy is no more onerous than necessary to achieve its aim. We have not identified other remedies that would be effective.
- 10.79 The incremental cost of the legislative process as envisaged in paragraph 10.72 above would be very low.

¹²⁵⁸ See [CC3](#), paragraph 95.

Improving coordination between Ofgem and DECC on policy design and implementation

- 10.80 Responsibility for setting up the legal framework and regulating the GB energy markets is shared between different public bodies (principally DECC and Ofgem) and the industry itself (with respect to certain areas that are self-governed through industry codes). In some cases, the implementation of a particular energy policy requires a combination of measures taken by DECC (mainly through legislation), Ofgem (mainly through licence conditions) and the industry (through the amendment of codes). In our provisional findings, we identified concerns relating to the overlap of DECC's and Ofgem's functions and the interaction between measures adopted independently by DECC and Ofgem. For example, we highlighted the inefficiency of disjunctive implementation processes of DECC and Ofgem in the context of moving to 17-day switching and P272 (half-hourly settlement of certain category of customer). (Similar issues relating to industry codes are addressed separately below.)
- 10.81 In our provisional findings, we found that institutional pressure by DECC might have been one of the factors behind certain decisions taken by Ofgem that we consider were not in the best interest of customers.
- 10.82 We noted that Ofgem's decisions to implement SLC 25A and certain of the RMR rules were taken against a backdrop of DECC taking powers – or stating its readiness to take powers – to implement changes in primary legislation in the event that Ofgem did not act. We do not know how material this context was in influencing Ofgem, but we noted that the coincidence of DECC's and Ofgem's actions risked creating the perception of a lack of independence on the part of Ofgem.
- 10.83 We noted that it is always possible that DECC and Ofgem will disagree on a particular area of policy, but noted that where such disagreements did occur, it would be preferable if there were a mechanism through which such disagreements could be surfaced transparently and that such a mechanism would mitigate the perception of a lack of independence.
- 10.84 We also noted cases¹²⁵⁹ in which the implementation of policy goals had been delayed (or suboptimally implemented as a result of inconsistencies between regulations) due to a lack of coordination between DECC, Ofgem

¹²⁵⁹ See, for instance, 17-day switching and half-hourly settlement as examples of delayed implementation. DECC's capacity market reform and Ofgem's EBSCR code modification provides an example of insufficient consideration of the interplay between different policies.

and the industry. Our expectation would be that there should be mechanisms in place to mitigate these risks.

- 10.85 We provisionally concluded that these shortcomings were a feature of the GB energy markets that contributed to the Governance AEC.
- 10.86 To address these issues, we proposed in the Remedies Notice two possible mechanisms to increase the transparency and effectiveness of the relationship between DECC and Ofgem, ie:
- (a) an ex ante mechanism allowing Ofgem to set out its views on particular DECC policy proposals; and
 - (b) a mechanism allowing Ofgem to seek formal directions from DECC with respect to certain regulatory interventions.

Aim of the remedy

- 10.87 The proposed remedy should seek to facilitate rational debate between DECC, Ofgem and the industry, and promote regulatory stability. The benefits would be twofold. This package would, on the one hand, contribute to increasing the robustness and transparency of DECC's and Ofgem's decisions and, on the other hand, reduce the risk of inefficient implementation of policy decisions.
- 10.88 In the Remedies Notice we also noted, for the reasons set out in paragraphs 11.75 and 11.76 of the provisional findings report, that preserving Ofgem's independence, both actual and perceived, is essential to the well-functioning of the energy markets. The broad rationale for the creation of independent economic regulators in privatised sectors of the economy is to provide greater certainty to potential investors that they will have a reasonable opportunity to earn a return on their investments if they operate efficiently. The expectation is that delegating authority over certain decisions to an independent, technocratic authority that will make decisions according to a clear set of criteria established in advance will reduce ex ante estimates of the risks of investment and hence the return on investment investors will require. In a competitive market, the benefits arising from a reduced cost of capital should in turn be passed through by energy suppliers to customers.

Parties' views

- 10.89 Many parties welcomed the CMA's assessment of the issues arising from the overlap of DECC's and Ofgem's roles. Some parties also expressed explicit support for the proposed remedy.

- *Views on Ofgem being able to comment on DECC policies*

- 10.90 Nine parties suggested that Ofgem should be able to comment on some of DECC's policies, but there were mixed views as to the potential scope of this remedy. Most respondents suggested a fairly broad remit. Centrica said Ofgem should be able to express views on any DECC policy as with any other interested market participant. It also stated that where Ofgem believed that a DECC policy conflicted with the objective of promoting competition, it should also issue an open letter to DECC setting out its view in full, with an obligation on DECC to respond. RWE felt that Ofgem should have the right and duty to submit comments to DECC in the context of an impact appraisal of policies that were likely to affect competition. Scottish Power argued that it was appropriate for Ofgem to express views where a DECC policy had a bearing on Ofgem's regulatory functions, and in particular in case of conflicts with its statutory objectives.¹²⁶⁰ Similarly, EDF Energy argued that this right/duty should relate to Ofgem's statutory duties.
- 10.91 Other parties (Flow Energy, Ecotricity and National Energy Action) also suggested that Ofgem should be able to comment on a wide range of DECC's policies. E.ON, however, proposed a narrower scope, suggesting that Ofgem's comments should be confined to issues relating to the delivery of policies. Indeed, E.ON noted that the government has a democratic mandate and that it should not be for an independent regulator to challenge the broad aspects of policies.
- 10.92 Scottish Power also noted that although Ofgem's views should normally be made public in the interest of transparency, this should not preclude informal dialogue between Ofgem and DECC while such policies were being formulated.¹²⁶¹
- 10.93 E.ON and Flow Energy suggested that DECC should have to respond to any Ofgem comments on policy.

- *Views on formal direction from DECC to Ofgem*

- 10.94 Few parties expressed clear support for Ofgem having the right to seek a formal direction from DECC. For Centrica, this right should only be used where it found that any policy promoted by DECC conflicted with its duties; and for RWE, only where Ofgem was implementing a decision or policy promoted by DECC which was likely to deliver outcomes that deviated from those expected to result from the operation of effective competition (in which

¹²⁶⁰ See Scottish Power response to Remedies Notice, paragraphs 17.3 & 17.4.

¹²⁶¹ See Scottish Power response to Remedies Notice, paragraph 17.4.

case such directions and the reasons for making them should be made public).

10.95 A majority of parties argued that there was no need for Ofgem to seek a formal direction from DECC to implement a certain policy. Some of these parties noted concerns about the risk of undermining Ofgem's independence and weakening the accountability of its regulatory decisions¹²⁶² (eg EDF Energy and E.ON) or suggested this could be an issue but highlighted EU requirements for national energy regulators to operate independently of government (Centrica and Citizens Advice/Citizens Advice Scotland, and Scottish Power¹²⁶³). RWE, however, suggested that if the mechanism was implemented properly ensuring sufficient independence and compliance with EU requirements for national energy regulators, then such a measure could significantly strengthen Ofgem's independence and perceived independence and would help to drive out the uncertainty RWE and others had experienced in recent years arising out of government intervention in regulatory processes.

10.96 Some parties offered comments on how to make the proposal for a formal direction work in practice. For example, Centrica suggested that any specific DECC direction should be in direct response to a request for direction from Ofgem (and remain within the bounds of such a request). Ecotricity suggested that any direction must always be subject to consultation and impact assessment.

- *Views on the relationship between DECC and Ofgem*

10.97 Although our proposed remedy to set up a formal mechanism for Ofgem to seek direction received limited support, most respondents acknowledged the need for greater transparency in the relationship between DECC and Ofgem and increasing clarity on their respective roles. SSE suggested that 'introducing a formal mechanism for DECC/Ofgem policy reconciliation would increase transparency and improve the quality of public debate and policy decision-making'. Centrica expressed broad support for remedies which 'clarify roles and responsibilities, and improve the transparency of regulatory decision making.' Centrica noted that DECC's responsibility for setting overall energy policy and Ofgem's role in overseeing and maintaining competitive markets and the regulatory framework had been blurred at times.

¹²⁶² EDF Energy response to Remedies Notice, paragraph 17.5.

¹²⁶³ See Scottish Power response to Remedies Notice, paragraphs 17.5–17.10.

- 10.98 Other parties and stakeholders expressed support for a clear separation of Ofgem's and DECC's roles (Energy UK, ESB, University of Exeter, Changeworks, CBI and the Highland and Islands Housing Association). In this respect, Ovo Energy¹²⁶⁴ stated that it would support anything that promoted greater regulatory and policy certainty. Scottish Power was not supportive of a remedy in the form proposed because it considered it might reduce the independence of the regulator. It also argued that the precise timing and history of any government influence on particular Ofgem's decisions (in respect of SLC 25A and the RMR tariff rules) was unclear and the remedies proposed by the CMA would be unlikely to have prevented it.
- 10.99 Five parties referred to the Strategy and Policy Statement as an existing mechanism that could help to establish clearer boundaries between DECC and Ofgem. These parties included Ofgem, which stated that the Strategy and Policy Statement was 'one important route for providing more clarity over our respective roles'. EDF Energy argued that although a Strategy and Policy Statement had yet to be formally adopted by the government, it could provide an 'opportunity to promote regulatory certainty and increase alignment between the Government's energy policy objectives and the way in which Ofgem regulates the sector.'¹²⁶⁵ Similarly, the University of Exeter suggested it would be helpful for 'the Government to resurrect the discussion surrounding its SPS (Strategy and Policy Statement)' because 'the process of setting out key relationships and responsibilities between DECC and Ofgem would provide a useful framework.' For Citizens Advice/Citizens Advice Scotland, the Strategy and Policy Statement's effectiveness in this respect would be limited because it would likely only contain high-level rather than detailed content on policy design and would only be infrequently updated, resulting in content gaps.
- 10.100 Some parties made more general comments about the value of introducing some form of document setting out the roles of DECC and Ofgem in the energy markets. Gazprom said it would support a framework which would set out details as to the development of policies, the cost/benefit analysis undertaken and any disputes arbitrated. First Utility suggested that such documents could take the form of a Memorandum of Understanding 'covering how Ofgem and DECC will work within their respective remits and where these meet, setting out best practice for handling this.'

¹²⁶⁴ See Ovo Energy response to provisional findings and Remedies Notice, p32.

¹²⁶⁵ See EDF Energy response to Remedies Notice (August 2015), paragraph 17.7.

Design considerations

10.101 As noted above, the aim of the proposed remedies package is:

(a) to increase the robustness and transparency of DECC's and Ofgem's decisions; and

(b) to reduce the risk of inefficient implementation of policy decisions.

10.102 Having reviewed parties' responses to the Remedies Notice, we remain convinced that mechanisms allowing clearer roles for Ofgem and DECC, and transparency as to their interactions, would improve the robustness and transparency of policy decisions. This would include the proposal to require Ofgem to comment on policy proposals and draft legislation that is relevant to Ofgem's statutory objectives and duties.

10.103 However, for the reasons set out below, we consider that a mechanism allowing Ofgem to seek a direction from DECC as to how to use its power would be ineffective and could have unintended consequences. We have therefore considered alternative mechanisms that would pursue the same objective, by clarifying the respective roles and responsibilities of DECC and Ofgem, and by improving the coordination of their powers and interventions when implementing policies.

Ofgem's duty to comment on draft primary and secondary legislation relating to the GB energy markets regulatory framework

10.104 Under the current regulatory framework,¹²⁶⁶ Ofgem has a duty, when expedient or requested by government, to give information, advice and assistance with respect to any matter in respect of any function of Ofgem under the GA86 and EA89. Moreover, it has the power to publish any advice or information if it appears to Ofgem that such publication would promote the interests of consumers. This effectively enables Ofgem to comment on any government draft statutory instrument, and to respond to any public consultation, when it considers it relevant to any of its functions.

10.105 Ofgem and DECC have put to us that, in practice, Ofgem provides such advice or information in relation to draft policy instruments on an ad hoc basis by means of private letters at staff level. It is, however, unusual for Ofgem to publish these letters, or even to provide a summary of the interactions between Ofgem and DECC. In our view, the absence of an established practice by which Ofgem publishes views on DECC's policy

¹²⁶⁶ See, in particular, sections 34 & 35 of the GA86 and 47 & 48 of the EA89.

proposals (and of any Ofgem statement providing a framework for such publications), is not in the interests of transparency and an informed public debate.

10.106 Further, because such public statements are rare, there is a risk that, if Ofgem wished to make public comments on a particular proposal in the future, the significance of any concerns that it raised would be overstated in the public debate. In turn, awareness of this risk may effectively cause Ofgem's officials to err on the side of caution by keeping both technical and substantive comments private.

10.107 In order to increase transparency in policy making – and help underpin Ofgem's independence – we believe Ofgem should publicly comment on relevant draft legislation and policy proposals in a systematic way. In particular, where relevant, Ofgem should highlight the potential impacts of policy proposals, and expose any challenges or technical difficulties relating to implementation. By publishing such views (referred to hereafter as *Opinions*), it would openly contribute its technical expertise to the design of policy initiatives with a view to making the decision process more robust. It would also open a transparent discussion between DECC and Ofgem, which would help to air differences and, by doing so, highlight areas potentially requiring further analysis or future reviews. The publication of such *Opinions* would serve to ensure a more coherent regulatory process, and reduce the risk of suboptimal policy implementation due to a lack of coordination, as indicated in paragraph 11.66 of the provisional findings report.

- *Scope of Opinions*

10.108 Parties have made several suggestions as to the circumstances in which it would be appropriate for Ofgem to comment publicly on draft policies. We would expect Ofgem to comment publicly on the expected impacts of policy initiatives that are relevant to Ofgem's statutory objectives and duties.

10.109 Moreover, in order to keep this mechanism workable, it is in our view appropriate to have some form of materiality threshold, ie limiting Ofgem's duty to comment on draft legislation and policy proposals that are likely to have a substantial impact on the GB energy markets. We note that this may include policies developed by government departments other than DECC. For instance, fiscal measures developed by HM Treasury (eg the carbon price floor) may have significant implications on GB energy markets and therefore on Ofgem's future activities.

10.110 We would therefore expect the scope of these Opinions to vary depending on the nature of the draft policies, and consider it appropriate for Ofgem to have discretion to determine the level of detail to include in each Opinion.

10.111 These Opinions should complement (and be informed by) the ongoing analysis of aggregate impacts of regulation on the energy markets that would be performed by Ofgem (see paragraphs 10.157 to 10.214 below). Indeed, such analysis would provide insight on the cumulative impact of various government policies on the GB energy markets, and on existing trends (eg the evolution of prices and energy companies' profits over time).

10.112 In view of the technical nature of Ofgem's role in this context, we expect Opinions to broadly cover the following issues:

- (a) the impact of draft legislation on each of the three key policy objectives of decarbonisation, security of supply and affordability;
- (b) the interaction between draft legislation and the existing regulatory framework (including licences and industry codes);
- (c) any necessary steps required to implement draft legislation (including changes to licences or industry codes); and
- (d) the likely overall effectiveness of draft legislation in achieving the government's stated objectives (and expected net benefits).

10.113 This proposed remedy would not preclude Ofgem from having iterative confidential interactions with government departments at any stage of the formulation of a policy, nor does it impose a duty to disclose a detailed account of such interactions.

- *Timing for the publication of Ofgem's Opinion*

10.114 As per the scope of the Opinions, we consider it appropriate for Ofgem to have discretion to determine the appropriate time for publishing such Opinions, subject to a general principle that the Opinion should be published in time for Parliament and/or government to take the Opinion into consideration before reaching a decision. Moreover, where a draft piece of legislation is subject to a consultation process, the appropriate time for Ofgem to publish an Opinion would be in the early stage of this consultation, in order to allow stakeholders to reflect on it before they formally respond within the relevant consultation period.

- *Response from DECC*

10.115 We consider that DECC should seek to address material concerns raised by Ofgem within the context of its appraisal of the policy proposal (eg within the context of an impact assessment) and, where the proposal is subject to a consultation, in the government's response to it.

- *Implementation of this remedy*

10.116 As noted above, Ofgem has wide-ranging powers to publish any advice or information if it appears to Ofgem that such publication would promote the interests of consumers.¹²⁶⁷ In our view, these powers enable Ofgem to publish Opinions as set out above. However, for this proposed remedy to be effective, the publication of such Opinions needs to be established as common practice. We have considered two non-exclusive options for the purpose of implementing this proposed remedy:

- (a) A recommendation to DECC to amend section 35 of the GA86 and section 48 of the EA89 in order to include a duty on Ofgem to publish an Opinion on all draft legislation and policy proposals which are relevant to Ofgem's statutory objectives and which are likely to have a material impact on the GB energy markets; the exact scope, level of details and timing of the Opinion would be left to Ofgem to determine, taking into consideration the specific circumstances of each case and the principle of proportionality.
- (b) A recommendation to Ofgem to publish a statement by which:
 - (i) (if not included in legislation as per paragraph (a) above) Ofgem would commit to publish an Opinion on all draft legislation and policy proposals which are relevant to Ofgem's statutory objectives and which are likely to have a material impact on the GB energy markets; and
 - (ii) Ofgem would set out the high-level principles underlying its approach to preparing and publishing Opinions on all draft legislation and policy proposals which are relevant to Ofgem's statutory objectives and which are likely to have a material impact on the GB energy markets.

¹²⁶⁷ See in particular sections 34 & 35 of the GA86 and 47 & 48 of the EA89.

10.117 For the reasons set out below, we have provisionally decided to recommend a legislative change, but recommend Ofgem to use its existing power to implement this remedy in the shorter term.

- *Considerations relating to the effectiveness of this remedy*

10.118 We consider that the publication by Ofgem of Opinions would significantly improve the transparency over Ofgem's assessment of the impacts of contemplated legislation, and of the interaction with the existing regulatory framework. Increased transparency would in our view improve the quality of the policy development process, in particular by making the rationale for interventions clearer, by exposing the views of different parties and by reinforcing the perception of Ofgem's independence and credibility. More specifically, it would create opportunities to air any disagreements between DECC and Ofgem, and highlight areas of policy interventions that require particular attention within the context of their appraisal and/or ongoing review.

10.119 We therefore believe that this remedy would contribute to addressing in part the Governance AEC, ie the absence of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making and implementation can be addressed transparently.

10.120 As noted above in paragraph 10.105, Ofgem already has the power to publish views on draft legislation and we therefore provisionally recommend that Ofgem implements this proposed remedy as soon as possible following our final report by issuing an Opinion on all draft legislation and policy proposals which are relevant to Ofgem's statutory objectives and which are likely to have a material impact on the GB energy markets. However, we believe that the creation of an established practice, so as to avoid the risk identified in paragraph 10.106 above, would reinforce the effectiveness of this proposed remedy in the longer term. To create such an established practice, and provide stronger incentives to Ofgem, we consider it appropriate to recommend that DECC amend section 35 of the GA86 and section 48 of the EA89.

10.121 Such a legislative change, however, would not be time sensitive, so that it is not necessary in our view to initiate a legislative process for the purpose of this proposed remedy only. Instead, a provision to that end can be included within the next draft energy act (or any relevant omnibus bill).

- *Considerations relating to the proportionality of this remedy*

- 10.122 The implementation costs arising from the proposed remedy would be very low and, for the reasons set out in paragraphs 10.120 and 10.121, no more onerous than necessary to achieve its aim.
- 10.123 As noted in paragraph 10.120, we considered an alternative, less intrusive remedy, consisting in a recommendation to Ofgem, but concluded that it would not be as effective in the long term.
- 10.124 We consider that the incremental costs for Ofgem to publish Opinions would be low considering that it already reviews and provides views (albeit seldom publically) on draft legislation. These incremental costs should be substantially outweighed by the benefits arising from the increased robustness and transparency of the decision-making process. For instance, as highlighted IN paragraphs 11.66 to 11.69 of the provisional findings report, a lack of coordination and transparency between Ofgem and DECC has led to sub-optimal outcomes in the past (eg **both** Ofgem and DECC seeking to remedy the same ‘missing money’ problem) – the prevention of which justifiably outweighing the concomitant costs.
- 10.125 This proposed remedy would also leave significant leeway for Ofgem to have iterative confidential interactions with DECC, and to determine the timing and content of Opinions. This would allow Ofgem to assist DECC throughout the policy formulation process, and to allocate its resources efficiently. For these reasons, we believe that this remedy would not produce disadvantages which are disproportionate to the aim.

Mechanism for Ofgem to seek a formal direction from DECC

- 10.126 In our Remedies Notice, we noted that there are no formal powers for DECC to direct Ofgem to implement a specific change, nor clear formal processes for Ofgem and DECC to discuss transparently a strategy for the implementation of DECC’s policies.
- 10.127 A number of parties commented on the possibility for Ofgem to seek a formal direction from DECC. The intention behind this proposal was to give Ofgem an instrument to express its disagreement with a policy set out by DECC, and to give stakeholders some transparency with respect to the strategy for implementing a policy.
- 10.128 Having reviewed parties’ responses, and carried out further thinking, we consider that this proposal would not be effective in achieving this objective. Although their roles and responsibilities interact, it is important to ensure that

both government and Ofgem carry out their functions independently and in compliance with their statutory objectives and duties. The principle of Ofgem's independence from both industry and government is enshrined in European legislation,¹²⁶⁸ and requires among other things to ensure that the staff and management of the national regulatory authority (ie Ofgem) 'do not seek or take direct instructions from any government or other public or private entity when carrying out the regulatory tasks'. Moreover, under the GA86 and EA89, Ofgem is under a duty to carry out its functions in the manner which it considers is best calculated to further the principal objective. The proposed remedy risks undermining Ofgem's independence (or the perception of Ofgem's independence).

- 10.129 Bearing these considerations in mind, we consider it inappropriate to seek to pursue the objectives set out above through the mechanism of formal directions. We discuss below alternative mechanisms that are in our view more effective and proportionate in addressing the Governance AEC.

Mechanisms designed to clarify the role and responsibilities of DECC, Ofgem and the industry, and to allow an efficient delivery of policy objectives

- 10.130 In our provisional findings, we identified a number of situations in which implementation of policy goals had been delayed or suboptimal (eg incomplete) due to a lack of coordination between DECC, Ofgem and the industry. In our provisional findings we gave two types of examples of these inefficiencies:

- (a) The failure to implement, in a timely manner, all the regulatory changes that are required for a policy initiative to be effective (for instance a change to standard licence conditions or to an industry code which are required in practice to give full effect to a statutory instrument). A delayed (or imperfect) implementation can be caused either by a failure to identify the need for consequential changes, or poor management of the implementation process that leads to inconsistencies and/or delays. Examples of this, set out in Appendix 11.2 to the provisional findings report, relate to 17-day switching and half-hourly settlement, where DECC decided not to adopt certain provisions by way of statutory instrument, with the result that certain changes imposed by DECC were not sufficiently supported by implementing measures.

¹²⁶⁸ See Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC and Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC.

(b) A lack of understanding of the interplay between parallel ongoing changes. An example of this relates to Ofgem's Energy Balancing Significant Code Review carried out shortly after DECC's proposals for the introduction of a capacity mechanism.

10.131 We found in our provisional findings that the line between the respective roles and responsibilities of DECC and Ofgem were often blurred, and this may exacerbate the issues identified above.

10.132 To a certain extent, these issues could be mitigated by our proposed remedy relating to the duty for Ofgem to comment on DECC's policies. Indeed, that remedy would give Ofgem the opportunity to raise concerns relating to the implementation of a policy change (eg consequential changes, interplay between DECC's policy proposals and other regulations).

10.133 However, we are concerned that that proposed remedy on its own will not be fully effective in achieving the objective set out above, and in particular will not be effective in addressing the lack of coordination between DECC and Ofgem (eg in the case of 17-day switching).

10.134 An attempt to clarify the respective roles and responsibilities of Ofgem and DECC, and improve the coordination of their actions, led to the introduction, by the Energy Act 2013 (EA13), of a mechanism – the Strategy and Policy Statement – by which DECC can provide more clarity about the respective roles of Ofgem and government.

- *Strategy and Policy Statement*

10.135 A draft Strategy and Policy Statement was published in August 2014, but DECC has not yet exercised its power to designate that document. In principle, this document is to be reviewed every five years by DECC, in order to reflect changes in policies.¹²⁶⁹

10.136 The aim of the Strategy and Policy Statement is to ensure that policy and regulation will be consistent and coherent in the energy markets. For this purpose, the Strategy and Policy Statement should clearly set out:

(a) the government's strategic policy priorities;

¹²⁶⁹ It may also be reviewed in certain specific circumstances, for example after a general election, if Ofgem notifies DECC that a policy outcome contained in the Strategy and Policy Statement is not realistically achievable, or after a significant change in the government's energy policy.

- (b) the policy outcomes to be achieved as a result of the implementation of that policy; and
- (c) the roles and responsibilities of those who are involved in implementation of that policy.

10.137 The EA13 further provides that Ofgem, in response to the Strategy and Policy Statement, must publish:

- (a) a forward plan for each financial year, which sets out its strategy for furthering the policy outcomes set out in the Strategy and Policy Statement; and
- (b) an annual report which must, in particular, include Ofgem's assessment of:
 - (i) how it has contributed to the delivery of the policy outcomes contained in the Strategy and Policy Statement; and
 - (ii) if it has failed to do any of the things mentioned in its forward plan for that year.

10.138 In our view, the Strategy and Policy Statement will be a useful instrument to provide additional clarity to stakeholders about policy priorities and the roles and responsibilities of DECC, Ofgem and the industry in achieving these. This would be a useful overarching framework for both Ofgem and the industry (eg within the context of self-governance) that should facilitate consistent regulatory interventions. We therefore recommend government to designate the Strategy and Policy Statement as soon as practicable.

10.139 However, we note that, by its nature, the Strategy and Policy Statement is unlikely to contain detailed provisions as to the implementation of specific policies. We are concerned, therefore, that it will not effectively address some of the factors that contribute to the Governance AEC, specifically the lack of coordination between DECC and Ofgem with respect to the details of the implementation of policies.

10.140 We believe, therefore, that it is necessary to complement the Strategy and Policy Statement with mechanisms that would improve such coordination. Such mechanisms would apply to specific policies the implementation of which is complex and requires multiple changes to the existing regulatory framework.

- *Mechanisms to increase the transparency of the policy implementation process*

10.141 We note that joint initiatives have been undertaken in the past by DECC and Ofgem in order to increase the transparency and coordination of their actions. These are for instance:

- (a) DECC's and Ofgem's joint consultation and implementation programme regarding smart metering;¹²⁷⁰
- (b) a Memorandum of Understanding¹²⁷¹ between DECC and Ofgem relating to the arrangements in the event of financial distress of an energy network company; and
- (c) DECC's and Ofgem's joint action plans setting out a number of commitments by DECC and Ofgem to help independent energy suppliers to enter and grow in their target markets.¹²⁷²

10.142 DECC and Ofgem have also put to us that they interact regularly for the purpose of discussing policy implementation. However, the outcome of these interactions has not been transparent and therefore not open to consultation. In our view, a transparent and coordinated approach between DECC and Ofgem to implement policies should be more frequent and follow consistent patterns.

10.143 We also note that any joint statements between DECC and Ofgem need to be sufficiently detailed to ensure that they cover all the consequential changes and effects that are required to achieve the expected net benefits of a policy, as identified in the relevant impact assessments.

10.144 An example of a failure to do this is provided by DECC's and Ofgem's joint consultation and implementation programme regarding smart metering, and in particular its supporting document 'Regulatory and Commercial Framework'.¹²⁷³ These documents address various aspects of the roll-out of smart meters, but only briefly discuss whether amending the settlement periods (ie a move towards mandatory or optional half-hourly settlement) was required for the emergence of time-of-use tariffs. There was no clarity

¹²⁷⁰ See Ofgem and DECC (July 2010), [Smart metering implementation programme: Prospectus](#).

¹²⁷¹ See [Memorandum of Understanding between the Gas and Electricity Markets Authority, the Department of Energy and Climate Change and Her Majesty's Treasury](#).

¹²⁷² DECC and Ofgem (August 2013), [Government and Ofgem Action Plan: Challenger Businesses \(Independent Energy Suppliers\)](#).

¹²⁷³ Ofgem (July 2010), [Smart Metering Implementation Programme: Regulatory and Commercial Framework](#).

provided as to what action should be taken to achieve the desired outcome and who should be responsible.

10.145 Since ‘load shifting’ was a material aspect of the case in favour of the roll-out of smart meters in DECC’s impact assessment, as highlighted in our provisional findings report (paragraph 8.280), we consider that DECC and Ofgem should have agreed on a set of concrete actions to ensure that such benefits would be delivered, including clear responsibilities for taking forward proposals for settlement reform. Further, as any such change was likely to require a code modification and a change in commercial practices, DECC and Ofgem should have considered more carefully parties’ incentives and hence whether the required change would be likely to be delivered through an industry-led process.

10.146 We believe that DECC and Ofgem should publish detailed joint statements in circumstances where the implementation of a DECC policy objective is likely to necessitate, in order to achieve its stated objective, parallel or consequential Ofgem interventions (eg through a licence change) or a code modification.¹²⁷⁴ The level of detail of this implementation strategy should depend on the nature and complexity of the policy or on its consequential implementation. However, we would expect these joint statements to cover broadly the following main areas:

- (a) an action plan setting out the list of regulatory interventions (including code changes), and the relevant entity in charge of designing and/or approving such interventions, that are necessary in order to implement the policy;
- (b) an estimated timetable for the completion of each necessary intervention; and
- (c) where appropriate, a list of relevant considerations that will be taken into account in designing each regulatory intervention.

10.147 Publishing detailed joint statements would facilitate the engagement of stakeholders, as these would have more clarity about the actual implications of the proposed action plan. They would therefore be in a better position to contribute their knowledge and expertise of the most legal and technical

¹²⁷⁴ Better coordination between Ofgem and the industry is also required where Ofgem’s regulatory interventions require amendments to the industry codes. This issue is discussed in below, where we propose a greater role in setting up a strategic vision for code governance, including the areas of codes that Ofgem consider needs to be amended.

details of the industry, and to comment on DECC's and Ofgem's expectations regarding code changes.

- 10.148 This in turn should be an effective way to raise, earlier in the process, possible legal or technical issues to be addressed, and to gain an understanding of the likely effects of the relevant reform. It follows that these joint statements must be consulted upon before concluding the appraisal of the policy.
- 10.149 This process would also give more legal certainty to parties about the likely pace and technical implications of a given policy, allowing them to roll out the necessary internal changes (eg IT).
- 10.150 As noted above, some policy changes will require code modification proposals to be raised by the industry. It is important therefore to ensure that DECC's strategic vision and policy objectives (as set out in the Strategy and Policy Statement) are reflected in the code governance process. This proposed remedy, which is focused on the relationship between DECC and Ofgem, therefore works synergistically with our proposed remedies in relation to code governance, and in particular the need for Ofgem to develop a strategic plan for code modifications. We address this issue in our discussion of our proposed remedies regarding code governance.
- 10.151 For the avoidance of doubt, nothing in this joint statement should prejudice the outcome of any future appraisal, nor constrain Ofgem (or DECC) in the way in which it exerts its functions in a manner that it considers is best calculated at the time to further its principal objective.
- 10.152 Taking all the above factors into account, we have therefore provisionally decided to recommend that DECC designates a Strategy and Policy Statement, setting out its policy objectives, the respective roles of DECC and Ofgem in meeting these policy objectives, and principles governing the interaction between DECC and Ofgem. We have also provisionally decided to recommend that, where appropriate, DECC and Ofgem publish joint statements setting out a detailed plan of action for the implementation of specific policies, with clear responsibilities assigned between them.
- *Consideration relating to the effectiveness of this remedy*
- 10.153 This proposed remedy should help provide transparency to stakeholders about the complete process of policy development and implementation, from the high-level objectives of government policies to the assessment and approval of the implementation measures needed to achieve these objectives. It follows that public bodies, as well as private entities within the context of consultations, will be in a better position to identify inconsistencies

between contemplated regulatory interventions and the existing legal framework, including consequential changes that might be required across licences and industry codes. This in turn should lead to better project management of the process of designing, assessing and implementing policies. We therefore believe that it would contribute to addressing the Governance AEC, in particular the feature concerning the absence of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making and implementation can be addressed transparently.

10.154 We note, however, that this remedy would focus on the allocation of responsibilities. It would then be the responsibility of each stakeholder (DECC, Ofgem and, within the context of codes changes, the industry under Ofgem's supervision) to develop and implement the regulatory actions set out in the joint statement. Within that context, our proposed remedy requiring Ofgem to publish Opinions on relevant draft legislation (see above) would further contribute to addressing this feature.

10.155 As noted above in paragraph 10.141, DECC and Ofgem have in the past taken initiatives consistent with our proposed remedy. No change in legislation is required and can be implemented by DECC and Ofgem immediately. We are therefore confident that this proposed remedy is capable of effective and timely implementation. We note in this respect that government has made a commitment to give a public response to any recommendation made to it within 90 days of the publication of a CMA report.¹²⁷⁵

- *Consideration relating to the proportionality of this remedy*

10.156 This proposed remedy would in our view be effective in achieving its aim. For the reasons set out in paragraph 10.155, we believe that this remedy is no more onerous than necessary and the least onerous that we have considered. The incremental costs of this proposed remedy, ie setting out clear plans and consulting on the steps that DECC deems necessary to implement certain policies, would be low and only incurred in a limited number of circumstances set out in paragraph 10.146 above. In those circumstances, it would only increase the transparency around work already carried out to a large extent by DECC and Ofgem. Similarly, as regards the designation of the Strategy and Policy Statement, this remedy should not add any further costs that were not already contemplated by the EA13. We believe that any such costs would be substantially outweighed by the

¹²⁷⁵ See [CC3](#), paragraph 95.

benefits arising from the increased robustness and transparency of the decision-making process.

Transparent analysis of impacts of policy and regulation

10.157 In the provisional findings, we noted aspects of the structure and governance of the regulatory framework that have both contributed to the development of policies which are not in the best interests of consumers, and hindered the development of policies which are in the public interest. In particular, we provisionally found that the lack of effective communication on the forecast and actual impact of government and regulatory policies on energy prices and bills is one of the features contributing to an overarching feature of a lack of robustness and transparency in regulatory decision-making. In turn, this increases the risk of poor policy decisions which have an adverse impact on competition.

10.158 In the Remedies Notice, we asked stakeholders for their views on how the impacts of energy policies both before and after implementation could be communicated more effectively, with a focus on the trade-offs that result from those policies across the differing – and sometimes conflicting – overarching policy objectives within the energy sector (eg reducing emissions, safeguarding security of supply and ensuring that energy prices are affordable, often referred to collectively as ‘the trilemma’). In particular, we requested feedback on:

- (a) the existing practice on ex ante and ex post assessment of the impacts of energy policies;
- (b) the gaps in the current analysis, whether assessments are sufficiently disseminated to appropriate parties (and who those appropriate parties might be); and
- (c) whether there was a need for further analysis of (and/or better communication of) the impacts of policies by Ofgem, DECC or a new, independent body.

Aim of the remedy

10.159 The aim of this proposed remedy can be seen as comprising two elements:

- (a) providing a clear and trusted assessment of the GB energy markets and regulation, including an analysis of the forecast and actual impacts and trade-offs resulting from energy policies that have been implemented (including updating forecasted impacts) and an overview of commercial trends in the GB energy markets; and

- (b) improving the communication of that analysis in order to inform public debate and policymaking.

Parties' views

10.160 Parties responding to the consultation¹²⁷⁶ expressed widespread agreement with the CMA's provisional finding that there is a lack of effective communication of the ex ante and ex post impacts of policies and the trade-offs between different policy objectives, which gives rise to a provisional AEC, and general support for this part of the remedies package proposed to address this AEC. The parties agreed that a clear communication of policy impacts ex ante and ex post, and of the interactions and trade-offs between forthcoming and existing policies, was essential to public debate around energy prices and effective future policy-making.

- *Views on the existing analysis*

10.161 Parties' responses supported our view that there are typically some shortcomings in DECC's analysis, including the lack of a cumulative evaluation of policies and independent scrutiny. While some parties were aware that DECC published ex ante impact assessments on all new individual policies, they pointed out that impact assessments focused only on the specific impacts of the policy under consideration and that there was little consideration of interactions with other policies. One party noted the recent move towards the retrospective evaluation of policies and said that this complemented impact assessments, although it observed that the number of policies selected for review might be limited due to the resources involved. Parties also commented on the need to ensure that analysis conducted by policymaking institutions was subject to challenge or scrutiny by an independent, external body (it was clear that some stakeholders were unaware that all of DECC's impact assessments are currently scrutinised by the Regulatory Policy Committee).

10.162 The parties' responses flagged that there is a need for the ex ante and ex post assessment of policy impacts and trade-offs to be presented in a holistic way, and in a format which consumers are able to understand. They suggested that this should include the likely impact of policies on bills, presented on a 'pence per unit' basis, to enable comparison against current rates paid by customers across the GB energy markets, and a simple

¹²⁷⁶ Respondents included the Six Large Energy Firms, several small suppliers (Ecotricity, Opus Energy, First Utility) and consumer groups. The suppliers' trade body, Energy UK, stated that it looked forward to working with the CMA on its suggestions.

explanation of suppliers' costs and how they might vary. As well as highlighting the omissions in the analysis currently available, the parties identified various issues concerning the quality of that analysis, including:

- (a) a lack of transparency, particularly in relation to the underlying assumptions relied upon;¹²⁷⁷
- (b) inconsistency, either with information subsequently published or as compared with information provided by other institutions, which impacts adversely on efficient decision-making concerning investment (particularly when coupled with the transparency issue, noted above);¹²⁷⁸ and
- (c) the use of counterfactuals, whereby DECC presents the benefits of a policy as compared with a counterfactual where no action is taken (rather than a counterfactual where another policy approach is adopted), or which incorporates changes in bills resulting from causes other than the policy intervention, creating confusion.

- *Views on who should perform the role set out in the proposed remedy*

10.163 The parties also felt that the information already in the public domain often lacked independence. They noted that there were unclear incentives to provide objective analysis and that this undermined trust and public confidence in the information: parties observed that there was an incentive for DECC to exercise confirmation bias, as the body responsible for developing policy, but that there was also a risk of confirmation bias by Ofgem,¹²⁷⁹ and that Ofgem had previously shown a tendency to bow to political pressure, despite its formal independence. It was clear from the parties' responses that they identified a need for an independent body to perform the role of disseminating reliable information, in a form accessible to all stakeholders, which set out clearly and credibly the impact of policies and trade-offs across different policy objectives. Some parties specified, for example, that this information should be produced on a regular basis, or that it should have a common structure.

¹²⁷⁷ One party cited as an example the impact assessment for DECC's original proposals for an Energy Companies Obligation (ECO) which, in its view, lacked transparency around the assumptions as to customer contributions in relation to Green Deal financing plans taken out by consumers. This made it hard to identify any confirmation bias in DECC's assessment. The assumptions as to contributions subsequently turned out to have been inaccurate, with the result that the projected cost of ECO to consumers was underestimated.

¹²⁷⁸ Examples cited included the figures published by the Office for Budget Responsibility relating to low carbon generation at the time of the summer 2015 budget were projected to be over £2 billion higher in 2019/20 than had been estimated at the time of the March 2015 budget.

¹²⁷⁹ The impact assessments produced for the RMR rules were cited as an example of this.

- 10.164 On that basis, a few parties were strongly in favour of a new institution being established in order to perform the new role set out in the proposed remedy. RWE submitted that there was a need for a new institution with responsibilities separate to those of DECC and Ofgem. Under its proposed approach: DECC and Ofgem would retain responsibility for setting out policies' estimates of impact and the role of the new institution would be to provide its independent view, identifying where it takes a different view on impact and explaining the origin and nature of the differences.
- 10.165 However, the majority of respondents were neutral or supported the role being performed by Ofgem, as a body independent from government. The need for independence was given as the reason why DECC would not be the appropriate body to perform this function. Parties acknowledged that extending the remit of existing organisations to encompass this function was likely to be easier than creating a new institution for this purpose and that Ofgem had the appropriate skills and resources to conduct the analysis and communicate its analysis to consumers (subject to the proper exercise of its independence). They noted that Ofgem also had access to a substantial amount of market data and regulatory reporting, by virtue of its existing functions, which could be fed into its analysis (this might include, potentially, the additional financial reporting envisaged below).
- 10.166 Where there were aspects of the analysis which fell outside Ofgem's area of competence, Ofgem could seek input from the other bodies such as the Committee on Climate Change, which already produced reports on the impact of meeting carbon budgets on energy bills. Ofgem's role in relation to regulatory reporting (see our proposed remedy on financial reporting below) would also promote efficiencies, as the creation of a new body might result in an additional regulatory reporting burden being placed on industry participants. One party also commented that the body performing the role would need to have sufficient authority that its conclusions would contribute to improving policy.
- 10.167 Whether the role was housed within an existing institution or a new institution set up, the point was made that a clear delineation of responsibilities was essential.

Design considerations

- 10.168 Assessments seeking to improve the understanding of the impacts of energy policies (and therefore contribute to increasing the robustness of regulatory decision-making) may be considered to vary along two dimensions. First, the assessment may take place at two different stages in the policy development cycle:

- (a) The assessment of draft legislation or regulatory interventions before adoption (ex ante). Ex ante appraisal enables policymakers to consider the benefits of a proposed policy as against the costs before deciding whether or not to go ahead with its introduction.
- (b) The ongoing assessment (ex post) of the impact of the regulatory framework on the GB energy markets. Ex post evaluation of the impacts allows policymakers to reflect on the extent to which policies have achieved their objective, permitting lessons to be learned and facilitating improved future policymaking.

10.169 Second, assessments vary according to the extent to which they cover individual policies or packages of several policies. Broadly speaking, assessments can be considered to fall within one of two categories, addressing either:

- (a) the impact of individual policies, ie the appraisal of draft legislation (ex ante), which enables the costs and benefits of the policy to be fully explored, and the review post-implementation of existing legislation, which facilitates the evaluation of the policy's effectiveness; or
- (b) the aggregated impact of a package of energy policies on the GB energy markets, which provides a clear picture of the interplay between policies, the trade-offs within policies and their influence on the GB energy markets.

10.170 The table below shows the different types of assessment against these two dimensions.

Table 10.1: Overview of policy assessments

	Impact of individual policy	Cumulative impact of policies
Ex ante assessment	Impact assessments/policy appraisals	Projected impact of package of policies
Ex post assessment (evaluation)	Evaluation of individual policies	Evaluation of package of policies/ongoing monitoring

10.171 In the paragraphs below, we consider the existing level of assessment available and then propose changes that, building on the existing framework, will contribute to remedying the Governance AEC.

- *Assessment of individual policies*

10.172 As regards the assessment of individual policies that currently takes place, initiatives from government are subject to an impact assessment at the proposal stage.¹²⁸⁰ DECC typically produces an impact assessment in respect of each policy proposal which it seeks to introduce, prior to implementation. Assessments are carried out on an individual basis. Although a template is followed to ensure consistency of approach, this does not allow for comparison across policies or any kind of cumulative evaluation, as each assessment focuses on an individual policy in isolation, and against a case-specific baseline. Trade-offs between policy objectives are typically considered as part of the impact assessment. For example, although a particular policy proposal may focus primarily on one policy objective (such as reducing emissions), the effect on other objectives is generally also considered as part of the cost-benefit analysis, either in monetised form, or otherwise quantified or, where neither is possible, as a qualitative assessment. Distributional implications (notably impacts on energy bills and prices) are also generally included.

10.173 Impact assessments carried out by government are subject to independent scrutiny by the Regulatory Policy Committee. The Regulatory Policy Committee is an independent advisory body the remit of which is to ensure that decisions are made on the basis of a robust, evidence-based policymaking process. The role of the Regulatory Policy Committee is to deliver external scrutiny of regulatory and deregulatory proposals put forward by government to ensure that the evidence and analysis presented in impact assessments are fit for purpose. It does not comment on the merits of policy proposals; its opinions are expressed as a red/amber/green rating, with a red-rated 'not-fit-for-purpose' opinion denoting not a flawed policy, but that the evidence as presented in the impact assessment is inadequate. All impact assessments must be assessed as 'fit for purpose' by the Regulatory Policy Committee.¹²⁸¹ The process permits the re-submission of impact assessments where these are not initially given a green rating. DECC has a strong track-record of producing 'fit for purpose' Regulatory Policy Committee assessments; since the Regulatory Policy Committee was

¹²⁸⁰ See [The Green Book](#) and [Better Regulation Framework Manual](#).

¹²⁸¹ They are then cleared by the Reducing Regulation sub-committee.

established in 2011, it has assessed 85% of DECC's impact assessments as fit for purpose¹²⁸².

- 10.174 According to central government guidance, as enshrined in the so-called *Green Book*¹²⁸³ and *Magenta Book*,¹²⁸⁴ policies should be reviewed in the context of a policy cycle, according to which they should not only be subject to ex ante appraisal but to ex post evaluation. In practice, evaluation has been carried out less systematically than appraisal.
- 10.175 Going forward, as a result of the *Better Regulation Framework Manual*, policies that impose a regulatory burden on businesses will be exposed to a post-implementation review. Review clauses should impose a statutory duty to carry out post-implementation reviews of the measure in a specified timescale, usually within five years of it coming into force. Review clauses are mandatory for all measures that regulate business (including both domestic and EU-derived measures).¹²⁸⁵
- 10.176 The purpose of a review is to establish whether, and to what extent, the measure has achieved its original objectives. For that purpose, government shall publish a report of its review, including a post-implementation review impact assessment, and must obtain approval from the Regulatory Policy Committee. In particular, the review must address the following three questions, with a view to concluding whether the measure should be removed, renewed without any changes or amended: (i) are the policy objectives that led to the introduction of the measure still valid and relevant? (ii) if the objectives are still valid and relevant, is regulation still the best way of achieving those objectives, compared to the possible alternatives? (iii) if regulation is still justified, can the existing measure be improved?
- 10.177 DECC is currently in the process of identifying matters for priority evaluation.
- *Assessment of the aggregate impact of a package of policies*
- 10.178 There is already extensive information and analysis in the public domain in relation to energy policy (see paragraph 11.48 of the provisional findings). For example, the Committee on Climate Change has a remit to report to government on emissions reductions, including assessment of the impacts of

¹²⁸² Impact assessments are also subject to peer review by other government departments; however, this is a more informal process and the reviews are focused primarily on the likely impacts of policies on the area of business for which those departments are responsible.

¹²⁸³ HM Treasury, *The Green Book: Appraisal and Evaluation in Central Government*.

¹²⁸⁴ HM Treasury (April 2011), *The Magenta Book: Guidance for Evaluation*.

¹²⁸⁵ Certain exceptions exist, for example time-limited measures that are subject to an existing 'sunset' clause which causes them to expire within one year of coming into force (sunset clauses provide for automatic expiry of the measure on a specified date).

policies aimed at tackling climate change on energy bills and prices. DECC produces an annual report on the estimated impacts of energy and climate change policies on energy prices and bills, and National Grid has a statutory obligation to report on gas security of supply. The National Audit Office has a remit to report on the value for money of government expenditure and policies.

- 10.179 Ofgem carries out analysis on a wide range of areas, including security of supply¹²⁸⁶ and energy prices and profits, and publishes various indicators designed to track, among other things, the profitability and the customer service performance of individual suppliers (see in this respect our proposed remedy on financial reporting below). We note also that Ofgem has committed to report annually on the retail energy markets, which has led to the publication in September 2015 of the first Retail Energy Market report.
- 10.180 The purpose of these publications is to ‘foster understanding, trust and confidence’ among stakeholders by publishing more information about the markets Ofgem regulates. They seek to track the contribution of the retail and wholesale markets – including the way in which Ofgem regulates them – in achieving the outcomes for consumers set out in its strategy. However, Ofgem does not scrutinise in this context government policies, which is an essential element of understanding the GB energy markets.
- 10.181 Despite the range of the analyses available, none takes a holistic approach and provides a picture of the overall impact of the regulatory framework on the GB energy markets; instead, different institutions tend to focus on specific elements of the trilemma (eg the Committee on Climate Change on reducing emissions, National Grid on security of supply, Ofgem on the functioning of the markets).
- 10.182 While we understand this reflects the remit of each of these institutions, the segmentation of this analysis hampers in our view the objective to ‘foster understanding, trust and confidence among stakeholders’ in policy regulation and energy markets, and does not appropriately carry out a balanced and objective assessment of the policy trade-offs deriving from the trilemma.
- 10.183 Analysis has been done within government in the past setting out the aggregate impact of a broad range of climate change and energy policies in terms of social costs and benefits,¹²⁸⁷ but this analysis has not been systematically updated (or at least communicated to an external audience).

¹²⁸⁶ Ofgem (June 2014), [Electricity Capacity Assessment 2014](#).

¹²⁸⁷ See, for example, the Analytical Annex to the [UK Low Carbon Transition Plan](#).

10.184 Another concern relating to the existing analysis available in the public domain relates to the lack of independent scrutiny (or apparent lack of independent scrutiny) in relation to certain aspects of energy policies. For example, where policies are evaluated by the policymaking body (eg DECC's assessment of the impacts of energy and climate change policies on energy prices and bills), there is a risk of engendering at least a perception of confirmation bias. Independent assessment is therefore important in order to evaluate existing policies and to ensure effective policymaking in the future. Trusted analysis is also crucial to inform the public debate on energy. Without such trust, effective debate is undermined.

- *Communication of the existing analysis*

10.185 In the provisional findings, we observed that, although the existing analysis covers a broad range of policies, this information is inadequately communicated:

In our view, however, these analyses should be communicated more effectively to a wider audience, in particular interactions between policies and policy trade-offs within policies. Clearer communication around these issues may increase the transparency of the information already available and improve the quality of the public debate and policy decision-making.
(paragraph 11.50)

10.186 The existence of disparate analyses, focusing on individual policies and/or on different policy objectives, creates considerable challenges for stakeholders to get access to, and link, all the available analysis. It might also lead to inconsistencies and confusion, as observed by some parties in their responses, and contribute to an overall lack of transparency, which in turn, inhibits productive debate and effective policymaking.

Proposed remedy

10.187 As stated above, the aim of this proposed remedy is to provide a clear and trusted assessment of the impact of policy interventions in the energy markets and to improve the communication of that analysis to all stakeholders (including policymakers, industry, media and public audience), with a view to informing public debate and assisting in the effective formulation of energy policy.

10.188 In order to achieve the aim of the remedies package, we consider below the changes that, in our provisional view, should be made in the following areas

- (a) the assessment of the forecast impacts of individual policies by government (ex ante policy appraisal);
- (b) the assessment of the actual impacts of individual policies by government (ex post evaluation); and
- (c) the independent assessment of the aggregate impact of a broad package of climate change and energy policies (both ex ante and ex post).

10.189 We also consider how to ensure the effective communication of the above assessments to a wider audience. The overall objective is to inform public debate in this area and assist in the effective formulation of energy policy.

- *Assessment of the forecast impacts of individual policies – appraisal by government*

10.190 As already mentioned, initiatives from government are typically subject to an impact assessment at the proposal stage, which in turn is subject to independent scrutiny from the Regulatory Policy Committee.

10.191 The format of the impact assessments requires that the policy objectives, the expected impacts and any alternate policy options considered are all set out in detail and a cost-benefit analysis carried out. The assessment is then subjected to the independent scrutiny of the Regulatory Policy Committee which performs a quality assurance role, for example by conducting a sensitivity analysis of the impact assessment or picking up on any assumptions based on out-of-date data.¹²⁸⁸

10.192 Our view is that DECC's processes are fit for purpose and that the some of the remedies proposed in this section (ie Ofgem's publication of Opinions on draft legislation and Ofgem's evaluation of the broad range of policies governing GB energy markets) will facilitate in the future government's appraisal of draft legislation.

- *Assessment of the actual impacts of individual policies – evaluation by government*

10.193 As regards the review post-implementation of individual policies, we believe that the requirement, introduced by the *Better Regulation Framework Manual*, for government to carry out reviews of its policies will provide valuable insights to policymakers. The evidence for this review will be based

¹²⁸⁸ Some parties commented on the quality of this analysis, around the lack of transparency in relation to assumptions underpinning the analysis, the inconsistencies with information published by other institutions, and the use of confusing counterfactuals. We believe that these comments should be addressed to DECC directly.

on actual impact, rather than forecast impact. A comparison between actual impacts and forecast impacts might also assist government in future appraisal processes.

10.194 One potential issue may be the amount of resources which DECC chooses to dedicate to this exercise: the *Better Regulation Framework Manual* permits a range of approaches, from a full review for high-impact measures to a light-touch, desktop exercise;¹²⁸⁹ however, the *Better Regulation Framework Manual* makes clear that, where the policy being reviewed has an impact of more than £50 million, a substantial review is expected. While it is too early to assess the effectiveness of post-implementation reviews by government of individual policies as envisaged by the *Better Regulation Framework Manual*, we are satisfied that the role of the Regulatory Policy Committee provides a form of checks and balances on the quality of these reviews and do not propose any changes to this process at this point.

10.195 We therefore fully support the requirement under the *Better Regulation Framework Manual* to carry out a regular review of individual policies and believe it will contribute to increasing the robustness of the decision-making process. In our view, for the reasons set out above, evaluation by the government of its own policies must be complemented by a regular, independent evaluation of the broad range of policies governing the GB energy markets. We therefore believe that the proposed remedy set out below will facilitate the government's evaluations of individual policies.

- *Independent evaluation of the broad range of policies governing GB energy markets – state of the market assessment*

10.196 As already outlined, various institutions carry out analyses of broad policy areas (see paragraph 11.48 of the provisional findings report). In our view, however, these analyses should be communicated more effectively to a wider audience, in particular interactions between policies and policy trade-offs within policies (eg concerning the trilemma). Also, meaningful ex post evaluation of policy impacts and trade-offs is in our view currently hampered by a lack of information concerning how wholesale energy costs, network costs, policy costs and profits contribute to changes in retail prices (and in energy companies' profitability).

10.197 Having regard to all of the above, we believe there is a need for a more effective assessment of the cumulative policy impacts on the GB energy

¹²⁸⁹ *Better Regulation Framework Manual: Practical Guidance for UK Government Officials* (March 2015, currently being updated), paragraph 1.8.19.

markets. In our view, a holistic and thorough review of the effects of energy policies on GB energy markets has the potential to inform public debate and improve future policymaking in this area. A key facet of this review would be the clarification of generation and retail profitability and the contribution to price increases made by wholesale energy costs, network costs, profit costs (and similar). As noted above, we have provisionally found that this lack of financial transparency is one of the features that has hindered robust and transparent regulatory decision-making, giving rise to the Governance AEC. The changes to financial reporting of revenues, costs and profits by generators and suppliers proposed in the context of the remedy relating to the financial reporting (see below) will contribute directly to an assessment of the state of the GB energy markets which is fit for purpose.

- 10.198 A more effective assessment of the cumulative policy impacts on the GB energy markets should provide both an ex post evaluation of actual impacts of climate change and energy policies as well as a projection of the forecast impact of these policies, taking into consideration structural changes in the foreseeable future (eg delayed implementation of legislation, changes in generation portfolio).
- 10.199 The parties' responses supported a proposal for an independent body to perform the role of disseminating reliable information, in a form accessible to all stakeholders, which sets out clearly and credibly the impact of policies and trade-offs across the different limbs of the trilemma. Having reviewed the parties' submissions, we consider that Ofgem is the appropriate independent authority to conduct this 'state of the market' assessment. The proposed role is compatible with Ofgem's existing remit and would require Ofgem, as the sector regulator, to draw on its extensive knowledge of the markets. As noted by one of the responding parties, where Ofgem is not well placed to comment (eg on some aspects of climate change, as its remit extends only to gas and electricity, rather than other relevant areas such as transport and agriculture), it can draw on the analysis of other institutions, eg the Committee on Climate Change. Giving this role of publishing cross-policy impacts and trade-offs to Ofgem would also create efficiencies due to the existing regulatory reporting regime, which affords it access to significant amounts of industry data; these would be maximised by the proposed remedy relating to financial reporting (see paragraphs below).
- 10.200 For the above reasons, we think that Ofgem is well-placed to perform the role due to its status as an independent, non-departmental public body. However, in order to strengthen its independence and remove any risk (actual or perceived) of confirmation bias, we have provisionally decided to recommend the creation of a new unit within Ofgem (eg an office of the chief

economist), distinct from the policy teams within the organisation. Such an office of the chief economist would be tasked with producing the state of the markets assessment on behalf of Ofgem.

10.201 Due to the complexity of the subject area, achieving a comprehensive and holistic assessment of the actual impacts of policies in the sector, and the trade-offs between different policy objectives, would be challenging. DECC highlighted in particular the difficulties involved in translating wholesale prices into retail prices due to the individual hedging strategies adopted by energy companies and the impact these have on the way in which savings are passed on to consumers. Although there will undoubtedly be challenges inherent in producing an holistic and wide-ranging assessment, Ofgem's sector knowledge and understanding of the energy markets nonetheless make it best-placed to address these. Also, centralising expertise within an Office of the Chief Economist could help overall understanding of the impact of a wide range of climate and energy policies, and increase consistency over time and across areas in the economic evaluation of policies.

10.202 As stated above, we envisage that Ofgem's assessment will set out policy initiatives implemented across the energy sector during the review period and provide analysis on the following areas:

- how energy prices and bills have evolved over the period of the review and what has contributed to this, including the cost of regulation;
- a periodically updated assessment of the social costs and benefits of climate and energy policies;
- the profitability of energy firms, and in particular the Six Large Energy Firms, on the basis of the data acquired as a result of the financial reporting remedy proposed below;
- the impact of initiatives to reduce emissions, including a tracker to measure progress against decarbonisation targets;
- the effectiveness of measures introduced to maintain security of energy supply and progress against targets;
- the interplay between these two areas and the affordability of prices (trilemma trade-offs); and
- relevant trends and drivers for the forthcoming year, such as forecasts as to the likely direction of wholesale costs.

10.203 We envisage that this assessment would be published once per year, in line with Ofgem's commitment to report annually on retail markets. This would also be consistent with the publication of certain other annual reports addressing discrete aspects of the energy markets and which would inform Ofgem in carrying out this task. (See paragraphs 10.178 to 10.184. This includes, for instance, Ofgem's electricity capacity assessment, DECC's annual report on the estimated impacts of energy and climate change policies on energy prices and bills, and the Committee on Climate Change's annual report.)

10.204 We envisage that the audience for the assessment will include stakeholders of all kinds, such as government, industry participants, media contacts and consumers. The different sections of the audience will have different expectations and requirements. As explored above, there is a need for government and industry to understand the detailed analysis which can then inform debate and the development of policy, whereas the media and consumers require a more accessible digest (eg in the form of an executive summary, which could be supported by media briefings). We envisage that Ofgem would be well placed to decide how to leverage its existing channels in order to communicate its findings to all of these stakeholders in the most appropriate manner. We therefore do not propose to be prescriptive in this regard.

- *Considerations relating to effectiveness*

10.205 As noted above (see paragraph 10.169), appraisals and evaluations of policies should focus on two key aspects:

(a) the impact of individual policies; and

(b) the aggregated impact of energy policies on the GB energy markets.

10.206 We consider that the existing level of assessment of the aggregated impact of energy policies is insufficient and contributes to the Governance AEC (and in particular to the lack of effective communication on the forecasted and actual impact of government and regulatory policies over energy prices and bills). We have therefore provisionally decided to recommend Ofgem to carry out such an assessment annually. We believe that Ofgem has the level of independence and expertise to provide robust and trusted analysis to all stakeholders. To reinforce the effectiveness of this proposed remedy, we have also provisionally decided to recommend Ofgem to establish an internal unit with relevant cross-cutting expertise (eg an office of the chief economist).

10.207 As this new unit would essentially draw on existing resources and expertise, it could therefore be achieved in a relatively short time. Some recent initiatives taken by Ofgem show in our view that it is already committed to carry out analysis of this nature that may foster understanding, trust and confidence among stakeholders (see paragraphs 10.179 and 10.180). We therefore believe that this proposed remedy is capable of timely and effective implementation.

10.208 We consider that such a state of the market assessment produced by Ofgem would also facilitate DECC's appraisal and evaluation of policies. Similarly, our recommendation to Ofgem to publish Opinions on draft legislation (see paragraphs 10.104 to 10.125 above) will facilitate DECC's appraisal of individual policies.

10.209 We believe that the benefits that would arise from a trusted and independent assessment of the markets would provide benefits to the decision-making process and public debate.

10.210 For these reasons, we believe that this proposed remedy would contribute to addressing the Governance AEC by providing clear and trusted assessment of the GB energy markets and regulation, and improving the communication of that analysis in order to inform public debate and policymaking.

- *Considerations relating to proportionality*

10.211 In terms of the assessment of the state of the market, the main costs of this proposed remedy would be related to the recruitment and staffing costs attached to establishing a new unit (eg Office of the Chief Economist) within Ofgem. The level of these costs might be comparable to the costs incurred during the development of the state of the market report produced by Ofgem prior to the market investigation reference being made to the CMA, although these would be reduced by economies of scale and increased productivity over time. Also, as some of these analyses are already being carried out within Ofgem (although not in a centralised way), only the incremental costs should be considered. In any event, we believe that such costs would be largely outweighed by the benefits arising from the proposed remedy.

10.212 In terms of the analysis of individual policies in accordance with the *Better Regulation Framework Manual*, the proposed approach (of supporting the innovation brought by it, including reviews of policies) does not attract any costs over and above what is currently planned.

10.213 For these reasons, we believe that our proposed remedy is no more onerous than necessary to achieve its aim.

10.214 We considered (and consulted upon) the possibility of creating a new institution to perform the role of producing the state of the market assessment. The sole advantage of this proposal would have been that a new institution would be fully independent from policy development. However, the disadvantages of this approach included the significant additional costs it would incur, diseconomies of scale and issues around credibility/visibility in an already crowded space. As set out above, the majority of parties supported using an existing body rather than creating a new body. Although it has a role in policy development, Ofgem is independent of government and our proposal provides for an additional degree of independence through the establishment of a separate office within Ofgem to take on the new remit. We therefore believe that our proposed remedy is the least intrusive of the remedies we have considered.

Regime for financial reporting

Introduction

10.215 We provisionally found that a lack of a regulatory requirement for clear and relevant financial reporting concerning generation and retail profitability was a feature of the GB gas and electricity markets that, in combination with other features set out in paragraph 10.7, gave rise to the Governance AEC.¹²⁹⁰ This proposed remedy seeks to address weaknesses in the current reporting regime so that Ofgem in the future will be better placed to make decisions using relevant information on the revenues, costs and profitability of the principal firms active in these markets.

10.216 We also believe that the proposed remedy will provide Ofgem with information that will allow it to provide a clear and trusted assessment of the GB energy markets (see above our proposed remedy relating to the annual publication of a state of the market assessment by Ofgem). This information will also be relevant in preparing Opinions (see proposed remedy above) on government's draft policy proposals that are likely to have a material impact on energy markets. This in turn will inform the public debate and enhance government's ability to design and implement appropriate policies.

- *Ofgem's current reporting regime for the Six Large Energy Firms*

10.217 Each year Ofgem obtains profit and loss accounts for certain firms' generation and retail supply activities ('segmental statements'). Specifically,

¹²⁹⁰ [Provisional findings](#), paragraph 11.86.

pursuant to sections 16B and 19A¹²⁹¹ of the gas and electricity supply standard licence conditions respectively, Relevant Licensees (as defined in the standard licence conditions¹²⁹²) are required to prepare and publish on their website a consolidated segmental statement¹²⁹³ in respect of information relating to the revenues, costs and profits of their activities in the generation and supply of electricity and the supply of gas and electricity to any premises.

10.218 We note that currently only the Six Large Energy Firms qualify as Relevant Licensees and therefore, in the section below, we discuss this proposed remedy with reference to the Six Large Energy Firms. For the reasons set out in paragraphs 73 to 75 of Appendix 10.3, we are not proposing to change this definition.

10.219 We described the evolution of the current reporting regime from when it was first proposed in 2008 to the current position in Appendix 11.1 of our provisional findings. The key elements of the current regulatory reporting regime (ie as reflected in the 2014 segmental statements) are that:

- (a) the profit and loss accounts are segmented by broad generation technology and broad retail customer type, in line with each of the Six Large Energy Firms' organisational structure;
- (b) no balance sheets are provided;
- (c) wholesale energy revenues and costs are measured diversely (and therefore not comparably¹²⁹⁴ across firms);¹²⁹⁵
- (d) figures are prepared on a (modified) historical cost accounting basis;

¹²⁹¹ The current requirements under this reporting regime are set out in Standard Condition 16B of [Electricity Generation Licences](#) (p53) and Standard Condition 19A of the [Electricity](#) (p104) and [Gas Supply Licences](#) (p100). These licence requirements are supplemented by [Ofgem's reporting guidelines](#).

¹²⁹² Relevant Licensee means the holder of a supply licence granted if (a) it supplies, or it and any of its affiliates jointly supply: i. electricity to more than 250,000 domestic customers; or ii. gas to more than 250,000 domestic customers; or iii. electricity to more than 250,000 non-domestic customers; or iv. gas to more than 250,000 non-domestic customers, respectively; and (b) it or any of its affiliates is a holder of an electricity generation licence.

¹²⁹³ We note that the term 'consolidated' in 'consolidated segmental statements' is misleading in the context of this regulatory reporting regime. This is because the purpose of the regime is to provide **segmental** rather than **consolidated** financial information and because, although the retail supply and generation profit and loss accounts are added together to give a total, this does not constitute the outcome of a full consolidation across this part of the value chain.

¹²⁹⁴ We discuss the qualitative characteristic of financial information that is comparability in Appendix 10.3, paragraphs 59–63.

¹²⁹⁵ See provisional findings, [Appendix 10.5](#), Annex A.

(e) there are no prior year comparatives;¹²⁹⁶ and

(f) the profit and loss accounts are audited and published in the form mandated by Ofgem.

10.220 Ofgem publishes every year a document comparing and contrasting revenues, costs and profits across firms and across time, together with some commentary.¹²⁹⁷

- *Description of the feature: lack of a regulatory requirement for clear and relevant financial reporting concerning generation and retail profitability*

10.221 We note that Ofgem has put considerable effort into setting up and improving this financial reporting obligation since its introduction in September 2010,¹²⁹⁸ and that this has influenced some of the Six Large Energy Firms which have adopted market-based transfer charging practices since then. In our view, however, the segmental information produced under this regime is not sufficient for Ofgem to be able to undertake and interpret the Six Large Energy Firms' profitability in generation and retail supply in a way that provides a clear understanding of outcomes in all of the relevant markets.

10.222 As an example, Ofgem has not been able to assess if, and to what extent, each of the Six Large Energy Firms has made profits in excess of their cost of capital and interpret that profitability by distinguishing between the Six Large Energy Firms' performance as suppliers and their performance as purchasers of energy. As a result, Ofgem's ability to assess the state of competition in the energy markets, identify issues and then take appropriate actions will be seriously hampered.

10.223 We also note that the Six Large Energy Firms are not under a requirement to provide a balance sheet for their generation operations despite the fact that the costs of investment in fixed assets can be very significant. We have noted a fundamental lack of comparability between firms¹²⁹⁹ due to inconsistencies in the reporting of their generation activities. While we have provisionally not found evidence of excessive profitability in generation in the

¹²⁹⁶ Since their inception in respect of the 2009 financial year, each of the Six Large Energy Firms' published segmental statements provided results for the current period only even though each of the Six Large Energy Firms had also been active in the immediately preceding prior period in both generation and retail supply.

¹²⁹⁷ For example, [the revenues, costs and profits of the large energy companies in 2013](#). For 2014 this analysis was included in Ofgem's [Retail and Wholesale Market Reports](#).

¹²⁹⁸ Ofgem (2010), [Update on Energy supply probe remedy: publication of segmental generation and supply accounts by energy companies](#).

¹²⁹⁹ See Appendix 10.3, paragraphs 59–63 for a discussion of comparability.

recent past,¹³⁰⁰ Ofgem should, in our view, be in a position to make its own assessment in the future. This lack of comparability between firms is likely in our view to hamper Ofgem's future ability to assess the nature of competition in generation markets and identify appropriate actions.

10.224 In parallel, there has been a lack of stakeholder confidence in, and understanding of, the information provided under this financial reporting obligation, particularly around transfer charging.¹³⁰¹ We believe this has contributed to a lack of shared understanding of market trends and of the nature of competition, which has contributed to the overarching feature that we have provisionally identified, ie a lack of robustness and transparency in regulatory decision-making.

- *Our proposed remedy and envisaged outcome*

10.225 The remedy we proposed in the Remedies Notice sought to ensure that Ofgem regularly obtains the financial information from the Six Large Energy Firms that will allow it to undertake and interpret robust profitability analysis in both the generation and retail markets. This analysis, in conjunction with other relevant evidence, will then allow Ofgem to provide a trusted assessment of the state of competition in generation and retail markets, and in turn make better decisions. This same information would also make an important contribution to other stakeholders gaining confidence in the robustness of the reporting of the financial performance of the Six Large Energy Firms as generators and retail suppliers, and therefore an understanding of their businesses.

Aim of the remedy

10.226 The purpose of the proposed remedy is therefore to ensure that Ofgem obtains from the Six Large Energy Firms clear and relevant financial information so as to be able to assess and interpret generation and retail profitability. This analysis will then allow Ofgem, in conjunction with other relevant evidence, to assess the state of competition in GB generation and retail supply markets, take relevant decisions and provide a clear and trusted assessment of the energy markets that will inform the public debate.

¹³⁰⁰ See provisional findings report, paragraphs 4.88 & 4.89.

¹³⁰¹ Transfer charging can be used to transfer profits from one part of the value chain (eg retail supply) to another one (trading or generation). If these other parts of the value chain are either not subject to reporting requirements (eg trading) or make losses (eg generation), then the true extent of profitability can be disguised. Such a concern was evident in, for example, the questioning by the Energy and Climate Change Committee of the Six Large Energy Firms in 2013. See transcript [Energy Prices, Profits and Poverty](#), 29 July 2013.

10.227 Ofgem and other stakeholders, as set out in Appendix 10.2, raised wider concerns over current segmental reporting, beyond Ofgem's ability to perform such analysis. It is therefore also important that stakeholders have confidence that, regardless of the organisational structure of each of the Six Large Energy Firms, the financial information produced is relevant, complete, understandable and comparable across each of the Six Large Energy Firms. Achieving this outcome, which is important to building trust in the sector, is therefore also an aim of this proposed remedy.

Views of stakeholders

- *Comments on the provisional AEC*

10.228 We received a range of responses from the Six Large Energy Firms, other retail suppliers and generators, consumer advocates and academics regarding this possible financial reporting remedy. Some of the responses, particularly from the Six Large Energy Firms, prefaced their responses to this possible remedy by challenging whether there had been any link between deficiencies in the current reporting regime and adverse effects on competition.

10.229 We have not, at this stage, made a final decision regarding the existence and form of any AEC and/or resulting detriment. We have based our provisional decision on remedies on our provisional findings, with the proposed remedies set out here designed to address the feature giving rise to the Governance AEC of a lack of a regulatory requirement for clear and relevant financial reporting concerning generation and retail profitability. Our final decision on any AEC, and appropriate remedies, will take into account the responses to our provisional findings as well as responses to this provisional decision on remedies.

- *Comments on the possible reporting remedy*

10.230 In this section we have focused on stakeholders' comments on this proposed remedy that specifically address its design, effectiveness and proportionality. These comments relate not just to the formal responses to the Remedies Notice but also any comments relevant to the development of the remedy in hearings we held with the Six Large Energy Firms and Ofgem after we published our provisional findings report.

10.231 We have included a thematic summary of stakeholders' responses regarding the remedy and a summary of responses on a stakeholder-by-stakeholder

basis in Appendix 10.2. We highlight some of this feedback in the discussion below concerning the design of the reporting remedy.

Design considerations

10.232 We have identified four key deficiencies in the existing regulatory financial reporting obligation:

- (a) Some firms' activities are separated along firm-specific divisional lines rather than relevant market lines.
- (b) Firms are not required to provide a balance sheet as well as profit and loss account.
- (c) Wholesale energy costs for retail supply are not disaggregated in a manner that allows Ofgem to understand, for the purposes of its regulatory functions, the level of profitability of the Six Large Energy Firms' retail activities on a comparable basis.
- (d) Firms are not required to provide prior period comparatives.

10.233 In this section, we explain the impact of these deficiencies on Ofgem's ability to carry out its statutory functions and set out our proposed enhancements to address each of them. These enhancements will, in our view, ensure that Ofgem receives on a regular basis 'clear and relevant financial information' regarding the Six Large Energy Firms, and therefore will contribute to remedying the proposed Governance AEC. Later in this section we consider how to implement this remedy.

- *A: Separation of firms' activities along market rather than divisional lines*

10.234 The Six Large Energy Firms are all large businesses active in a number of different geographical markets (including the GB energy markets). We have found in their current financial reporting to Ofgem that the activities which each of the Six Large Energy Firms groups into its generation and retail supply divisions differ across the Six Large Energy Firms. This reflects their different choices about the best way to organise themselves internally across their value chain (ie divisional lines), and not necessarily the different markets in which they compete (ie market lines).¹³⁰² However, our view is that Ofgem needs financial information based on market definitions, rather

¹³⁰² By this we mean that each of the Six Large Energy Firms makes its own choice on what it considers to be the most effective organisational set-up for its organisation as a whole. However, we do not see each of the Six Large Energy Firms to be competing in different product markets as regards GB generation and retail supply.

than on firms' operating divisions, to assess the state of competition in these markets.

- 10.235 More specifically, one shortcoming of the current regime relates to the accounting for wholesale energy. For some of the Six Large Energy Firms, transfer charges across market boundaries are not always based on market prices for products available in the market at the time of the purchase or sale, and even when transfer charges are broadly based on such principles, they are sometimes based on bespoke products that are relatively illiquid.
- 10.236 Our provisional view is that the solution to this deficiency is for the Six Large Energy Firms to report their activities along market lines, which are more relevant to the purpose of helping assess the competitiveness of markets, rather than for the Six Large Energy Firms to simply report on the activities which each one has grouped in their 'generation' and 'retail supply' operating divisions for that period. This would also have the effect of enhancing considerably cross-firm comparability.
- 10.237 Several stakeholders, including all of the Six Large Energy Firms, told us that regulatory reporting requirements should not in any way constrain their ability to run their businesses in the way that best fitted their commercial interests. Our view is that the proposed reporting would not preclude the Six Large Energy Firms from maintaining their own divisional structures (including for the purpose of their annual reports). However, those of the Six Large Energy Firms that chose to base their accounting along divisional lines rather than market lines would be required, under the proposed remedy, to produce a separate set of accounts for regulatory reporting purposes only.
- 10.238 Reporting along market lines for the purpose of our proposed remedy entails the following principles:
- (a) The Six Large Energy Firms should report all activities that relate to a particular market (as defined for that purpose by Ofgem) regardless of how these activities are allocated for statutory or internal reporting purposes.
 - (b) Reporting in relation to each relevant market should be done on a stand-alone basis, taking into account (as per (c) and (d) below) those goods and services a firm in one market provides to itself in another (transfer charging).
 - (c) Transfer charging (for the purpose of (b)) should be based on goods and services transacted freely between one independent party active in one market and another independent party active in another market.

(d) Transfer prices should be based on the prevailing prices for that good or service as per (c) as at the time of sale or purchase.

10.239 In Appendix 10.3 we elaborate on these principles and on the principles for identifying relevant markets and segments within markets.

10.240 We also propose that the Six Large Energy Firms should use only standard wholesale products, and not bespoke products, as the basis for transfer charging between the different markets in respect of internal supply. We believe that such a measure will help ensure that transfer charging is seen to be robust, reliable, consistent over time, and comparable between the Six Large Energy Firms.

10.241 We propose to recommend that Ofgem publish the Six Large Energy Firms' financial statements prepared along market lines (and not on a firm-specific divisional basis as is currently the case).

- *B: Provision of balance sheet as well as profit and loss account*

10.242 The Six Large Energy Firms are not currently required to prepare balance sheets alongside their profit and loss accounts either for generation or retail supply. As a result, Ofgem cannot undertake an analysis of the profitability of the Six Large Energy Firms' generation and supply activities, which would involve calculating the return on capital earned by such firms and comparing that return to a benchmark 'normal' rate of return¹³⁰³. When undertaking our profitability analysis within the context of this investigation, we also found that not all of the Six Large Energy Firms were able readily to provide robust balance sheet information, even at a broad market level.

10.243 This is a particularly important issue for generation, as it is a very capital-intensive activity. Working capital requirements (debtors and creditors) are also significant and can differ materially across markets and market segments (eg retail domestic direct debit customers versus standard credit customers).

10.244 We propose that the Six Large Energy Firms should be required to prepare balance sheets at least to cover all generation markets and all retail supply markets separately. This should be done along market lines (for reasons akin to those set out in paragraph 10.234. The profit and loss account would

¹³⁰³ Currently Ofgem can compare margins across the Six Large Energy Firms (albeit not necessarily on market lines). However, an assessment of margins (or profits) does not enable an assessment of profitability because the latter requires all costs of supply to be taken into account, including those that relate to balance sheet items.

need to tie in with the balance sheet, the profit in the former reconciling¹³⁰⁴ with the change in net assets in the latter.^{1305,1306} Providing a balance sheet on such a basis will enhance the integrity of the profit and loss account by helping to ensure that no items are missing and that revenues and costs in the profit and loss account are consistent with values given in the balance sheet.

10.245 Some of the Six Large Energy Firms have submitted that preparing balance sheets without also revaluing assets to their current value would not assist Ofgem.¹³⁰⁷ We disagree. The purpose of this requirement is to provide the information Ofgem needs as a starting point to undertake and interpret the Six Large Energy Firms' profitability in the different relevant markets. This does not preclude Ofgem needing, on occasion, to make adjustments to that information, subject to it determining that any change is proportionate to the aim it needs to achieve. Indeed, we recognise that Ofgem may need to update certain assets or liability values to undertake and interpret its profitability analysis. Balance sheets as per our proposal, although imperfect, will at least provide Ofgem with balance sheets that are complete and internally consistent with suppliers' profit and loss accounts, which will be a considerable advantage when undertaking a profitability assessment.

10.246 We propose to recommend that Ofgem publishes the Six Large Energy Firms' balance sheet information, prepared along the market lines as set out in paragraphs 10.234 to 10.241, as a minimum for generation and retail supply separately.

- *C: Disaggregation of wholesale energy costs for retail supply between standardised opportunity cost and residual elements*

10.247 The cost of wholesale energy is the single largest cost item in the profit and loss account for retail suppliers. However, the amounts reported for wholesale energy reflect each firm's purchasing strategy regarding both the timing¹³⁰⁸ and choice of wholesale product. As wholesale energy prices can trend upwards or downwards over time, the level of reported costs, even for standard wholesale products, can be heavily influenced by the timing of

¹³⁰⁴ The reconciling items would relate to transactions with owners, such as dividend payments.

¹³⁰⁵ See *Profits determined on the basis of comprehensive income*, paragraphs 52–54, within [Appendix 10.1](#) (Profitability approach) to the provisional findings report.

¹³⁰⁶ This requirement would not involve a fundamental change of approach to current reporting for the profit and loss account, rather it might mean that certain profit and loss items, which are currently treated as reconciling items between these profit and loss statements and the segmental statements for statutory reporting, would need to be reported on the face of the profit and loss account. See Appendix 10.3, paragraph 34.

¹³⁰⁷ Appendix 10.2, paragraph 15.

¹³⁰⁸ ie how far ahead of the delivery period a firm agrees to purchase wholesale energy.

purchases. Likewise, bespoke purchases delivered in the current period may well reflect prices negotiated some time ago and as part of a broader, multi-period agreement.

10.248 In addition, reporting wholesale energy costs on the basis of each of the Six Large Energy Firms' individual purchasing strategy has done little to address the persistent question as to why retail prices for some domestic and small business consumers appear not to have tracked changes in prevailing wholesale energy prices.¹³⁰⁹ There is currently no mechanism by which the Six Large Energy Firms can be held to account following marked changes to the prevailing cost of wholesale energy.¹³¹⁰ The perceived lack of relationship between wholesale and retail prices has led to a persistent concern that the prices paid by many consumers for energy might not reflect the outcome of a process of strong rivalry between retail suppliers.

10.249 Historically, however, no consensus between stakeholders has been reached to identify the most relevant way to measure wholesale energy costs for the purpose of understanding this relationship and the level of profitability of the Six Large Energy Firms in their retail activities. At least three different approaches have been advocated by different stakeholders:

- (a) an 'accounting' approach based on incurred costs (outturn or forecast depending on context);¹³¹¹
- (b) an approach based on costing wholesale energy on the basis of prevailing wholesale spot prices;¹³¹² and
- (c) an approach based on costing wholesale energy on the basis of prevailing wholesale forward prices, typically one year ahead.¹³¹³

10.250 We discuss the merits of each approach in turn.

10.251 An accounting approach would be to use the costs incurred by each retail supplier for this purpose. However, simply taking reported historical costs (eg as reported in segmental statements), would not reflect competitive

¹³⁰⁹ See provisional findings report, [Appendix 7.2: Cost pass-through](#).

¹³¹⁰ We note that the concern about the relationship between cost and price of retail energy has not been limited to wholesale energy costs. Stakeholders seeking to promote the interests of consumers have also had the desire to be confident that changes in retail prices attributed to changes in level of network costs and the cost to retail suppliers meeting environmental and social obligations, were also reflective of the cost of provision. The difference between wholesale energy on the one hand, and network and environmental and social costs on the other, is that there has been no consensus across all stakeholders about how to measure the cost of wholesale energy for these purposes.

¹³¹¹ See [Appendix 10.2](#), paragraphs 8 & 11, for examples.

¹³¹² See the provisional findings report, [Appendix 10.5](#), Annex B for an example.

¹³¹³ See provisional findings report, [Appendix 7.2](#) as an example of this approach.

market dynamics. In a competitive market, one would expect retail suppliers to be constrained by the prices that rivals offer customers (and therefore the costs that these rivals incur to supply those customers).

- 10.252 One possible variant of this ‘accounting’ approach would be to substitute the historical cost of any bespoke purchases with an estimate of the cost of purchasing the same volumes of gas or electricity using standard wholesale products at the same point in time as when the bespoke purchases were contracted for.¹³¹⁴ Another variant of this ‘accounting’ approach is to use a stylised purchasing strategy such as implemented in Ofgem’s SMI. Whilst such an approach was not firm-specific, it was intended to broadly reflect the costs that would have been incurred by a firm typical of the Six Large Energy Firms.¹³¹⁵
- 10.253 The most ready, and easily implementable, alternative approach to measuring wholesale energy costs would be to substitute actual purchase costs with purchase costs based on wholesale ‘spot’ prices prevailing at the time of delivery. This approach has an intuitive appeal in that, in a market characterised by perfect competition, the market-clearing wholesale price (ie spot) will equate to the marginal cost of production/supply at the point of delivery, be it in relation to generation or wholesale gas supply.¹³¹⁶ The limitation of such an approach is that it analyses wholesale prices from the perspective of a generator and/or wholesale gas supplier deciding whether it should run a generation plant or physically supply gas, not from the perspective of a retail supplier.¹³¹⁷ Furthermore, as explained below, for a retail supplier to purchase all the volumes it requires at, or near the time of delivery, could constitute an imprudent approach to managing the risk of adverse price movements concerning wholesale energy. We note that such an approach historically has been a major contributory cause of several retail suppliers, both small and large, going bankrupt.¹³¹⁸
- 10.254 A third candidate approach that is often advocated would be to estimate, over a series of successive points in time, the total cost that a retail supplier would expect to incur to supply a customer using the prices for standard wholesale products¹³¹⁹ prevailing at each point in time.¹³²⁰ Such an

¹³¹⁴ This is the approach we put forward in our Remedies Notice, paragraph 108(a).

¹³¹⁵ See also second footnote to paragraph 10.276.

¹³¹⁶ See provisional findings, [Appendix 4.1](#) regarding discussion of generation supply stack model.

¹³¹⁷ As explained in paragraphs 25–28 in Appendix 10.3, between generation and wholesale gas supply, there is a trading ‘market’.

¹³¹⁸ See Appendix 3, *Exits from the supply markets since 2000 (to 2006)*, of Supplementary evidence submitted by Energywatch to the Select Committee on Business and Enterprise, dated 28 July 2008.

¹³¹⁹ These products would be forward products.

¹³²⁰ See graph titled ‘Not laughing’ in article titled ‘[The Energy Business](#)’, *The Economist* (13 February 2016) as an example.

approach, however, would not take into account the cost to retail suppliers of meeting the **actual** demand of their customers in subsequent reporting periods, that will also be a function of, among other things, the extent of the departure from seasonally expected weather norms experienced for that period and the accuracy with which the retail supplier has been able to forecast its customer numbers over that same period.

- 10.255 No consensus has emerged on which, if any, of these approaches is most relevant to assessing the intensity of competition in the GB retail supply sector and profitability of firms.
- 10.256 However, for the reasons set out in paragraphs 10.247 and 10.248, we consider there is a compelling need for developing a common measure of wholesale energy costs that can be applied across the Six Large Energy Firms. This would make the relationship between wholesale and retail prices more transparent and therefore lead to a greater understanding of the nature of competition in the retail markets.
- 10.257 In our Remedies Notice we proposed to assess the cost of wholesale energy used within retail supply solely on the basis of market prices for standard wholesale products.¹³²¹ The Six Large Energy Firms pointed out certain limitations of such an approach and the alternative ‘spot’ pricing scenario analysis we had previously carried out.¹³²² They submitted that the former did not necessarily reflect their actual purchase costs and that the latter reflected an imprudent approach to purchasing which would substantially increase the likelihood of a supplier becoming insolvent, if wholesale costs were to rise sharply.¹³²³ We have therefore revised this aspect of this proposed remedy.
- *Our revised proposed remedy concerning the costing of wholesale energy costs for retail supply*
- 10.258 Businesses tend only to commit to deliver goods or services at a future point in time for an agreed price if they are also able to purchase their major inputs for meeting this commitment at the same time. Such an approach affords businesses a degree of confidence about the profit margins they will

¹³²¹ This is the first variant of the accounting approach discussed in paragraph 10.251.

¹³²² Provisional findings report, [Appendix 10.5](#), Annex B (Wholesale spot scenario analysis).

¹³²³ [Appendix 10.2](#) paragraphs 8–12.

eventually earn.¹³²⁴ This is particularly the case when the prices of certain major inputs can unexpectedly rise sharply.

- 10.259 We have observed that energy firms also tend to adopt this approach. For example, we understand that generators only sell forward for an agreed price if at the same time they are also able to secure the fuel and carbon allowances required for a given price. Similarly, when agreeing a contract to supply in retail markets on a fixed-term fixed-rate basis, retail suppliers tend to seek at the same time to purchase forward at a given price in the wholesale markets the energy they expect to supply over the term of the contract.
- 10.260 The extent to which suppliers are able to purchase wholesale energy forward therefore influences the range of retail tariffs that firms are willing to offer their customers. Centrica stressed this aspect of the operation of the retail market to us.¹³²⁵ Retail suppliers may be reluctant to supply customers under a particular tariff at a given price unless they can at the same time purchase the wholesale energy they expect to supply at that given price in forward markets, at least on an approximate basis.
- 10.261 By purchasing forward when taking on a commitment to supply their customers on a particular tariff at a given price, retail suppliers minimise their exposure to subsequent movements in wholesale energy costs without resorting to costly insurance products. By **not** purchasing ahead of taking on a commitment to supply retail customers, suppliers would also avoid the risk of paying more for wholesale energy than they could expect to recover in a highly competitive retail market.¹³²⁶
- 10.262 We describe the cost of purchasing in line with this approach set out in the paragraph above as the purchase ‘opportunity cost’, rather than a historical or current (‘spot’) cost. At the point at which a retail supplier commits to supply its customer on a particular tariff at a given price, we could expect a prudent retail supplier to purchase forward its expected wholesale energy requirements in order to be confident that it will in due course be able to

¹³²⁴ We note that this practice is called hedging. We, however, tend to avoid the use of the term hedging because it can relate to purchasing wholesale energy for transactions a firm forecasts that it will enter into, rather than ones that it has contractually entered into. As we explain later, we make a distinction between these two types of ‘hedging’.

¹³²⁵ Appendix 10.2, paragraph 10.

¹³²⁶ We note that a ‘highly competitive’ market represents a more exacting standard than the “well-functioning” market referred to in our Guidelines. We are proposing the ‘highly competitive’ standard for this analytical purpose (ie to determine a measure of the purchase opportunity cost) rather than for normative purposes (ie this is how the retail market should operate).

meet its obligations in relation to its customers.¹³²⁷ Under this approach, the (expected) cost of pursuing the opportunity to supply an individual customer is therefore the prevailing wholesale market price at the point of taking on the commitment to supply, ie the date of the contract between the retail supplier and customer. This amount represents the cost of the other commercial opportunities foregone by the retail supplier.^{1328,1329}

- 10.263 Costs calculated on this purchase opportunity cost basis would at the same time reflect the costs of purchasing wholesale energy that one might expect to observe in highly competitive markets. In such a retail market, suppliers who had not purchased key inputs ahead of having a guaranteed profitable outlet for them, would be compelled to factor into their prices the prevailing cost of satisfying the obligation to supply.
- 10.264 Reporting on the basis of incurred cost (or an approximation thereof) as the Six Large Energy Firms currently do in their segmental statements is likely to cause a problem when interpreting profitability because reported performance will reflect a mix of (a) a firm's performance acting as a retail supplier, and (b) the outcome of the way in which that firm has actually purchased its wholesale energy, the latter of which may not be directly relevant for assessing the nature of competition in the retail markets.
- 10.265 We propose that the Six Large Energy Firms should disaggregate their actual wholesale energy purchase costs for their retail supply businesses between an opportunity cost calculated on a standardised basis and a residual amount. We propose to achieve this by recommending the introduction of a reporting rule that involves standardising the point ahead of delivery at which it is deemed that the Six Large Energy Firms take on the commitment to supply. This point would be the point at which each of the Six Large Energy Firms becomes contractually committed to supply energy on a particular tariff at a given price for the volumes that the customer will demand. For example, for a one-year fixed-term fixed-rate tariff, this point would currently be roughly two weeks before the start of the 12-month

¹³²⁷ A retail supplier could, of course, choose not to purchase at this point and rely on near time and spot markets. However, such a retail supplier would be taking on the risk of adverse price movements that could threaten it with bankruptcy. Historically such an approach has not been sustainable over the longer term. See paragraph 10.253.

¹³²⁸ While, in principle, such a firm could sell on any energy it had already purchased, it would remain under an obligation to supply the customers it had previously contracted with. So, were the firm to sell on this energy in practice, it would then have to purchase the requisite amount of wholesale energy once again at the subsequently prevailing price. The firm would, therefore, leave itself exposed to unexpected movements in wholesale energy prices between the point at which it sold the energy it had originally bought and the point at which it purchased the energy for the second time.

¹³²⁹ See also paragraph 10.254 as an example of this approach.

delivery period. For the SVT, this point would be approximately a month ahead of delivery.¹³³⁰

- 10.266 Under this proposed approach, while requiring more granular information on wholesale energy costs to be published by each of the Six Large Energy Firms than is currently the case, the information would help Ofgem disaggregate outturn financial performance for each of the Six Large Energy Firms between (a) its performance acting as a prudent retail supplier operating in a highly competitive market, and (b) the outcome of the way in which that firm has actually purchased its wholesale energy.
- 10.267 Our proposal to recommend that Ofgem mandates that each of the Six Large Energy Firms disaggregates its wholesale energy costs for retail supply for reporting purposes in line with the approach described above, should not be interpreted as our advocating that energy firms, and in particular the Six Large Energy Firms, should necessarily purchase their wholesale energy in this way.
- 10.268 We propose that firms calculate the opportunity cost of their wholesale energy purchases on this standardised basis using standard wholesale products. This is for two main reasons. Firstly, this approach will strip out any variations in cost arising from the use of non-standard products. Standard products are products which guarantee the supply of a stipulated quantity of energy over a stipulated period whereas non-standard products feature other potential benefits or disadvantages, which effectively means they are bundled products.¹³³¹ Secondly the prices for the standard wholesale products are the result of a market process that we have provisionally found to be competitive and are readily observable and verifiable (see Section 5 of our provisional findings report).
- 10.269 We set out further details of how we propose the Six Large Energy Firms should estimate the opportunity cost of their wholesale energy purchases on a standardised basis for each type of tariff, including evergreen tariffs such as the SVT, in Appendix 10.3. We propose to recommend that the methodology described in Appendix 10.3 be incorporated either directly into

¹³³⁰ See Appendix 10.3, paragraph 53 for further detail of this proposed treatment of the SVT tariff for the purpose of calculating purchase opportunity costs.

¹³³¹ For example, long-term gas contracts can feature the option to buy more in one period to meet exceptional demand at the price stipulated in the contract at the expense of being able to buy less in another future period. This is a valuable 'swing' option to a retailer supplier who otherwise might have to buy extra energy at an elevated spot price reflecting the exceptional demand at that point in time. Another example is that a purchaser of intermittent energy, like wind, takes on the added cost of addressing any shortfalls/excesses between what the wind farm was predicted to supply and what it actually did supply.

a standard licence condition or guidance that is directly linked to the condition.

- *Residual wholesale energy costs*

10.270 There will be some actual cost that retail suppliers have incurred that is not captured within this measure of the purchase opportunity cost. We call this the residual cost. This residual cost will reflect the cost to the retail supplier of holding positions in the wholesale energy market arising either from purchasing wholesale energy in advance of the point at which it becomes contractually committed or, having taken on a contractual commitment to supply, the firm holding an open position before it contracts for its expected wholesale energy needs closer to the point of delivery. In this way, the residual cost will reconcile the purchase opportunity cost with the actual cost incurred.

10.271 Some retail suppliers may wish to offer a degree of price smoothing on their variable tariffs by changing prices less frequently than the maximum frequency allowed under the contract with their customer or in accordance with the notice period mandated by the regulator for price changes.¹³³² These suppliers may in practice seek to purchase the volumes they expect to supply at the smoothed price somewhat further ahead of delivery than the point at which they become contractually committed to supply their customers at a given price. For suppliers which seek to provide a degree of price smoothing, an element of this residual cost will therefore reflect the incremental purchase cost (on an opportunity cost basis) of supplying energy on this smoothed basis.

10.272 To ensure the integrity of the financial statements, it is important that both the opportunity and residual cost elements of wholesale energy purchases are identified in the profit and loss account. Otherwise retail suppliers would not be able to fully account on the face of the profit and loss account for all of the wholesale energy they have actually purchased in order to supply their customers, and thereby report the profits they had actually made from supplying their customers in the period.

¹³³² Retail suppliers are free to change the price of their evergreen variable tariffs such as the SVT as often as they like subject to the domestic customers' ability to terminate the evergreen contract after giving a maximum notice period of 28 days (SLC 24.6). See Standard Condition 24.6 of the [Electricity](#) (p209) and [Gas Supply Licences](#) (p191).

- *Publication*

10.273 The Six Large Energy Firms currently publish their wholesale energy purchase costs for retail supply on a historical cost basis disaggregated between their domestic and non-domestic customers for both electricity and gas. For the purposes of the proposed remedy, we propose that the Six Large Energy Firms should be required to disaggregate their wholesale energy purchase costs between the estimated purchase opportunity cost and residual cost elements on the face of the published profit and loss account. In the notes to the segmental statements, we also propose that the Six Large Energy Firms breakdown these cost elements by broad tariff type.¹³³³

- *Envisaged outcome*

10.274 With this information Ofgem would be in a better position than it currently is to interpret any individual firm's profitability in the retail markets because there would be a mechanism to identify each of the Six Large Energy Firms' wholesale energy purchase cost on a common, standardised basis. In particular, Ofgem would be able to:

- (a) assess the actual profitability of each of the Six Large Energy Firms, given the purchasing decisions it has made (which includes the incremental impact on profit of each of the Six Large Energy Firms entering transactions on the basis of expected customer behaviour at a portfolio level); and
- (b) use such profitability assessment to inform a judgement on whether retail competition is working effectively, by stripping out the impact of individual firms' purchasing strategies and isolate that profitability that would have been reported had the Six Large Energy Firms, in respect of wholesale energy purchases only, acted as prudent retailers supplier operating in a highly competitive market.

- *Ex ante financial information and the SMI*

10.275 As a complement to accounting information, it is possible to produce forward-looking (ex ante) financial information. This information substitutes, for example, a forecast bill for a typical consumer on a typical tariff for outturn revenues and a forecast of the cost of supplying that customer for outturn costs. As set out in Appendix 11.1 to our provisional findings report,

¹³³³ We note that the cost of complying with this proposed requirement relates to the cost of calculating the estimate of the purchase opportunity cost by broad tariff type, and not the cost of publishing this information.

Ofgem developed alongside the ex post reporting regime its own reports which sought to track the relationship between costs and prices. This initiative became known as the Supply Market Indicator (SMI). In May 2015, Ofgem suspended the SMI ahead of a review of the information it collected and published so that it could provide greater transparency about the market to inform the energy debate.¹³³⁴

10.276 In its most recent form the SMI sought to compare the expected annual bill under the SVT of one of the Six Large Energy Firms for a domestic customer with typical energy consumption against the costs¹³³⁵ that Ofgem forecast that such a retail supplier would need to incur in order to supply that typical customer. Having established the forecast bill total and associated costs, Ofgem then inferred a retail supply margin that the chosen firm of the Six Large Energy Firms concerned might be expected to earn in the following 12 months. For the wholesale energy cost element of this calculation, Ofgem estimated the cost it expected a firm typical of the Six Large Energy Firms to have actually incurred based on an 18-month stylised hedging strategy.¹³³⁶

10.277 There is a potential read-across between the purchase opportunity cost approach we are proposing and the calculation of wholesale energy costs within the SMI. We therefore considered the relevance of this information to Ofgem's ability to infer trends in the strength of the competitive pressure on SVT prices over time. As already noted in paragraph 10.252, we observe that the measure of wholesale energy costs within the SMI is one that reflects a forecast of costs that would be historically incurred, not the one that might be expected to inform prices in a market characterised by vigorous competition.

10.278 We also observe that to annualise the prevailing SVT prices in order to estimate the expected annual bill builds into the analysis an expectation that such an outcome would be compatible with the workings of a competitive market. We consider that outcome to be unlikely. The enduring characteristic of retail markets is that the market cost of its key input, wholesale energy, is both volatile and subject to discontinuities. As a consequence changes in wholesale cost would be expected in a competitive market to fairly rapidly

¹³³⁴ [Ofgem announces review of markets data.](#)

¹³³⁵ Note that Ofgem did not attempt to forecast all costs that a retail supplier would need to incur, rather only the costs that would be accounted for in each Six Large Energy Firm's profit and loss account for retail supply. Such an approach would, for example, omit the costs of servicing working and other operational capital.

¹³³⁶ In 2008 as part of its Supply Probe work, Ofgem researched how the Six Large Energy Firms actually purchased wholesale energy. On the basis of its findings Ofgem used a strategy where costs are based on firms starting to purchase energy 18 months ahead of the time of delivery as its central assumption to track the relationship between wholesale costs and the domestic retail prices of the Six Large Energy Firms. See paragraphs 1.10 & 1.13 of [Ofgem's Methodology for Supply Market Report](#), 31 January 2012.

impact retail prices, how quickly depending on the extent to which suppliers had already committed to supply their existing customers for a given price in the future.

- 10.279 Citizens Advice told us that we should not focus exclusively on ex post financial reporting and there was also a need for current analysis/forward-looking projection of the costs of retail supply which would help consumers understand the drivers of price rise or price cut. Citizens Advice was therefore concerned about the prospect of a protracted suspension to the SMI.¹³³⁷
- 10.280 In this regard, the purchase opportunity cost approach can also be used to forecast wholesale energy costs on an expected basis. In the paragraphs above we have described this approach applied on an outturn basis (ie the purchase opportunity cost of the firm meeting actual demand in the historical period) because this proposed remedy deals with outturn financial statements.
- 10.281 However, the purchase opportunity cost approach can be used to estimate the level of energy costs that a firm would expect to incur at any one point to meet the expected demand of its customers.
- 10.282 We therefore consider that the purchase opportunity cost would provide a helpful, and likely better, basis against which the Six Large Energy Firms might explain movements in the pricing of their tariffs with regard to changes in wholesale energy prices, rather than using a forecast of the costs as per the approach used by Ofgem's SMI (ie what Ofgem would expect the Six Large Energy Firms to incur were they each to be consistently implementing an 18-month rateable hedging strategy for the SVTs they offer).
- 10.283 As segmental financial statements appear only once per year, typically several months after the balance sheet date (which, in the case of SSE, is three months later than the other Six Large Energy Firms¹³³⁸), Ofgem may want a more timely, if less complete, tool to monitor the trend in the relationship between wholesale costs (ie wholesale energy, network costs and social and environmental costs) and prices. This analysis would be akin to our cost pass-through analysis which stops at $t=0$, and makes no attempt to predict the level of future prices.
- 10.284 Were Ofgem therefore minded in future to develop a revised tool to monitor the linkage between movements in wholesale prices and retail prices, then

¹³³⁷ Appendix 10.2, paragraphs 35 & 146.

¹³³⁸ See discussion of SSE's year end in Appendix 10.3, paragraph 71.

we would encourage Ofgem to consider the purchase opportunity cost approach for measuring wholesale energy costs.

- *D: Prior period comparatives*

10.285 Ofgem's decisions involve making judgements based on evidence, including that relating to the financial performance of the Six Large Energy Firms. Consequently, financial information about one of the Six Large Energy Firms is more useful if it can be compared with similar financial information about the other Six Large Energy Firms and over time.

10.286 Currently the Six Large Energy Firms are required to report their profit and loss figures only for the current period. This has meant, historically, that whenever the Six Large Energy Firms changed their accounting policies or basis of transfer charging from one period to the next, then there was no mechanism to systematically make sure that figures for the prior year were restated, and that the firm appropriately described the changes in the basis of preparation.

10.287 We therefore propose to recommend that the financial statements provided to Ofgem, both the profit and loss account and balance sheet, should include prior period comparatives based on the same accounting rules. The external audit opinion would cover both current and prior period figures. This is standard practice for statutory reporting.

10.288 This will enable Ofgem to undertake and interpret profitability analysis confident that for two adjacent periods the information has been presented on a comparable basis. In the published profit and loss accounts and balance sheets the Six Large Energy Firms would provide comparative figures.

10.289 In Appendix 10.3 we discuss in further detail the importance of comparability in financial information. We explain in that appendix how other elements of our proposed reporting remedy would contribute to greater comparability of the segmental financial information for generation and retail supply across each of the Six Large Energy Firms than has previously been the case.

- *Implementation mechanism for proposed enhancements to existing reporting remedy*

10.290 In our Remedies Notice we proposed that any reporting remedy would be by way of a recommendation to Ofgem rather than by way of order. Either approach would in principle be possible: either Ofgem can modify the

relevant licence conditions or we could issue an order that the Six Large Energy Firms report in a certain way.

- 10.291 A revised reporting regime would be a key tool for Ofgem to ensure it receives the relevant information it needs to perform its statutory functions, and take decisions that are in the best interests of existing and future consumers. Our proposed remedy therefore identifies how certain – highly relevant – financial information should be reported and suggests at least generation and retail supply be covered. We have provisionally decided not to recommend in any more detail the precise formats for the segmental financial statements. These are decisions that Ofgem is best placed to take.
- 10.292 The proposed financial remedy is also likely to need to be updated on a regular basis, a role that would naturally fall to Ofgem. Ofgem may develop its own proposals to enhance the reporting regime, and we believe it would be efficient to manage any such enhancements as part of a single implementation programme. Ownership by Ofgem is also critical to the longer-term success of the financial reporting project.
- 10.293 We have therefore provisionally decided to implement the proposed enhancements to the existing financial reporting regime by way of a recommendation to Ofgem.

Considerations relating to effectiveness

- 10.294 The proposed remedy seeks to revise the current financial reporting regime by way of a recommendation to Ofgem to introduce licence conditions for each of the Six Large Energy Firms to:
- (a) report their generation and retail supply activities along market lines;
 - (b) report balance sheets as well as profit and loss accounts for these activities;
 - (c) disaggregate wholesale energy costs for retail supply across broad tariff types between a standardised purchase opportunity cost and a residual element; and
 - (d) report prior year figures prepared on the same basis as current period figures
- 10.295 We now consider the effectiveness of our proposals as a whole in terms of the objectives we set out for the aim of the remedy above.

- *Effectiveness in providing relevant financial information for Ofgem*

10.296 We consider that the proposed financial information will provide a robust starting point for Ofgem to undertake and interpret profitability analysis. This analysis will then allow Ofgem, in conjunction with relevant other evidence, to assess the state of competition in the markets, identify issues and then take appropriate decisions.

10.297 The first and third proposed measures set out above will at the same time greatly enhance the cross-firm comparability of the financial information and the fourth measure will enhance comparability from one period to the next. Many stakeholders articulated their criticism of the existing reporting regime in terms of the lack of comparability of the financial information produced under it.

10.298 With clear and relevant financial information, Ofgem will also be in a much better position to more effectively:

- (a) investigate developments within markets;
- (b) monitor effectiveness of existing remedies and implement any new remedies; and
- (c) evaluate policy impacts on bills.

10.299 The information will also contribute to Ofgem's ability to carry out an independent evaluation of the broad range of policies governing GB energy markets, as contemplated by other parts of this governance remedies package.

- *Effectiveness in enhancing stakeholder confidence in the segmental financial information produced by the Six Large Energy Firms*

10.300 By strengthening the principles under which the Six Large Energy Firms transfer costs and revenues into retail supply and generation, the revised reporting regime should provide the comparability and financial accountability of the Six Large Energy Firms that stakeholders have called for.

10.301 We have observed in our provisional findings report (paragraphs 11.9 and 11.10) that there is a lack of shared understanding of the factors that have led to price increases, and that it is possible that the public debate is poorly informed about the factors driving such price increases. We consider our proposal for the Six Large Energy Firms to disaggregate their wholesale energy costs by broad tariff type between that element that a prudent retail

supplier would incur in a highly competitive market and the remainder would provide a better basis for public debate and understanding.

Considerations relating to proportionality

10.302 We now consider the proportionality of our proposals as a whole in terms of the relevant considerations as set out below.

- *Effective in achieving its legitimate aim*

10.303 As explained above, each of the four proposed enhancements to the existing financial reporting regime are designed to enhance Ofgem's ability to perform its functions effectively. As a result, we consider that each proposed enhancement will be effective in achieving this aim by addressing the feature of a lack of a regulatory requirement for clear and relevant financial reporting concerning generation and retail profitability, which in turn should increase Ofgem's ability to carry out its functions effectively. The information produced under the remedy is also designed to improve public understanding of the Six Large Energy Firms' financial performance in generation and retail supply, and therefore help Ofgem providing clear and trusted analysis to other stakeholders (including DECC). This in turn should increase the robustness and transparency in regulatory decision-making.

- *No more onerous than needed to achieve its aim*

10.304 Each proposed enhancement is designed to improve the relevance of the ex post financial information available to Ofgem. This can only be achieved through some sort of financial reporting remedy. We have recognised that there will be a financial cost to the Six Large Energy Firms of complying with the new reporting requirements. However, in limiting our recommendation to those markets in greatest need of this level of transparency (generation and retail supply), and not recommending that Ofgem adopts the new reporting enhancements more broadly (to additional markets) or more narrowly (to granular segments) we believe the proposed remedy is no more onerous than necessary to achieve its aim. In addition, as noted in paragraphs 25 to 28 in Appendix 10.3, we have provisionally decided not to order the Six Large Energy Firms to report separately on their activities in trading markets.

- *The least onerous if there is a choice between several effective measures*

10.305 Each proposed enhancement is in response to a clearly identified reporting deficiency, ie a lack of a particular design feature of the current reporting

regime. As a result we set out a single solution to remedy the lack of each design feature, ie a reporting regime with the design feature. We have reached our proposed remedy having completed detailed analysis of the Six Large Energy Firms' businesses, and having taken into account their representations, we have designed the remedy so that each of the proposed enhancements is no more onerous than needed to remedy the identified deficiency.

- *Does not produce disadvantages which are disproportionate to the aim*

10.306 In the following paragraphs, we consider the likely costs of implementation for each proposed design enhancement before considering the benefits in a holistic way.

10.307 Costs of implementation will be incurred in part by Ofgem, but principally by the firms subject to the proposed remedy, namely the Six Large Energy Firms. Some costs would be one-off and some would be ongoing. There may also be changes in the information that would need to be audited. The starting point for analysis is the cost to the Six Large Energy Firms of ongoing compliance with the current segmental reporting framework (including Ofgem's SMI) and the administrative costs to Ofgem of setting and revising reporting requirements. The cost of imposing this proposed remedy is the incremental costs brought about by the enhancements to the existing reporting regime.

- *Assessment of costs: separation of firms' activities on market rather than divisional lines*

10.308 Most of the Six Large Energy Firms are now in a position to report broadly along market lines. For retail supply in particular, the Six Large Energy Firms either report wholesale energy at the cost to the firm or as a transfer charge into retail supply on the basis of standard wholesale products available at the time of purchase.¹³³⁹ Departures from the principle of reporting along market lines arise chiefly because some of the Six Large Energy Firms have transferred some activities intrinsic to their role as retail suppliers or generators in GB into their trading divisions. As a result, the associated transfer charges are not along market lines.

10.309 Where this is the case, there will be a need for such firms to modify their transfer charging approach only for regulatory reporting purposes. We have not investigated in detail what each individual firm concerned might need to

¹³³⁹ See provisional findings, [Appendix 10.5](#), Annex A.

do and any associated cost. However, we have looked at what one of the Six Large Energy Firms, SSE, has recently done (for its 2014/15 financial year) in order to overhaul the basis of its transfer charging. SSE told us that this investment was part of a wider investment to monitor and manage the risks it took on when buying and selling commodities for generation and retail supply. SSE had spent £[X] of a [X] wider investment on a reporting module which had enabled it to report its generation and retail supply activities on the basis of how they would have interacted with the external market had they not been part of an integrated group.¹³⁴⁰

10.310 Our view is that one of the Six Large Energy Firms with the most to do in this area is likely to be EON. Hitherto EON has reported its generation activities on a (non-market) toll generator basis and its retail supply activities as though E.ON is always able to purchase shaped wholesale energy products. However, E.ON is in the process of splitting itself up¹³⁴¹ and will need to revise its systems accordingly. RWE has a separate issue in that, although it ultimately reports its generation activities on a full function basis, it achieves this outcome by transferring across the net profit or loss on optimising its generation fleet as initially accounted for within its trading division. As a result, it is not practical for RWE to present all revenues and costs as they would be reported by a stand-alone full-function generator.

10.311 The costs of implementation will therefore be quite specific to each of the Six Large Energy Firms and their individual circumstances. Whatever the individual costs may be for some of the Six Large Energy Firms, it is the case that most of the Six Large Energy Firms either do, or have the capability to, report along market lines.

- *Assessment of costs: provision of balance sheet*

10.312 Similarly, the costs of implementing this design enhancement will depend on whether firms already do or have the capability to report along market lines. Therefore there should be little incremental cost, at least so far as reporting at a pan-generation or pan-retail supply basis for the firms who do/can report along market lines.

10.313 However, as discussed in paragraph 9 in Appendix 10.3, one issue we found when conducting our profitability analysis was that not all of the Six Large Energy Firms' working capital balances (debtors and creditors) for their retail supply operating divisions reflected their external payment terms and as a

¹³⁴⁰ Appendix 10.2, paragraph 48.

¹³⁴¹ Appendix 10.2, paragraph 89.

consequence these balances were not stated along market lines. Some of these Six Large Energy Firms then asked us to restate these balances in our profitability analysis. These Six Large Energy Firms would therefore need to restate these balances to reflect external payment terms in order to comply as the difference between the two would be material to an assessment of their total capital employed.

- *Assessment of costs: disaggregation of wholesale energy costs for retail supply between standardised opportunity cost and residual elements*

10.314 The cost of obtaining this disaggregation relates to gathering the necessary input information, doing the calculations and obtaining assurance on these calculations through a suitable audit opinion. Although not prepared for the same purpose, this activity is broadly comparable to the activity Ofgem undertook in order to estimate wholesale energy costs for the currently suspended SMI.¹³⁴² Our proposed remedy, however, requires a two-stage calculation¹³⁴³ to identify opportunity purchase costs on a standardised basis and such costs to be disaggregated by broad tariff type. This process would, therefore, be likely to result in some extra cost to be incurred in order to perform these calculations, and these costs would be incurred by the Six Large Energy Firms.

- *Assessment of costs: prior period comparatives*

10.315 Firms constantly strive to maintain and improve the quality of their financial reporting. From time to time this may result in changes in the basis of preparation. The cost of implementation is therefore the cost of restating the prior period figures and procuring an audit opinion that extends to prior year comparatives.

10.316 The Six Large Energy Firms will incur costs in restating their prior year comparatives whenever they materially change the basis of preparation for their segmental statements. This will depend on how often they need to make material changes. This approach is universal practice in statutory reporting and is what firms would seek to do for internal management purposes.

¹³⁴² Albeit it the SMI's coverage relates to domestic customers only, whereas this proposed enhancement to the reporting of wholesale energy costs would cover all retail customers, ie SME and I&C too.

¹³⁴³ See Appendix 10.3, paragraphs 49 & 50.

- *Assessment of benefits of remedy*

10.317 With the enhanced information that would be produced under this proposal Ofgem would be much better placed to undertake and interpret the Six Large Energy Firms' profitability. Ultimately this will enable Ofgem to make better decisions in its role as regulator. It will also put Ofgem in a stronger position to address stakeholder concerns about profitability as well as perform the analysis to support its full range of responsibilities. This would minimise the risk of undue pressures on Ofgem and thereby help avoid the risk of ill-advised interventions either on the part of Ofgem or other (government) bodies.

- *Assessment of proportionality of remedy*

10.318 It is challenging to quantify the benefits expected to arise from this proposal. However, we believe these benefits, which are expected to arise from better policy making in the future, are likely to be considerable for the reasons set out at the beginning of this section. We note in particular that Ofgem's perceived inability to resolve the debate over the Six Large Energy Firms' profitability was one of the factors that contributed to the reference for this market investigation.

10.319 We also note that the costs are those that need to be incurred to ensure that all of the Six Large Energy Firms, not just those which currently possess the relevant reporting capability, are properly financially accountable for their generation and retail supply activities.

10.320 We therefore consider that the benefits are likely to greatly exceed the associated costs. This proposed financial reporting remedy is, fundamentally, about providing Ofgem with information essential to it being able to perform its functions effectively and it being seen to do so.

Assessment of the proposed remedy against the relevant statutory functions of Ofgem

10.321 Where the CMA is considering whether to modify the licence conditions of entities involved in the transmission of electricity, in deciding whether such action would be reasonable and practicable, the CMA must 'have regard' to the relevant statutory functions of Ofgem.¹³⁴⁴

¹³⁴⁴ Section 168 of the 2002 Act and paragraph 347 of [CC3](#).

- 10.322 Ofgem's statutory functions concerning the transmission of electricity are set out in Part 1 of the EA89, as amended by the EA10, and include (among other things) granting transmission licences, promoting efficiency and economy on the part of persons authorised by licences or exemptions to transmit, distribute or supply electricity, and to secure a diverse and viable long-term energy supply.
- 10.323 Ofgem's principal objective in carrying out such functions is to protect the interests of existing and future consumers of gas and electricity supply.¹³⁴⁵ In reaching a decision to make a recommendation that Ofgem modify a licence condition, we must therefore assess the proposed remedy against Ofgem's principal objective, as set out above.
- 10.324 In our provisional findings, we noted that the lack of robustness in decision-making and implementation increased the risk of poor policy decisions which have an adverse impact on competition. We have also identified within the context of this investigation regulatory interventions which have had an adverse impact on the interest of existing and future consumers (see, for instance, the simpler choices component of the RMR rules, SLC 25A).
- 10.325 As part of our own application of the legal framework requiring us to decide upon proposed remedies that are effective and proportionate,¹³⁴⁶ we have noted that this proposed remedy would contribute to increasing the robustness of the policy decision-making and implementation. It will provide Ofgem with financial information relevant to carrying out its functions effectively, including by providing clear and trusted analysis to other stakeholders (including DECC).
- 10.326 We consider therefore that this proposed remedy, by reinforcing the robustness of the decision-making process, and reducing the risk of poor regulatory interventions by Ofgem or DECC, will be in the best interests of existing and future consumers.

¹³⁴⁵ See, among others, section 3A and section 6B of the EA89.

¹³⁴⁶ These objectives include, among other things, a requirement on the national regulator to take all reasonable measures for a competitive, secure and environmentally sustainable internal market in electricity within the European Community, and ensuring appropriate conditions for (i) the effective and reliable operation of electricity networks, taking into account long-term objectives; (ii) developing competitive and properly functioning regional markets within the European Union; (iii) eliminating restrictions on trade in electricity between member states; (iv) eliminating restrictions on trade in electricity between member states; (v) facilitating access to the network for new generation capacity; (vi) ensuring that system operators and system users are granted appropriate incentives, in both the short and the long term, to increase efficiencies in system performance and foster market integration; (iv) ensuring that customers benefit through the efficient functioning of their national market; and (viii) helping to achieve high standards of universal and public service in electricity supply, contributing to the protection of vulnerable customers.

Proposed package of remedies: effectiveness and proportionality

Assessment of effectiveness

Introduction

10.327 In our provisional findings, we identified an overarching feature of a lack of robustness and transparency in regulatory decision-making giving rise to the Governance AEC. This feature is underpinned by four features, relating to the decision-making process:

- (a) the lack of a regulatory requirement for clear and relevant financial reporting concerning generation and retail profitability;
- (b) the lack of effective communication on the forecasted and actual impact of government and regulatory policies over energy prices and bills;
- (c) Ofgem's statutory objectives and duties which, in certain circumstances, may constrain its ability to promote effective competition; and
- (d) the absence of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making and implementation can be addressed transparently.

10.328 Each proposed remedy that we are considering complements each other and seeks to improve DECC's and Ofgem's decision-making and implementation process by addressing, in whole or in part, one or more of these underlying features. We assess below

- (a) whether this proposed remedies package is effective in achieving the overarching aims of our remedial action;
- (b) whether this proposed remedies package is capable of effective implementation; and
- (c) the timescale over which the proposed remedy measures will take effect

Assessment against aims of the remedies

- *Robust analysis underpinning decision-making and improving transparency*

10.329 For the reasons set out above, in order to ensure that robust analysis is carried out and made available to all stakeholders, therefore informing the

policy debate and the decision-making process, we propose to recommend the following:

- (a) DECC to initiate a legislative change so as to set up a clear and established process for Ofgem to comment publicly, by publishing Opinions, on all draft legislation and policy proposals which are relevant to Ofgem's statutory objectives and which are likely to have a material impact on the GB energy markets; pursuant to this remedy, and for the reasons set out above, Ofgem would be in a better position to openly contribute its technical expertise to the design of policy initiatives with a view to making the decision-making process more robust and transparent.
- (b) Ofgem to publish annually a state of the market report which would provide analysis regarding issues such as (i) the evolution of energy prices and bills over time, (ii) the profitability of key players in the markets (eg the Six Large Energy Firms), (iii) the social costs and benefits of policies, (iv) the impact of initiatives relating to decarbonisation and security of supply, (v) the trilemma trade-offs, and (vi) the trends for the forthcoming year.
- (c) Ofgem to enhance the existing financial reporting obligation so as to ensure that in their reporting the Six Large Energy Firms:
 - (i) separate their activities on market rather than divisional lines;
 - (ii) provide a balance sheet as well as profit and loss account;
 - (iii) disaggregate their wholesale energy costs for retail supply between standardised opportunity cost and residual elements; and
 - (iv) provide the previous period as a comparative using the same accounting rules.

10.330 In order to support these three proposed remedies, we have provisionally decided to recommend Ofgem to create a new unit (eg an office of the chief economist) within Ofgem, which would build expertise across the different areas of the energy markets with a view to publishing annually a state of the market report as set out above.

10.331 We believe that the implementation of these remedies, in combination with the existing current processes, would improve DECC's decision-making. Our remedy relating to Ofgem's role in giving Opinions on draft legislation would contribute to the robustness of DECC's impact assessments, and to the consistency of approach over time and between stakeholders in carrying out

analysis. Also, DECC's assessment of contemplated or existing policy interventions would in our view be greatly facilitated by the existence of an ongoing analysis of the market by Ofgem, which would provide a shared understanding of market trends and of the nature of competition. In particular, this would allow DECC to consider more easily the aggregate impacts of the regulatory framework on, and the trade-offs between, different policy objectives.

10.332 A better designed financial reporting obligation on the Six Large Energy Firms will address specifically the first underlying feature we have identified in our provisional findings. It will allow Ofgem to carry out more robust and detailed analysis on certain key aspects of the markets, making Ofgem's state of the market reports and Opinions more authoritative.

10.333 The creation of a new body internal to Ofgem, such as an Office of the Chief Economist, with cross-cutting expertise, would in our view facilitate Ofgem's exercise of its new functions summarised above, and in turn the effectiveness of our remedial action in improving the robustness of the analysis underpinning the decision-making process.

- *Well-defined powers, roles and objectives aligned with the interests of customers*

10.334 Many initiatives have been taken in the past in an attempt to clarify policy objectives and the respective roles of Ofgem and DECC, in particular the proposal that DECC publish a Strategy and Policy Statement every five years. We strongly support this approach and expect Ofgem to take this Strategy and Policy Statement into consideration in setting out annual work plans for its work and for industry code governance (as regards codes, see below paragraphs 10.397 to 10.403). However, we are concerned that this might be insufficient to address issues arising from Ofgem's statutory objectives and duties (as per the second underlying feature we identified in our provisional findings) and from the implementation of policy (as per the fourth underlying feature we identified in our provisional findings).

10.335 In order to ensure that powers, responsibilities and objectives of stakeholders are well defined, we have provisionally decided to recommend that:

- (a) DECC introduces a plan for a new law which would include a provision deleting paragraph 1C from both sections 4AA of the GA86 and section 3A of the EA89;
- (b) in circumstances where the implementation of a DECC policy objective is likely to necessitate, in order to achieve its stated objective, parallel or

consequential Ofgem interventions (eg through a licence change) or a code modification, DECC and Ofgem publish detailed joint statements setting out:

- (i) an action plan setting out the list of regulatory interventions (including code changes), and the relevant entity in charge of designing and/or approving such interventions, that are necessary in order to implement the policy;
- (ii) an estimated timetable for the completion of each necessary intervention; and
- (iii) where appropriate, a list of relevant considerations that will be taken into account in designing each regulatory intervention.

10.336 As noted above in paragraph 10.73, the recommended changes would remove unnecessary constraints from Ofgem's statutory objectives and duties which may lead to suboptimal decision-making.

10.337 As noted above in paragraph 10.153, clear and transparent plans regarding decision-making and implementation of specific policies would in our view increase transparency about the complete process of decision-making, therefore putting stakeholders in a better position to identify inconsistencies between contemplated regulatory interventions and the existing legal framework, including consequential changes that might be required across licences and industry codes. This in turn should lead to better project management of the process of designing, assessing and implementing policies.

10.338 As noted below, our proposed remedies relating to code governance contain a recommendation to Ofgem to provide a strategic direction to the industry and to reflect these strategic objectives in annual work plans set out for each code.

10.339 Together, these proposed remedies will in our view ensure that at each level interventions following consistent objectives are pursued, and will facilitate the coordination between these interventions so as to achieve swift and effective implementation.

The proposed remedies are capable of effective implementation and timeliness

10.340 The proposed remedies that we have explored in this section seek to improve certain aspects of the decision-making and implementation process. In doing so, we are seeking to bolster the ability of relevant stakeholders to regulate these markets efficiently, and therefore to reduce the risk of the

detriment that we have observed continuing. However, the responsibility of any future intervention, and the quality of such decisions, rests ultimately with DECC, Ofgem and, in the context of code governance, the industry. While better processes reduce the risk of suboptimal interventions, it is in our view essential that stakeholders comply not only with the letter of our proposed remedies, but also with the broader spirit, and the overarching principles that underpin them. In practical terms, this means that the effectiveness of our proposed remedial actions will depend to a large extent on the support from stakeholders, and in particular DECC and Ofgem.

10.341 As noted in our guidelines, before making a recommendation to another public body, the CMA will form a view as to the likelihood that the recommendation will be acted upon. In reaching this view, the CMA must have regard both to the stated policy of the body to which the recommendation is to be directed and to the possibility that that stated policy may change, either in light of the CMA's recommendation or subsequent events (and if so, over what time period).¹³⁴⁷

10.342 In this section we have noted that the government's *Green Book* and *Better Regulation Framework Manual* have put significant emphasis on the need for robust economic assessment of policy initiatives. We have also noted that Ofgem considers that monitoring markets forms a crucial part of its role.¹³⁴⁸ We believe that our proposed remedies package is not only consistent with these policies but would support them in seeking to achieve better results, and ultimately better decision-making. Finally, we note that the government has made a commitment to give a public response to any recommendation made to it within 90 days of the publication of a CMA report.¹³⁴⁹ We are therefore confident that DECC and Ofgem will act upon these recommendations in a timely way.

Assessment of proportionality

10.343 For the reasons set out above, we believe that the remedies package as a whole will help to increase the robustness and transparency in regulatory decision-making. Each of the proposed remedies will contribute to this aim by helping to address one of the four features that give rise to the Governance provisional AEC.

¹³⁴⁷ CC3, paragraph 331.

¹³⁴⁸ See, for instance, Ofgem, *Wholesale Energy Markets in 2015*, paragraph 1.1.

¹³⁴⁹ See CC3, paragraph 95.

- 10.344 The first feature is addressed by our recommendation to enhance the existing financial reporting obligation set out in the standard licence conditions.
- 10.345 The second feature (lack of effective communication on the forecasted and actual impact of government and regulatory policies over energy prices and bills) is addressed by our remedies that seek to reinforce the level of analysis carried out by DECC, before and after implementation of primary and secondary legislation, and by Ofgem on an ongoing basis (as summarised above).
- 10.346 The third feature (Ofgem's statutory objectives and duties) is addressed by our recommendation to clarify Ofgem's principal objective.
- 10.347 The fourth feature (absence of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making and implementation can be addressed transparently) is addressed by the remedies that seek to improve coordination between Ofgem and DECC on policy design and implementation.
- 10.348 We believe that this remedies package is no more onerous than necessary and the least onerous as a package to address effectively the Governance AEC. Each of these remedies individually contributes to addressing the overarching feature by increasing the robustness of policy decision-making and implementation. These should not therefore be seen as alternative but as complementary remedies.
- 10.349 For the reasons set out above, we consider that this remedies package would only incur low implementation costs. Some remedies would put some limited additional burden on DECC's and Ofgem's resources, seeking to improve the robustness of the decision-making and implementation process. However, for the reasons set out above, we would expect these costs to be low as Ofgem and DECC are already required to carry out similar actions, and to be partially netted off by efficiency gains arising from an improved process. While we have noted that our financial reporting remedy should only have limited impact on the Six Large Energy Firms that already report on market lines, we acknowledged above that some of them would have to modify their transfer charging approach for regulatory reporting purposes.
- 10.350 However, in the light of the substantial impact of the regulatory framework and other public interventions in the GB energy markets, amounting to several billions each year, and the concrete risk of inefficient outcomes arising from such interventions (as identified in our provisional findings), we

consider that the costs of this proposed remedies package are justified by their aim and expected benefits.

Codes governance

Introduction and relevant context

10.351 In our provisional findings report, we provisionally found that a combination of features of the wholesale and retail gas and electricity markets in GB relating to industry code governance gives rise to the Codes AEC through limiting innovation and causing the energy markets to fail to keep pace with regulatory developments and other policy objectives. In particular, we are concerned that the Codes AEC has the impact of limiting pro-competitive change. The underlying features of the Codes AEC are the following:

- (a) parties' conflicting interests and/or limited incentives to promote and deliver policy changes; and
- (b) Ofgem's insufficient ability to influence the development and implementation phases of a code modification process.

10.352 The functioning of the governance framework for codes has a significant impact on consumers' interests and competition. Since privatisation, and as the GB energy markets have undergone the process of liberalisation, the role of codes within the wider regulatory framework has evolved dramatically. Originally, codes were mainly a tool for setting out common technical rules and standards for the upstream part of the sector.¹³⁵⁰ Under the current regime, codes perform two additional critical functions: firstly, they enable the implementation of high-level policy objectives such as security of supply; and, secondly, they underpin dynamic competition within the retail energy markets by ensuring a level playing field between new entrants and incumbent businesses.

10.353 Codes are therefore critical for the functioning of the regulatory framework, but they are also largely responsible for the complexity of that system. Indeed, following the introduction of eight¹³⁵¹ codes since privatisation, the

¹³⁵⁰ The two industry codes set up at the time of privatisation, the Grid Code and the Distribution Code (defined in Appendix 11.2 to our provisional findings report as the 'technical codes') were intended to provide technical rules relating to the upstream part of the sector.

¹³⁵¹ In Appendix 11.2 to our provisional findings report we identified the following codes as having been introduced since privatisation (they are collectively referred to as the 'commercial codes'): for gas, the Uniform Network Code, the independent Gas Transporters' Uniform Network Code and Supply Point Administration Agreement; and, for electricity, the Balancing and Settlement Code, the Connection and Use of System Code, the Master Registration Agreement, the System operator – Transmission owner Code and the Distribution

codes now include 10,000 pages of legally binding rules. The sheer complexity of this system may increase the risk of certain inefficiencies¹³⁵² and introduces substantial costs which might disincentivise both Ofgem and the industry from engaging efficiently with the code governance framework.

- 10.354 First, and most straightforwardly, the complexity of codes and the related governance arrangements creates significant compliance costs for industry participants. These costs are likely to discourage parties from fully engaging with consultations and other relevant processes. This is a particular concern due to the fact that these costs will weigh most heavily on smaller parties, which are a major potential source of pro-competitive innovation.
- 10.355 Second, this complexity may also be a hindrance to effective regulatory actions and enforcement by Ofgem. In our provisional findings, we noted that Ofgem has experienced difficulties in taking forward certain key regulatory actions. The complexity of the code regime may also be the cause of a reluctance on the part of Ofgem to intervene in areas which are governed primarily by codes (as shown for instance by the small number of Significant Code Reviews launched by Ofgem since it established that process¹³⁵³). We are further concerned that complexity may, in certain circumstances, increase the risk of circumvention and render enforcement more difficult.
- 10.356 In light of the above, we are concerned that Ofgem has not sufficiently sought to develop its expertise, powers and involvement in the code governance framework in a manner commensurate with the increased importance of that framework to competition and consumers' interests. In addition, we are concerned that the current system does not contain sufficient mechanisms which enable the consideration of the long-term development of codes within the broader regulatory framework (including system-level issues such as the appropriate scope and complexity of codes).

Aims of our remedial action

- 10.357 The aim of our remedial action is to ensure that regulation set in codes keeps pace with technical and commercial developments in the GB energy markets and promotes effective competition, consistently with DECC's and Ofgem's strategic objectives and policies. The proposed remedies package

Connection and Use of System Agreement. We note that this list does not encompass two further codes that are outside the scope of this report: the Green Deal Arrangements Agreement and the Smart Energy Code.

¹³⁵² For instance, the complexity of the system increases the risk that analysis to assess the benefits of a particular modification proposal is duplicated due to a lack of coordination between stakeholders (which typically results in Ofgem using its 'send back' powers to require a code panel to carry out further analysis, causing further delays).

¹³⁵³ See Appendix 10.4.

should recalibrate the roles and incentives of Ofgem and code administrators while maintaining industry's involvement – which is required given the technical nature of many code provisions – for the purpose of driving forward the delivery of code changes that affect competition and consumers' interests. This in turn should facilitate the longer-term development of the code governance framework under the supervision of Ofgem, which is ultimately responsible for the overall regulation of the energy markets.

- 10.358 To achieve that aim, our proposed remedies seek to clarify Ofgem's responsibility for the establishment and delivery of a strategic direction for codes, and to revisit code administrators' roles in supporting the industry and Ofgem in their respective functions. As regards Ofgem, these proposed remedies aim to increase its ability to engage more proactively with the code regime to fulfil its responsibilities, in particular to ensure that modification proposals are prioritised by the industry to support DECC's and Ofgem's strategic objectives, and that the analysis supporting recommendations from code panels is sufficient for Ofgem to take a decision. To facilitate such engagement, these proposed remedies create additional discretionary mechanisms through which Ofgem can input into modification processes and discuss cross-cutting issues.
- 10.359 In similar fashion, the proposed remedies package should recalibrate the powers and incentives of the code administrators so that they are able to develop modification proposals in a timely manner that supports Ofgem's decision-making. In particular, this remedies package seeks to ensure that code administrators' incentives are consistently aligned with those of energy customers and that their performance is monitored by Ofgem and improved over time.
- 10.360 Taken together, the changes described above should balance the powers and responsibilities allocated to the relevant stakeholders efficiently, taking into account the:
- (a) resources and expertise of each stakeholder group, as well as their independence from commercial interests (ie ability to act in the interests of consumers); and
 - (b) relative importance of each modification proposal and the need to prioritise scarce resources (eg focus Ofgem's attention on material modification proposals).

- 10.361 We noted in paragraph 10.353 above our concern that the expansion of the code regime is largely responsible for the current complexity of the regulatory framework governing energy markets. Exacerbating the complexity of the code system is the presence of a network of decentralised specialist entities that each govern a separate aspect of the codes regime. In general, we observe that it can be difficult to coordinate decentralised entities that by their nature act pursuant to code-specific objectives and the interests of different sets of stakeholders. This difficulty increases the risk that the delivery of cross-cutting pro-competitive code changes is delayed.¹³⁵⁴
- 10.362 Both government and Ofgem have stated policies seeking to reduce the overall burden of the regulatory framework on the industry. Our analysis and respondents' submissions indicate that there is broad agreement that the current complexity of the system greatly increases regulatory compliance costs, impedes effective monitoring and regulatory decision-making and, in some cases, the delivery of pro-competitive innovations. We consider, therefore, that there is widespread appetite for reforms that would tackle this system-level issue of complexity within the code regime. However, under the current regime no single stakeholder has the necessary combination of expertise, capacity and incentive to drive forward the reform process.
- 10.363 We believe that some of the remedies that we are considering would support DECC and Ofgem in this task of broader reform. Alongside those changes, this proposed remedies package would establish processes that will prompt and facilitate the gradual streamlining of the code regime. We expect Ofgem to keep reviewing the code governance regime and use these processes when appropriate so as to ensure that the regime is fit to handle pending system-level challenges including, for instance, the need to transpose the EU network codes.
- 10.364 In the light of the above, this proposed remedies package should put in place a regulatory framework that creates appropriate incentives and fora for stakeholders to address the system-level issues related to complexity and consider the benefits of consolidation in the long term as well as to align the decisions taken with the legislative objectives.

¹³⁵⁴ For example, Ofgem has put to us that the delays in the delivery of BSC MP 272 were partly attributable to the absence of adequate coordination mechanisms that could ensure the identification of necessary consequential modification proposals to other codes.

Parties' views

General comments

- 10.365 A number of parties (Drax, ESB, Northern Powergrid, Genserv) have put to us that Ofgem's ongoing Code Governance Review, which seeks to implement incremental changes to the current governance arrangements, represents the best method to address the issues that we have identified. Therefore, they have submitted that the CMA should refrain from implementing any of its proposed remedies in this area in order to allow the Code Governance Review process to run its course.
- 10.366 In contrast, Ofgem has proposed a remedy that represents a structural change to the current code governance regime.¹³⁵⁵ Indeed, it proposes the creation of a new single code body in charge of managing all aspects of the codes. Several of the Six Large Energy Firms (Centrica, SSE) have also argued for some form of centralisation of code management, though their suggestions envision a central body that would be more limited in scope, such as one entitled to set a 'strategic direction' for code development, project manage the change process or set, oversee and consult on improvements to the market rules.

Views on the licensing of code bodies (code administrators and delivery bodies)

- 10.367 By licensing the activities of code administrators and code change delivery, this proposed remedy aims to give Ofgem the power to efficiently monitor performance of the relevant code bodies, give them directions and impose sanctions when appropriate. A secondary aim of this proposed remedy is to further the harmonisation of the governance and modification arrangements across codes.
- 10.368 The majority of respondents agreed with the proposed aim of this remedy. In general, respondents (Ofgem, EDF Energy, Centrica, RWE, E.ON, ESB, [X], Co-operative Energy, Ecotricity) agreed that providing Ofgem with greater means to oversee code administrators would have a positive impact by harmonising arrangements and raising standards and service offering. Ofgem has also noted that licensing enables this accountability to be redirected towards the purpose of delivering positive outcomes for consumers.

¹³⁵⁵ See Ofgem's response to our provisional findings report.

- 10.369 RWE agreed that the creation of a separate licensable activity for code administration would address concerns where there are conflicts of interest by transferring code administration to an independent body. Two (out of four total which responded) of the code administrators (Elexon, Gemserv) agreed with the objective of the proposed remedy.
- 10.370 Scottish Power and Ecotricity posed the concern that this change would enable Ofgem to act through the code administrators in a way that would both undermine the code administrators' independence and the principle of industry code ownership.
- 10.371 Respondents provided a wide range of views in relation to the best method to achieve the proposed aim of this remedy. Some respondents chose to emphasise the potential downsides to a licensing regime for code administrators. The main criticisms raised by respondents were that it would be costly to implement (SSE, Gemserv) and complicated to operate (SSE, ESB) as well as that it would offer little benefit (ENGIE and unnecessary bureaucracy into the system (Total). Several respondents (Scottish Power, Drax, ESB, Elexon, Energy UK) argued that strengthening the Code Administration Code of Practice (see our provisional findings report, paragraph 11.127) would be a more flexible, cheaper and easier method to provide Ofgem with a sufficient level of oversight over code administrators.
- 10.372 Some respondents focused on the separate issue of whether a mandatory tendering regime for code administrator services should be considered as an alternative to or duplication of the proposed licensing regime. Several of the Six Large Energy Firms (RWE, EDF Energy, SSE) were open to the idea of a competitive tender regime as an additional means to ensure that code administrators meet the necessary requirements for independence, expertise and resource capacity. Gemserv felt that the main aim of this proposed remedy should be to introduce 'full code administration contestability' and that a tender regime was a better means to achieve that aim than a licensing regime.
- 10.373 Ofgem submitted that there were challenges associated with setting up a tendering regime in this context but that it was both feasible and beneficial. Centrica also felt that any tender process would need to strike a balance between selection in terms of both cost and ability.

Views on the grant to Ofgem of executive powers to draft code changes and set timetables

- 10.374 This proposed remedy aims to provide Ofgem with the powers to direct code changes and introduce mandatory timetables so that it can ensure that key

modification proposals that further consumers' interests or impact competition are developed and implemented in a timely and efficient manner.

- 10.375 A majority of respondents (across all categories of respondent) did not support this remedy, with three criticisms raised in particular. Firstly, some respondents (Good Energy, ICOSS, [X], Engie) argued that this proposed remedy would not add value as it would essentially lead to a duplication of Ofgem's current powers under the Significant Code Review process. Those respondents noted that the net impact of this proposed remedy would be to increase the level of uncertainty and bureaucracy surrounding the code modification arrangements. Secondly, some respondents (Ofgem, Scottish Power, Ecotricity) stated that they were concerned that Ofgem may not have a sufficient level of detailed technical expertise to undertake a greater level of responsibility in relation to the development of code modifications. Thirdly, some respondents (EDF Energy, SSE) were concerned that this change would increase regulatory risk as a result of undermining the ability of industry participants to appeal Ofgem decisions in this context. In addition, EDF Energy stated that the current approach and role of industry and code administrators meant that the risk of unintended consequences was minimised, resulting in a better outcome for consumers.
- 10.376 Ofgem noted two additional reasons as to why it was not appropriate for it to perform the expanded role contemplated by this remedy. Firstly, responsibility for project managing the development and delivery of individual modification proposals did not sit naturally within Ofgem's functions as an economic regulator. Secondly, allocation of this role to a licensee would be preferable as, in that case, there would be strong accountabilities against which performance could be measured and enforced.
- 10.377 Notably, each of the respondents (Centrica, SSE, E.ON) that indicated some form of support for this proposed remedy stated a preference that a much more limited version of the remedy be taken forward. Where Ofgem does have powers to raise its own code modification, Centrica considered it important that industry had the ability to appeal 'on the merits' of the case. Some of those respondents felt that the proposed remedy should merely grant Ofgem additional powers to intervene in order to establish indicative or mandatory timetables in certain, more limited ranges of circumstances, such as for those modifications which have been raised as a result of the SCR process. Other of those respondents argued that Ofgem could add value by providing some form of 'strategic direction' to the industry in relation to Ofgem's desired direction for code development.

Views on the creation of an independent code adjudicator

- 10.378 The aim of this proposed remedy is to streamline the approval stage of the modification process by transferring responsibilities during that stage from Ofgem to a newly created code-specific adjudicator.¹³⁵⁶
- 10.379 Almost all respondents responded negatively or in a lukewarm fashion to this proposed remedy (and some parties appeared to be unclear about the role and purpose of the proposed new body). Only RWE, SSE and EDF Energy supported the idea in principle, but made clear in their respective responses that they would need more detail on the remit of the proposed adjudicator to reach a final view on the matter. RWE has suggested that an independent code adjudicator, separate but working with a new entity dedicated to project managing code changes, should be appointed to make decisions on change and to take on the role currently carried out by Ofgem in relation to industry code modifications. In addition, EDF Energy stated that it could not support the remedy at this stage as the creation of a code adjudicator would bring additional cost, and risk unintended consequences.

Design considerations

- 10.380 We recognise upfront that a material proportion of modification proposals appear to be processed efficiently by the existing industry-led governance arrangements. In particular, we note that the scheme of self-governance, which Ofgem introduced in 2010 to provide a streamlined process for modification proposals deemed by the relevant code panel to be immaterial, appears to have led to quick approval and implementation of modifications, and we have not received submissions that this process has been used inappropriately.¹³⁵⁷ We consider that there is scope to expand the efficient usage of the self-governance scheme and that, to this end, Ofgem could publish additional guidance on how to interpret the key materiality criterion (see paragraphs 47 to 53 of Appendix 10.4 for a further assessment of the self-governance procedures).

¹³⁵⁶ This remedy is based on a submission by RWE in response to our provisional findings that queried whether Ofgem is the appropriate body to evaluate code changes given that it must act according to a statutory basis which encompasses issues not clearly related to the codes (eg sustainability, security of supply).

¹³⁵⁷ However, as noted in paragraphs 18 and 19 of Appendix 10.4, we consider that compared to the industry and code administrators, Ofgem has limited knowledge of certain code provisions and in particular those provisions that have not been the subject of an SCR process or submitted to Ofgem by a code panel. We are concerned that this may also include provisions that may potentially lead to competition issues – such as provisions relating to the allocation of gas tariff pages (see paragraph 10.26 above). As the regulator in charge of pursuing the best interests of existing and future consumers, it is in our view essential that Ofgem has an adequate understanding of the substantive provisions of codes, a clear direction for code governance and the ability to influence the initiation and development of code changes.

- 10.381 We are also mindful that, to the extent practicable, our remedies package should not exacerbate the regulatory burden on the industry and the system-level issue of complexity (as noted above in paragraph 10.353).
- 10.382 In light of the above and of our provisional AEC finding, we have sought to narrow the scope of our remedies to those areas where we have provisionally found that the current arrangements have a negative impact on consumers' interests and/or competition. In general, the design of our remedies seeks to improve the efficiency of those arrangements by adjusting the high-level incentives and roles of the relevant stakeholders rather than by tinkering with procedural details. The remedies considered below would entail a more proactive role for Ofgem in those situations in which code changes are being considered that are likely to have a significant impact on consumers and competition. While in the shorter term this would take the form of more formal engagement from Ofgem with respect to such modification proposals, including directly 'calling them in' where necessary, we expect that over time its involvement will increasingly take the form of influencing the activities of licensed code bodies and industry.
- 10.383 Under the current regime, Ofgem has two main functions in relation to delivering code changes that impact on consumers' interests and/or competition: first, to review (and, where appropriate, approve – it must approve unless there is a negative impact) all material code changes (its 'gatekeeper' function); and, second, to deliver complex or cross-cutting code changes through a SCR when the ordinary industry-led process has failed to do so (its 'gap-filling' function).
- 10.384 We support Ofgem's gatekeeper role. Ofgem is uniquely qualified to perform this function due to the strict legal requirements which protect its independence. Ofgem's obligation to consider its wider statutory duties and objectives in deciding on code changes also helps to ensure that the codes regime is adequately 'joined up' with the wider regulatory framework.
- 10.385 Analysed as a package, however, we consider that there are several interrelated issues with Ofgem's current functions and role in relation to codes including a lack of role clarity, the absence of a truly strategic role, and a lack of adequate discretion to intervene in the codes regime.
- 10.386 The particular configuration of Ofgem's functions has led it to intervene in the codes regime in a reactive and somewhat ad hoc manner. For instance, the code changes that Ofgem reviews as part of its gatekeeper function are

almost solely¹³⁵⁸ the product of industry initiative. Similarly, Ofgem has, in the past, not seemed to be willing to exercise its gap-filling function until it is clear that the ordinary industry-led process has failed to address an issue or is incapable of doing so. From an external perspective, this makes it hard to understand whether or how interventions are consistent with a single codes agenda and, as a result, the extent to which Ofgem and the industry are responsible for system-level developments.

10.387 Our concerns with respect to Ofgem's role in the current regime are the following:

- (a) In the absence of wider strategic expectations or objectives set by Ofgem in those contexts, industry participants are not given strategic signals which they can use to guide their allocation of resources across the portfolio of pending and ongoing code changes, which increases the risk that they allocate their resources inefficiently in the light of Ofgem's expectations, which may lead to delays in modifications processes and, ultimately, the delivery of code changes beneficial to consumers' interests and/or competition.
- (b) Ofgem's functions do not drive it to grapple with important system-level issues such as whether there is inefficient duplication across codes and whether the substantive scope of the codes is appropriate, undermining its ability to assess the impact of the wider regulatory framework.¹³⁵⁹
- (c) Ofgem's ability to intervene in the code regime is limited to either providing informal input through its attendance at code panel meetings and responses to relevant consultation documents, or to exercising its SCR powers to influence the initiation and prioritisation of code changes. While the former tends to be of low impact, the SCR process is an inflexible and resource-intensive¹³⁶⁰ tool that is only appropriate to address the most significant and complex code issues. This leaves Ofgem without the discretion to opt to intervene in an intermediate capacity in situations in which its input may be highly beneficial (eg scoping of analysis).

10.388 We are also concerned that, in the context of some codes, code administrators do not play a sufficient role in supporting the code governance

¹³⁵⁸ The exception to this rule would be code changes initiated following the SCR process, which has occurred infrequently in practice.

¹³⁵⁹ An example of the issues that may result from the current arrangement is the inefficient governance of the distribution of gas tariff pages, as noted in paragraph 10.26 above.

¹³⁶⁰ One indication of this fact is that the SCR processes so far have taken much longer to complete (40 months on average) than Ofgem's anticipated time frame (18 months).

arrangements. Currently, the core role that code administrators perform is secretarial in nature.¹³⁶¹ Some code administrators seem to have limited resources and expertise to assist the industry and Ofgem beyond a secretarial role. This is particularly problematic given the need of smaller code parties for support to engage with codes, due to their complexity, in particular in the contexts of submitting and progressing modification proposals. Therefore, we consider that there is scope to expand the role of code administrators to take on project management responsibilities that do not sit naturally with Ofgem, given its role of economic regulator.

10.389 A related set of issues flows from the inconsistent status and accountability of the various code administrators. As noted in our provisional findings, there is no uniform model for selecting or funding code administrators. We also noted with concern in that document that there is no direct mechanism by which Ofgem can hold those code administrators accountable for their performance.¹³⁶² Further, it is not clear that the incentives of these code administrators are always aligned with those of consumers.

10.390 The above factors have led us to believe that additional mechanisms are needed to ensure that code administrators are appropriately incentivised to perform to a consistent standard and with the right set of objectives. We consider that combining clear accountabilities for code administrators with an expanded manager role for those entities would help to ensure that there is a clear 'owner' of day-to-day responsibilities linked to the delivery of code changes (see Appendix 10.4, paragraphs 25 to 43 and 57).

10.391 As a separate matter, we note that in our Remedies Notice we proposed a remedy that would provide Ofgem with the powers to direct code changes and introduce mandatory timetables for the purposing of ensuring that key modification proposals (ie those that further consumers' interests and/or impact competition) are developed and implemented in a timely and efficiently manner.

10.392 In response to that proposed remedy, a number of respondents have submitted to us that they have concerns relating to Ofgem's ability to direct code changes. In particular, Ofgem has put to us that it does not have the

¹³⁶¹ We note that in 2010 Ofgem's Code Governance Review introduced a secondary role for code administrators to act as 'critical friend' for the purpose of facilitating industry participants' engagement in the governance and modification arrangements. We note further that while some code administrators perform an additional range of substantive functions, including, for instance, the performance of analysis, we note that such work tends to be undertaken on an ad hoc basis rather than as part of a clearly defined role.

¹³⁶² Typically, each code administrator performs services pursuant to a bespoke contractual arrangement with the relevant code parties. We also note that the code administrators must submit annual reports setting out how they have performed against KPIs included within the Code Administration Code of Practice. However, the Code of Practice is non-binding and Ofgem cannot sanction code administrators directly as they are not currently licensed entities.

capacity or the appetite to play a greater role in governing codes through an enhanced SCR process. In addition, various parties (including Ofgem) have stated that resource-intensive SCRs are not an efficient use of Ofgem's expertise or scarce capacity. They claim that Ofgem's capacity could be better leveraged if it were employed in the task of providing the industry with an early steer concerning Ofgem's expectations of:

- (a) the code changes (across all codes) it views as important to further the interests of consumers and/or competition; and
- (b) the scope of analysis required during the development stage of key modification proposals.

10.393 Taking into account the above, parties' submissions and the reasons set out in Appendix 10.4, we have revised our proposed remedies package, as described further below.

Revised remedies package to clarify and recalibrate Ofgem's and code administrators' respective roles and functions in relation to codes

10.394 Our revised remedies package shifts Ofgem's role in this context so that it is centred on a core responsibility to oversee the strategic development of the codes. To ensure that Ofgem has adequate support to fulfil this new responsibility, this proposed remedies package seeks to expand the role of code administrators so that they can progressively take on more of the day-to-day project management of modification proposals.

10.395 We note that the high-level adjustments described above retain the close involvement of industry in the development of codes. This approach reflects both our analysis and parties' submissions which indicate that robust ongoing engagement by the industry is an essential ingredient of a well-functioning code governance framework due to the technical nature of code provisions, which require a level of knowledge and expertise that it would be difficult and inefficient to replicate within Ofgem (see also paragraph 18 of Appendix 10.4). However, we consider it equally essential that Ofgem, as the regulator in charge of pursuing the best interests of existing and future consumers, remain ultimately responsible for the overall regulation of the energy markets, and therefore for the well-functioning of the codes governance arrangements.

10.396 Our general approach to designing this revised remedies package has been to provide Ofgem (and code administrators) with appropriate tools to fulfil the responsibilities set out in our recommendations without prescribing the precise means by which those respective responsibilities should be fulfilled.

In particular, Ofgem should consider on an ongoing basis whether the tools set out in this remedies package create the most efficient balance of responsibilities between the relevant stakeholders in the light of the ongoing evolution of the sector.

New responsibility for Ofgem to produce a strategic direction

- 10.397 We believe that Ofgem should publish a strategic direction in which it sets out its expectations for the strategic development of the codes over the year to come (the 'strategic direction'). This form of strategic direction would enable Ofgem to translate DECC's Strategy and Policy Statement (see paragraphs 10.135 to 10.140 above) into appropriate signals as to how it expects high-level policy decisions to be implemented via code changes. Ofgem should ensure that the steer covers a sufficiently broad time horizon (3+ years) to give the industry an understanding of the volume, nature and proximity of all relevant future changes.
- 10.398 Given our wider goal of ensuring an efficiently joined up system of regulation of the energy markets (see paragraphs 10.35 to 10.39 above), we consider that this strategic direction should be developed and published alongside Ofgem's annual report in response to the Strategy and Policy Statement (which when designated will set out the government's high-level policy goals for energy). In the process of developing this document, Ofgem should consult the code panels, code administrators and code parties to ensure that the strategic direction is capable of providing a meaningful steer to those stakeholders and of forming a basis for the strategic work plans (see paragraphs 10.401 to 10.403 below).
- 10.399 In terms of impacts, we consider that a strategic direction for codes would help identify areas requiring code changes, in the context of Ofgem's and code administrators' powers to initiate and prioritise modification proposals that have a significant impact on consumers' interests and/or competition ('strategically important modification proposals'). On a general basis, the strategic direction would provide code panels with a helpful metric against which they could more efficiently allocate capacity across the portfolio of code changes. Further, the strategic direction would also improve the ability of code panels to interpret what should be considered as 'material' for the purpose of determining which modification proposals should be eligible for self-governance.
- 10.400 Ofgem would be able to implement this remedy simply by publishing guidance stating that it intends to carry out this function. As it develops the strategic direction, Ofgem should coordinate with DECC to ensure that the strategic direction and Strategy and Policy Statement are appropriately

joined up in terms of their content. In addition, Ofgem should correspond with the relevant stakeholders and issue directions, if necessary, to ensure that it receives their input in developing the strategic direction.

New responsibility for Ofgem to lead the production of a set of strategic work plans

- 10.401 We consider that Ofgem could provide considerable incremental value if it developed, in collaboration with the relevant code bodies, a series of documents that set out the changes needed to deliver the strategic direction for each code. For that purpose, we propose that Ofgem should develop a series of code-specific ‘strategic work plans.’
- 10.402 As such, each strategic work plan would contain an indicative list of areas requiring change to implement the strategic direction (ie strategically important modification proposals). These work plans would help to identify key pinch points, risks and dependencies over the relevant time horizon. We consider that Ofgem should establish a development process that ties into the development of the strategic direction and which uses the input of each code panel and code administrator to a degree commensurate with the expertise and capacity of those entities. Ofgem should also consider whether there is incremental value in producing a consolidated cross-code strategic work plan.
- 10.403 Ofgem could implement this proposed remedy by publishing guidance on its website about the form and purpose of the strategic work plans. Ofgem should correspond with the relevant stakeholders and issue directions, if necessary, to ensure that it receives their input in developing the strategic work plans.

Creation of the ‘consultative board’ to serve as a forum for addressing cross-cutting code issues

- 10.404 This proposed remedy would involve a recommendation to Ofgem to create a standing forum (the ‘consultative board’) that would function primarily as a stakeholder management tool. The purpose of the consultative board would be to serve as a flexible forum at which Ofgem and other stakeholders could discuss and consider a range of cross-cutting issues such as matters linked to the development and delivery of Ofgem’s strategic direction, best practice considerations and the system-level functioning of the code regime.
- 10.405 We recognise that Ofgem already has the ability to attend and input at the various meetings held by the individual code panels. However, following our analysis and parties’ submissions, we consider that those fora tend to focus

by their nature on code-specific issues and do not foster the discussion of cross-cutting issues such as those described above. Therefore, in our view, an additional complementary forum dedicated to the discussion of such issues at which all industry stakeholders could participate would create incremental value.

10.406 We consider that the first capacity in which a consultative board would be beneficial relates to the strategic direction and work plans, as it would provide a forum for Ofgem, code administrators and the industry to discuss the development of these documents and ensure consistency across codes.

10.407 A second capacity in which the consultative board could be beneficial is that it could improve the efficiency and provide additional oversight of (strategically important) modification proposals. Centrica suggested that a single 'design authority', taking the role played today by code administrators, would be able to better coordinate cross-code change, resolve areas of contention, prioritise, and generally help project manage proposals such that they are delivered more promptly than today. While we do not propose the creation of an authority with formal powers to (partially) replace code administrators, we believe that the consultative board would provide support to Ofgem, code administrators and the industry so as to improve their ability to contribute to the delivery of (strategically important) code changes and improve the overall quality of the project management. An illustrative range of functions that the consultative board could perform in this context includes the following:

- (a) In relation to the scoping of analysis: providing a formal venue for Ofgem to contribute its initial views on the terms of reference of work groups.
- (b) In relation to the performance of analysis: improving the quality of analysis by ensuring that work groups are composed of members with the relevant expertise and, where appropriate, making additional resources available for the purpose of obtaining such expertise¹³⁶³ as well as reviewing discrete pieces of analysis performed during the development stage (following a request by the relevant code administrator).
- (c) In relation to cross-code changes: helping the code administrators to perform their functions, in particular in relation to identifying cross-code impacts.

¹³⁶³ In certain circumstances, Ofgem (or another stakeholder) may consider it beneficial to have additional analysis performed which goes beyond the relevant code's objectives (and thus would not be analysis included within the remit of the relevant work group or budgeted by the relevant code panel).

10.408 A third capacity in which the consultative board could be beneficial is that it could serve as a forum in which stakeholders could consider and tackle long-term system-level issues, such as revisiting the scope of codes, governance arrangements or reducing the complexity of the regime (eg by harmonising certain processes).

10.409 We do not consider it necessary to prescribe in our recommendation to Ofgem rules relating to the composition and governance of this board, nor to the frequency of the meetings. We would expect the consultative board to be composed of a comprehensive range of stakeholders, including code administrators and parties for each industry code, with Ofgem serving as chair. While Ofgem should seek cross-industry input, it should not design the consultative board's compositional structure in a way that may lead to significant costs or additional resource constraints for some or all industry participants. We note that the consultative board would not be a separate entity with its own powers and would thus only be able to act pursuant to the exercise of Ofgem's, code administrators' and industry's respective powers.

Ofgem to undertake periodic wholesale reviews of the code regime

10.410 Over time, Ofgem is likely to improve its understanding of strategic and cross-cutting code issues through its involvement in the development of the strategic direction and work plans as well as through engagement with stakeholders within the consultative board. We consider that Ofgem could capture the value of that understanding by undertaking wholesale reviews of the codes regime on a periodic basis. Ofgem could then use the findings of those reviews as a basis for making changes aimed at improve the efficiency of the regime, such as consolidating certain codes or reallocating powers and responsibilities between stakeholders.

New powers for code administrators to initiate and prioritise code changes for the purpose of delivering Ofgem's strategic direction

10.411 As noted above, we consider that there is scope for code administrators to perform certain key project management functions for modification proposals, where such project management is appropriate in the light of the complexity of the task and/or the substantive impact that the proposal may have on competition and consumers. In principle, and for the reasons set out in Appendix 10.4, we consider that code administrators could perform these functions by virtue of their expertise in the relevant code processes and their quasi-independent status.

10.412 This proposed remedy would involve a recommendation to Ofgem to grant code administrators the powers to initiate and prioritise code changes which,

in their view, either are necessary to deliver the strategic direction or capable of improving the efficiency of the code governance or modification arrangements.

- 10.413 The first aspect of this power would enable code administrators to fulfil their project management role more effectively by enabling them to increase the resources devoted to the development of changes that they consider to be complex or cross-cutting. Ofgem, as part of its implementation of this proposed remedy, should consider whether it is appropriate to grant itself some means to overrule code administrators' use of this power (eg a binding direction).
- 10.414 The second aspect of this power would lead to better utilisation of code administrators' expertise in code governance and modification processes and would thus improve the efficiency of the modification arrangements.
- 10.415 As code administrators would be subject to a licence pursuant to our proposed remedies package, Ofgem would be in a position to monitor code administrators' performance of these functions and, as the case may be, issue formal directions so as to influence their behaviour as appropriate.
- 10.416 In the long term, we would expect the role of code administrators to increase and to progressively take more responsibility from the industry in terms of management of code processes and performance of analysis, under the joint supervision of Ofgem and industry.

Ofgem to initiate and prioritise code changes for the purpose of delivering its strategic direction

- 10.417 This proposed remedy would involve a recommendation to Ofgem to take powers to initiate and prioritise code changes which, in its view, are necessary to deliver the strategic direction.
- 10.418 Ofgem's initiation of a code change under this power would trigger an obligation for the relevant stakeholders (eg the relevant code administrator and code panel) to develop and submit an end-to-end project management plan (including both the development and implementation stages) to Ofgem. The code administrator would then have an ongoing responsibility to report to the consultative board on the delivery of that plan.
- 10.419 Ofgem would have the option but not the obligation to contribute to the delivery of that plan, for instance, by agreeing to take responsibility for performing a discrete piece of the required analysis. This would grant Ofgem the discretion to tailor its input into the process in a way proportionate to the

materiality of the relevant code change and reflective of its own ongoing capacity.

- 10.420 Ofgem would also have the complementary ability to bestow ‘strategically important status’ on any ongoing modification proposal initiated by another stakeholder that Ofgem considers to be strategically important in the light of the strategic direction. In the event that Ofgem bestows that status on a particular code change, the modification process to develop that modification proposal would be subject to the same enhanced project management process described above.
- 10.421 To implement this remedy, Ofgem would need to modify the relevant licence conditions to set out the process for it to raise modification proposals under each of the codes.¹³⁶⁴
- 10.422 This proposed remedy should grant Ofgem the ability to provide input directly into a specific aspect of the modification processes to ensure the timely and effective delivery of its strategic direction. However, we are keen to ensure that Ofgem does not find it necessary to expend a significant proportion of its resource in this way, as this outcome would contradict our aim of focusing Ofgem’s role on strategic level input. Therefore, we would expect such granular interventions into the modification process may sometimes take the form of directions given to code panels and code administrators, rather than actual formal interventions, so as to ensure that modification proposals deemed strategically important are raised and prioritised by code administrators and code panels, and that the appropriate scope and level of analysis is carried out by working groups so that Ofgem can reach a decision as to their approval. In certain circumstances, Ofgem should proactively consider whether it is appropriate to commission an independent third party to provide additional project management, for instance to facilitate the implementation of complex or cross-cutting code changes.
- 10.423 The table below provides a visual overview of the modification route that would be followed by all code changes that do not qualify for self-governance (as noted above, the self-governance procedures would not be affected by our proposed remedies). However, the actual level of involvement of code administrators and Ofgem would vary from case to case, depending on the complexity and materiality of the modification proposal. For instance, we would expect that changes which are unlikely to have a significant impact on competition to follow a similar process to the

¹³⁶⁴ Under most codes, Ofgem is only entitled to raise modification proposals for the purpose of ensuring the consistency of the GB codes regime with EU legislation.

current ordinary procedure, with limited or no involvement by the consultative board or Ofgem (other than for the approval or rejection of the modification proposal).

10.424 On the contrary, we would expect 'strategically important' modification proposals to be prioritised by code administrators and code panels for the purpose of delivering Ofgem's strategic direction. As a result, such modification proposals will be subject to closer oversight by the consultative board (in particular when cross-code changes are involved), stronger project management by code administrators and possibly direct contributions to the performance of analysis from Ofgem and/or third party experts appointed for that purpose by Ofgem following discussions at the consultative board (again, the level of each of these actions would depend on the complexity and materiality of the relevant modification proposal).

Table 10.2: The end-to-end functions required to deliver a modification proposal

Function	Performing entity
Initiation	Either industry, code administrators or Ofgem
Prioritisation	If appropriate, code administrators or Ofgem
Creation of work groups (setting remit, selecting members etc)	Code administrators, if appropriate with oversight by consultative board (Ofgem)
Performance of analysis	Industry with possible intervention from code administrators/Ofgem
Project management	Code administrators (with additional formal powers as set out in licence)
Drafting legal text	Industry, with support from code administrators and, if appropriate oversight by consultative board
Approval	Ofgem
Implementation	Industry/delivery bodies, with possibility of project management by code administrators or third party appointed by Ofgem

Creation of a backstop executive 'call in' power

10.425 This proposed remedy would involve a recommendation to Ofgem to intervene to 'call in' an ongoing strategically important modification proposal in certain exceptional circumstances.

- 10.426 Ofgem's exercise of this power would transfer all procedural and substantive control in relation to the modification proposal at issue from the industry and relevant code administrator to Ofgem. Ofgem would then be in a position either to carry out the remaining required functions itself or to appoint third party experts to do so on its behalf. To maximise the deterrent effect of this power, and ensure that it does not become a means for the industry to exploit Ofgem's resources, we consider that Ofgem should pass on any consequential costs it incurs following the exercise of the call-in power to the relevant licensees. We note, however, that any such decision by Ofgem to exercise the call-in power and impose costs in the way envisioned above would need to be subject to robust procedural and judicial safeguards.
- 10.427 Though we consider that it is for Ofgem to define what constitutes exceptional circumstances for the purposes of this power, we expect that it would include at least the following two scenarios. Firstly, Ofgem could consider it inappropriate, as a matter of principle, for certain code changes to be dealt with primarily by means of self-regulation due to the significance of their impact on consumers' interests and/or competition.¹³⁶⁵ In such cases, it would not be sufficient for Ofgem to influence discrete steps of the modification process (as envisaged in our proposed remedy through the consultative board). Secondly, there may be instances in which Ofgem determines that the ordinary industry-led process has failed to deliver a strategically important modification proposal in a timely manner. To implement this change, as a baseline Ofgem would need to publish guidance indicating the factors that it would take into account in determining when to utilise the call-in power.
- 10.428 Additional legislative measures would need to be implemented in order to permit Ofgem to make code changes directly via its call-in power. We therefore recommend that DECC initiate a legislative process with a view to granting Ofgem an open-ended power to make code changes in the special circumstances identified above.
- 10.429 We consider that this proposed remedy, together with our proposed remedy for Ofgem to take powers to initiate and prioritise strategically important modification proposals, would form an effective substitute for Ofgem's current SCR powers (for a further assessment of Ofgem's SCR powers see paragraphs 54 to 57 of Appendix 10.4).

¹³⁶⁵ Possible examples could include provisions that are necessary to achieve the benefits of a strategic policy such as half-hourly settlement, which is needed to support the roll-out of smart meters or measures intended to ensure gas security of supply.

Supporting remedy: DECC to make the provision of code administration (and delivery) services a licensable activity

- 10.430 This proposed remedy would involve a recommendation to DECC to make the provision of code administration (and delivery) services a licensable activity. The purpose of this proposed remedy is for Ofgem to have appropriate sight of all relevant code development issues so that it can exercise its discretion to intervene in the most effective manner. To achieve this objective it is necessary to establish a clearer role for code bodies by licensing those entities and codifying their powers and responsibilities.
- 10.431 We do not seek to prescribe precisely which activities should be subject to such a licence. However, we note that the objective of this proposed remedy is to ensure that code bodies act in the interests of competition and consumers and that Ofgem is capable of monitoring the performance of all code bodies that administer and/or project manage modification proposals effectively and intervening to address non-performance, where appropriate. In light of that objective, we consider that, for the purposes of the proposed licence, the classification of 'code administration (and delivery) services' should include most of the required activities listed in Table 10.2 above. We note that under this construction, both code administrators and code-specific delivery bodies would need to be licensed following the implementation of this remedy.
- 10.432 Another objective of this remedy is to enable code bodies to take on greater responsibility in relation to the project management of modification proposals. For code bodies to evolve most effectively into 'code managers' Ofgem should refrain from micro-managing their behaviour, to the extent possible. This is important to ensure that those entities do not become reliant on formal directions from Ofgem to determine the most appropriate method to fulfil their codified duties.
- 10.433 We note that [§] has suggested a series of additional reforms, such as the standardisation of relevant websites that could be implemented in the short term before the introduction of the licence proposed by this remedy in order to start making code bodies more accountable. We consider that those reforms would provide incremental value and would help to ensure an efficient transition to a licensing regime but, given their incremental nature, they would be more appropriately taken forward by Ofgem as part of its ongoing CGR.

10.434 Following our analysis and our review of parties' submissions (including Ofgem's), we consider that the proposed licence for code bodies services should include (but not be limited to) the following conditions:¹³⁶⁶

- (a) requirement to carry out its functions having regard to the objectives of the relevant industry codes, Ofgem's Strategic Direction and Ofgem's principal objective and duties;¹³⁶⁷
- (b) effective coordination with Ofgem in relation to developing the cross-codes strategic work plan and the relevant code specific strategic work plan;
- (c) effective coordination with other code bodies in relation to delivering code changes with cross code impacts;
- (d) timely delivery of code changes set out in the strategic work plan;
- (e) effective project management of all modification proposals, including, in particular, appropriate consultation of all relevant code parties;
- (f) transparent provision and presentation of all relevant information including, in particular, through a clear and helpful website;
- (g) effective performance of the critical friend role;
- (h) minimisation of delivery costs; and
- (i) appropriate reporting of cross-cutting governance issues to Ofgem.

10.435 We consider that licensing code administrators and delivery bodies in the manner contemplated above would be a transparent and effective means of incentivising those entities to take up their new role in supporting Ofgem to deliver the strategic direction in a timely and efficient manner.

10.436 An important additional benefit of licensing code bodies is that this change would enable Ofgem to exercise its discretion to open up the market for code administration (and delivery) services to full competition. We expect that Ofgem would be able to establish a competitive tendering regime for the licences required following the implementation of this remedy. We also expect that effective competition within the market for code administration (and delivery) services would lead to some consolidation as the tendering

¹³⁶⁶ We note that it is for Ofgem to determine the extent to which these conditions would apply to delivery bodies which do not actively engage in the administration or project management of modification proposals.

¹³⁶⁷ We consider this to be appropriate since Ofgem will carry out its gatekeeper functions in respect of all modification proposals with a view to pursuing its principal objective and duties.

process would enable efficient entities to take on additional roles and responsibilities. This outcome would go some way to fulfilling this proposed remedies package's long-term objective of streamlining the codes regime.

10.437 We have considered whether, as an alternative, a package of measures centred only on a competitive tendering regime and not including any form of licence for code administration (and delivery) services would be capable of achieving the aim of this proposed remedy. However, the first issue that we note in relation to the alternative package described above is that Ofgem would potentially face change-control issues, as Ofgem would not be able to unilaterally modify tender agreements. It would also have to make amendments to each tender agreement individually through a series of bilateral negotiations, which could lead to delays and inefficiencies. The second issue with the package considered above is that Ofgem's only enforcement option would be to initiate court proceedings which may prove to be costly, lengthy and, in some cases, unsuccessful. Therefore, we consider that this arrangement may not adequately incentivise code administrators' behaviour to perform at the level needed for those entities to play a greater role in the code governance framework, as contemplated under this remedies package.

10.438 In implementing this remedy, Ofgem should consider whether it is appropriate to modify the licence conditions of certain code parties as an additional means to incentivise the behaviour of code bodies that would be licensed pursuant to this remedy (ie those code parties which are responsible for funding code administrators and which may seek to influence their actions).

Summary of the proposed remedies package

10.439 In summary, we consider that a package of remedies consisting of the following key elements would be effective in remedying the Codes AEC:

- (a) In relation to its approach to intervening within the code regime, the following recommendations to Ofgem:
 - (i) to publish a cross-cutting strategic direction for code development;
 - (ii) to oversee the annual development of code-specific work plans for the purpose of ensuring the delivery of the strategic direction;
 - (iii) to establish and administer a consultative board that would bring stakeholders together for the purpose of discussing and addressing cross-cutting issues;

- (iv) to take powers to initiate and prioritise modification proposals that, in its view, are necessary for the delivery of the strategic direction;
- (v) in exceptional circumstances, to intervene to take substantive and procedural control of an ongoing strategically important modification proposal, as appropriate; and
- (vi) to modify licence conditions to grant each code administrator the power to initiate and prioritise modification proposals that, in its view, are necessary for the delivery of the strategic direction or to improve the efficiency of the governance arrangements.

We would expect Ofgem to implement this proposed recommendation by way of amendments to the relevant standard licence conditions, and/or by ensuring that appropriate industry code modifications are developed and implemented, so as to set up the necessary processes and mechanisms for it to carry out these functions.

- (b) A recommendation to DECC that it should enact legislation to grant Ofgem the power to modify codes in certain exceptional circumstances.
- (c) A recommendation to DECC that it should require a licence for the provision of code administration (and delivery) services and, in the process of designing the associated licence conditions, ensure that such licence conditions are appropriately targeted to incentivise code administrators to take on the expanded role envisaged under this remedies package and minimise the regulatory burden on those entities.

Effectiveness of this remedies package

- 10.440 In terms of impacts, we consider that our remedies package would increase the efficiency and robustness of the code modification processes, by giving Ofgem appropriate tools to influence the development and delivery of strategically important modification proposals.
- 10.441 The strategic direction, and associated work plans, would identify areas requiring code changes and would also provide a systematic framework for Ofgem's and code administrators' exercise of their powers to initiate and prioritise strategically important modification proposals.
- 10.442 Code administrators (and delivery bodies), as licensed bodies with better defined powers and responsibilities, and appropriate funding, would be able to step into the process where appropriate to support Ofgem and code panels in their respective functions.

- 10.443 The creation of a consultative board would be a forum allowing Ofgem to engage more proactively with strategically important modification proposals. The consultative board would provide parties with a forum to surface cross-cutting or complex issues related to the development or implementation of code changes at an early stage, thus lessening the risk that such issues result in delays. Similarly, it would create a framework for Ofgem to engage early with strategically important modification proposals, so as to ensure that the analysis carried out during the development stage is appropriate. The consultative board would, among other things, discuss the appointment of third party experts for the purpose of carrying out detailed analysis or managing the implementation process (although we would expect that, over time, these roles would be progressively taken over by code administrators). It also will contribute to giving Ofgem a better grasp of the code regime, with respect to its substantive scope, which in turn will facilitate the broader policy objective, set out above, of promoting a streamlined and predictable regulatory framework.
- 10.444 Together, the measures described above should contribute to ensuring that the code regime is capable of keeping pace with wider technical and policy developments, including, for instance, the pending challenge of transposing the EU network codes.
- 10.445 We have also considered whether to include in our proposed remedies package further measures such as those proposed by Ofgem in its response to our provisional findings (see paragraph 10.366). We note that one of the objectives of Ofgem's proposed measures is to consolidate and simplify the codes regime (or at least the provisions relating to retail markets), which would be governed by a single entity.
- 10.446 While we accept that this would have some benefits, by reducing the complexity of certain code processes and costs for industry parties, we consider that designing our proposed remedies package in such a way as to achieve that objective directly would go beyond addressing the Codes AEC. In particular, it would require merging certain (parts of) industry codes, as well as creating a new body which would centralise a number of functions carried out by different stakeholders. We also note that it would only be feasible to make these changes in the much longer term and following significant institutional change that would entail significant implementation costs. Taking into account the above, we have deliberately designed our proposed remedies package in a way that is effective in addressing the Codes AEC within a reasonable time frame (see paragraph 10.447 below), which also supports Ofgem's long-term objective.

- 10.447 We expect this proposed remedies package to show results in the short and medium term. The measures within this proposed remedies package that involve a recommendation to Ofgem could be implemented and take effect within a relatively short period, once Ofgem has had a chance to develop the details of the proposed measures and consult stakeholders, as appropriate. We note that, as DECC must follow the normal legislative process in order to create a new licence for code administration (and delivery) services, the licensing remedy will likely be implemented and take effect in the medium term. We expect that Ofgem would award licences to each of the current code administrators (and delivery bodies) and then consider whether it would be appropriate to initiate a competitive tender for those licences.
- 10.448 A number of the proposed remedies considered within this package involve recommendations to Ofgem to change its approach to intervening in the codes regime. We consider that there is a high likelihood that Ofgem would implement our recommendations on the basis of its submissions to us and the consistent thrust of its ongoing work on the Code Governance Review. We note that Ofgem has the ability to modify the relevant standard licence conditions to alter the role of code administrators and it has done so in order to implement the proposals of its Code Governance Review. We note further that DECC has the power to create new licences for designated activities within the energy sector and recently exercised this power in September 2013 to establish a new licence for smart meter communication services.
- 10.449 For the reasons set out above, we consider that our proposed remedies package would be effective in targeting the features of the Codes AEC that we have provisionally identified, and is capable of effective implementation within a reasonable time frame.

Assessment of proportionality

- 10.450 We have assessed whether the proposed Ofgem-led programme would be proportionate on the basis of our guidelines. Specifically, our assessment has considered whether our proposed remedies package:
- (a) is effective in achieving its legitimate aim;
 - (b) is no more onerous than needed to achieve its aim;
 - (c) is the least onerous if there is a choice between several effective measures; and
 - (d) produces adverse effects which are disproportionate to the aim.

- 10.451 For the reasons set out above, and in Appendix 10.4, we have provisionally concluded that our proposed package of remedies would be effective in its legitimate aim of remedying the Codes.
- 10.452 In reaching our provisional decision on remedy design, we have sought to avoid imposing costs and restrictions on parties that go beyond what is needed to achieve an effective remedy.
- 10.453 The measures of our proposed remedies package that impact Ofgem leave it a wide margin of discretion over the precise nature of its involvement within the codes regime. This enables Ofgem to take a proportionate approach, allocating its resources only to those projects where its interventions are needed or appropriate, due to the complexity or materiality of the modification proposal in question.
- 10.454 We have also sought to ensure that our proposed remedies package retains close industry involvement in codes and, in turn, and does not unnecessarily disrupt legal certainty in this area of regulation. We believe that our proposed remedies package would maintain a key role for the industry, while increasing transparency and facilitating formal and informal engagement between the industry, Ofgem and code bodies.
- 10.455 We also consider that our approach to licensing code administration (and delivery) services should minimise the regulatory costs for affected entities. In particular, we note that our proposed remedy recommends the use of clear outputs-based conditions rather than prescriptive rules as a means to incentivise those entities toward desired behaviour. We note further that code administrators are already incentivised to perform pursuant to some of the proposed outputs-based licence conditions due to their inclusion in the (non-binding) requirements set out in the Code Administration Code of Practice.
- 10.456 We also note that, pursuant to our proposed remedies package, Ofgem would perform a periodic review of the codes regime for the purpose of assessing its functioning. In particular, this mechanism would enable Ofgem to review the appropriateness of the allocation of roles and responsibilities across the various stakeholders put in place by this remedies package. This mechanism increases the flexibility of this remedies package and lessens the risk that it will lead to a governance framework that is unnecessarily onerous for any of the main stakeholders.

- 10.457 We also considered other possible ways of addressing the Codes AEC. These included measures that we had put forward ourselves for consideration and some alternative measures that were put to us by parties in response to the Remedies Notice.
- 10.458 We provisionally found that each of the following alternative measures were less effective and/or more costly than the proposed remedies package set out above:
- (a) a set of measures centred on a grant to Ofgem of stronger powers to make changes directly to codes, for the reasons given in paragraph 10.392 above;
 - (b) an alternate approach to driving the behaviour of code administrators, under a contractual tendering regime, for the reasons given in paragraph 10.437 above; and
 - (c) Ofgem's proposal to create a single code entity, for the reasons given in paragraph 10.446 above.
- 10.459 Finally, we considered whether the proposed remedies package – or any specific measure within it – was likely to produce adverse effects which were disproportionate to the aim of remedying the Codes AEC.
- 10.460 Our proposed remedies package would require Ofgem to invest more resources in monitoring and supervising code changes that are likely to have a significant impact on competition and consumers. However, we consider that by focusing Ofgem's role on strategic determinations, and influencing code administrators and code panels, the associated costs should be limited, and certainly significantly less burdensome than those which Ofgem currently expends under the SCR process. We also expect that the strategic signals provided by Ofgem to the industry through its new functions will lead to significant efficiency gains as parties are able to better allocate their resources across the portfolio of pending and ongoing code changes.
- 10.461 Our proposed remedies package also contains powers for Ofgem to direct some or all aspects of a given modification procedure (in particular under the call-in power). However, we expect that these powers will be used only in exceptional circumstances, if at all, and thus should not lead to significant costs for Ofgem. We also note that the existence of these powers may act as an incentive on the industry to comply with Ofgem's directions.
- 10.462 While code administrators (or at least, some of them) would need additional resources to perform their expanded role efficiently (and, if appropriate, to appoint third party experts to carry out additional analysis or perform certain

functions to ensure that a certain modification proposal is developed and implemented efficiently), these costs are a form of centralisation of costs. Therefore, they are likely to lead to certain economies of scale and/or scope, for example by avoiding duplication or repetition of analysis (for instance, in circumstances where Ofgem would use its send-back power as a result of unsatisfactory analysis being submitted to it as part of a code panel recommendation).

10.463 We believe that better project management would reduce the time frames of complex modification proposals and, in turn, reduce the costs borne by industry as a result of engaging with the code modification processes. These benefits would, in our view, offset to a significant extent the additional costs incurred by code administrators and other delivery bodies. The net cost is therefore justified by the benefits arising from a better overall code governance framework.

10.464 We also note that, as the majority of this proposed remedies package will be implemented by means of recommendations to Ofgem, it is therefore ultimately for Ofgem to ensure that its interventions to implement this remedies package are not disproportionate to the expected benefits.

Why we propose not to move forward with the new code adjudicator

10.465 As stated in our Remedies Notice, the aim of this possible remedy was to streamline the approval stage of the modification process by reducing the number of disagreements occurring between the industry and the decision maker. Pursuant to this possible remedy, decision-making authority during the approval stage would be transferred from Ofgem to a new 'code adjudicator' created for that purpose.

10.466 After further consideration of this possible remedy, we have provisionally decided that there are issues relating to its underlying rationale as well as to its proportionality in the light of our Codes AEC provisional finding.

10.467 RWE's main comment in support of a new code adjudicator was that decisions on code changes should only be assessed against the relevant code objectives and not the broader issues contemplated by Ofgem's statutory basis. In all other contexts, Ofgem must take its statutory basis into account when making decisions. For this reason, we consider that restricting Ofgem's decisions on code changes in the way contemplated by this remedy would run contrary to our wider aim of ensuring a predictable regulatory framework. In addition, this change would introduce a risk that the codes could develop in a manner inconsistent or even contradictory to the wider regulatory regime.

- 10.468 We also recognise that there are efficiency gains from having a decision maker that has some degree of involvement in the modification process prior to the approval stage.
- 10.469 With regards to the proportionality of this remedy, we note that this remedy proposed to address the underlying features of the Codes AEC by changing the decision maker responsible for approving code changes. On the basis of our analysis and submissions put to us by several parties, we consider that the aim of this possible remedy would not facilitate the resolution of either of those features. Moreover, we consider that it is feasible to implement an effective solution to the Codes AEC without including this possible remedy. Therefore, implementing this remedy would also be disproportionate.

11. Provisional decision on remedies

- 11.1 In our provisional findings report and addendum, and pursuant to the updated analysis contained in our provisional decision on remedies, we have provisionally identified a number of AECs leading, in aggregate, to substantial levels of detriment for customers.
- 11.2 In this section we summarise our proposed remedies to address these provisional AECs and the detriment arising from them.

The CfDs AEC

- 11.3 The remedies package proposed to address the CfDs AEC and/or associated detriment is as follows:
- (a) A recommendation to DECC to undertake and consult on a clear and thorough impact assessment before awarding any CfD outside the CfD auction mechanism.
 - (b) A recommendation to DECC to undertake and consult on a clear and thorough assessment of the appropriate allocation of technologies and CfD budgets between pots.

The Locational Pricing AEC

- 11.4 The remedies package proposed to address the Locational Pricing AEC and/or associated detriment is as follows:
- (a) An order (the 'Locational Pricing Order') on National Grid (and amendments to National Grid's licence conditions) that would set out, among other things:
 - (i) the formula to calculate the transmission loss factors (which ultimately feeds into the imbalance charges) for this purpose;
 - (ii) an obligation on National Grid to create a load flow model;
 - (iii) an obligation on National Grid to create a networking mapping statement and collect annually relevant network data;
 - (iv) an obligation on National Grid to appoint third party agents to collect metered volumes data and to calculate annually the transmission loss factors pursuant to the principles set out in the order and using the models created, and information collected, pursuant to the order;

- (v) an obligation on National Grid to direct Elexon, as appropriate, to update the networking mapping statement and carry out other administrative tasks that are necessary to the calculation by the third party agents; and
 - (vi) an obligation on National Grid to raise any consequential code modification.
- (b) A recommendation to Ofgem to support National Grid by taking necessary steps that might facilitate the implementation of the Locational Pricing Order.

Electricity Settlement AEC

11.5 The remedies package proposed to address the Electricity Settlement AEC and/or associated detriment is as follows:

- (a) A recommendation to DECC to consult on amending the provisions of the Smart Energy Code that prohibit suppliers from collecting consumption data with greater granularity than daily unless a customer has given explicit consent to do so.
- (b) A recommendation to Ofgem to:
 - (i) conduct a full cost benefit analysis of the move to mandatory half-hourly settlement, including analysis of costs, benefits and distributional implications as well as mitigating measures;
 - (ii) start the process of gathering evidence for the analysis as soon as practicable;
 - (iii) consider the cost-effectiveness of alternative design options for half-hourly settlement such as a centralised entity responsible for data collection and aggregation; and
 - (iv) consider options for reducing the costs of elective half-hourly settlement, including (i) whether any of these options are likely to delay or accelerate the adoption of mandatory half-hourly settlement; and (ii) any challenges that may arise or benefits that may accrue from the existence of two settlement systems, including in particular the possibility of gaming/cherry picking behaviour.
- (c) A recommendation to both DECC and Ofgem that they publish and consult jointly on a plan setting out:
 - (i) the aim of the reform for half-hourly settlement;

- (ii) a list of proposed regulatory interventions (including code changes), and the relevant entity in charge of designing and/or approving such interventions, that are necessary in order to implement the half-hourly settlement reform;
- (iii) an estimated timetable for the completion of each necessary intervention; and
- (iv) where appropriate, a list of relevant considerations that will be taken into account in designing each regulatory intervention.

Gas Settlement AEC

11.6 The remedies package proposed to address the Gas Settlement AEC and/or associated detriment is as follows:

- (a) A recommendation to Ofgem to ensure implementation of Project Nexus by 1 October 2016 through monitoring closely the progress made by the industry in meeting intermediate milestones and to take (where appropriate) further measures to achieve this objective.
- (b) An order on gas suppliers (and amendments to gas suppliers' standard licence conditions) to submit all meter readings for non-daily metered supply points in GB to Xoserve as soon as they become available, and at least once per year, save for non-daily metered supply points with a smart or advanced meter, which must be submitted at least once per month.
- (c) A recommendation to Ofgem to:
 - (i) take responsibility for the development and delivery of a performance assurance framework to increase accuracy of the gas settlement process as soon as reasonably practicable, and at the latest within one year of our final report;
 - (ii) establish a project plan and allocate responsibility to Uniform Network Code parties to take actions for its implementation;
 - (iii) supervise its implementation; and
 - (iv) take appropriate steps to ensure that failure to meet targets under the performance assurance framework are sanctioned.

Prepayment AEC, RMR AEC and Domestic Weak Customer Response AEC

- 11.7 The remedies package proposed to address the Prepayment AEC, the RMR AEC and the Domestic Weak Customer Response AEC (together, the Domestic AECs) and/or associated detriment comprises the proposed remedies set out below.

Proposed remedies specific to the Prepayment AEC

- 11.8 The remedies proposed to address part of the Prepayment AEC and/or associated detriment are as follows:

(a) A recommendation to Ofgem to:

- (i) modify suppliers' standard licence conditions to introduce an exception to SLC 22B.7(b) so as to allow a supplier to set prices to prepayment customers on the basis of grouping regional cost variations which are applied to other payment methods within the same core tariff;
- (ii) deprioritise potential enforcement action pending the modification of SLC 22B.7(b) against any supplier to a prepayment customer that sets prices to prepayment customers on the basis of grouping regional cost variations which are applied to other payment methods within the same core tariff;
- (iii) take responsibility for the efficient allocation of gas tariff pages; and
- (iv) take appropriate steps to ensure that changes to the Debt Assignment Protocol are implemented by the end of 2016, and in particular in areas relating to objection letters, complex debt and issues relating to multiple registrations; including setting out clear objectives and a timetable with appropriate milestones, supervising progress against such objectives and milestones, and to take all steps, if and when necessary, to ensure delivery of these changes.

(b) The acceptance of undertakings from the Six Large Energy Firms or, absent such undertakings including the following three components:

- (i) a cap on the number of gas tariff pages that any supplier can hold (at 12);
- (ii) an obligation for suppliers to provide relevant information for Ofgem to monitor the allocation of the gas tariff codes; and

- (iii) a condition that allows Ofgem to mandate the transfer of one or more gas tariff pages to another supplier.
- (c) Absent such undertakings, we would recommend that Ofgem introduces a new licence condition in suppliers' standard licence conditions to include the three components set out above.

Proposed remedies concerning the RMR AEC

11.9 The remedies proposed to address the RMR AEC and/or associated detriment, as well as part of the Prepayment AEC and the Domestic Weak Customer Response AEC and/or associated detriment are as follows:

- (a) A recommendation to Ofgem to:
 - (i) modify gas and electricity suppliers' standard licence conditions to:
 - remove the following conditions (the 'Conditions'):
 - the ban on complex tariffs (SLC 22A.3 (a) and (b));
 - the four tariff rule (SLC 22B.2 (a) and (b));
 - the ban on certain discounts (SLCs 22B.3-6 and 22B.24-28);
 - the ban on certain bundled products (SLCs 22B.9-16 and 22B.24-28);
 - the ban on certain reward points (SLCs 22B.17-23 and 22B.24-28);
 - the prohibition against tariffs exclusive to new/existing customers (SLC 22B.30 and 22B.31); and
 - make any necessary minor consequential amendments; and
 - introduce an additional standard of conduct into SLC 25C that would require suppliers to have regard in the design of tariffs to the ease with which customers can compare value-for-money with other tariffs they offer;
 - (ii) deprioritise potential enforcement action pending the removal of the Conditions against any supplier that operates in breach of the Conditions;
 - (iii) remove the Whole of the Market Requirement in the Confidence Code and introduce a requirement for PCWs accredited under the

Confidence Code to be transparent over the market coverage they provide to energy customers.

Proposed remedies concerning the Prepayment AEC and the Domestic Weak Customer Response AEC

11.10 The remedies proposed to address part of the Prepayment AEC and part of the Domestic Weak Customer Response AEC and/or the associated detriment are as follows:

- (a) A recommendation to Ofgem to establish an ongoing programme (the 'Ofgem-led programme') to identify, test (through randomised controlled trials, where appropriate) and implement (for example, through appropriate changes to gas and electricity suppliers' standard licence conditions) measures to provide domestic customers with different or additional information with the aim of promoting engagement in the domestic retail energy markets, including a recommendation to conduct randomised controlled trials concerning the following shortlist of measures:
 - (i) changes to the information in domestic bills and how this is presented including a market-wide cheapest tariff message;
 - (ii) changes to the specific messaging that domestic customers receive in bills once they move, or are moved, on to an SVT and/or other default tariffs; and
 - (iii) changes to the name of the default tariffs.
- (b) Either the acceptance of undertakings from gas and electricity suppliers to participate in the Ofgem-led programme, or, absent a satisfactory number of undertakings being agreed with suppliers, either:
 - (i) a recommendation to Ofgem to modify gas and electricity suppliers' standard licence conditions to introduce an obligation on suppliers to participate in the Ofgem-led programme or requiring the provision of prescribed information;
 - (ii) an order on gas and electricity suppliers to participate in the Ofgem-led programme or requiring the provision of prescribed information, (including associated amendments to suppliers' standard licence conditions); or

- (iii) a recommendation to DECC to introduce legislation imposing a requirement on suppliers to participate in Ofgem-led research programmes.
- (c) An order on Gemserv to give PCWs access upon request to the ECOES database on reasonable terms and subject to satisfaction of reasonable access conditions.
- (d) An order on Xoserve to give PCWs access upon request to the SCOGES database on reasonable terms and subject to satisfaction of reasonable access conditions.
- (e) A recommendation to DECC to make the following changes to the current specifications of Midata phase two:
 - (i) Participation in Midata is mandatory for all gas and electricity suppliers.
 - (ii) The scope of Midata is expanded to include the following data fields: meter type, Warm Home Discount indicator, consumption data and time-of-use for those customers on Economy 7 meters or other time of use tariffs.
 - (iii) PCWs are given the ability to seek customer consent on the frequency with which they can access the customer's data through Midata; are required to present at least two options to a customer when seeking consent to access Midata (including one option concerning access on an annual or ongoing basis); and are given the ability to send updated tariff comparison information based on any subsequent access granted to a customer's Midata.
- (f) An order on gas and electricity suppliers requiring the disclosure to Ofgem, subject to certain use restrictions, of (i) certain details¹³⁶⁸ (the Domestic Customer Data) of their domestic customers who have been on one of their standard variable tariffs (or any other default tariff) for three or more years (the Disengaged Domestic Customers), and (ii) updated Domestic Customer Data every six months, for the purposes of a creating, operating and maintaining a secure cloud database containing the Domestic Customer Data and allowing rival suppliers to

¹³⁶⁸ This would be the customer's full name, billing address, consumption address, fixed telephone number, current supplier, meter type (eg unrestricted, Economy 7 etc), name of their current tariff, annual energy consumption, MPAN/MPRN and, as regards a customer on a restricted meter, certain additional consumption data by specified time periods and details of the customer's standing charges and volume rates. For the avoidance of doubt, the Domestic Customer Data would exclude details relating to any Disengaged Domestic Customer that opted out following receipt of an Opt-out Letter.

access and use the data for the purpose of postal marketing. The order would also require suppliers, prior to disclosing the Domestic Customer Data to Ofgem, to send a prescribed letter to each Disengaged Domestic Customer, explaining the proposed use of the customer's details, and including an opt-out mechanism for the domestic customer, at any time, to object to and prevent the proposed disclosure and use of their details.

- (g) A recommendation to Ofgem to (i) create, operate and maintain a secure cloud database for the purposes of holding the Domestic Customer Data; (ii) hold the Domestic Customer Data; (iii) enter into agreements with suppliers including, access to, and use restrictions concerning the Domestic Customer Data; and (iv) provide access to the Domestic Customer Data by any rival supplier that has entered into such an agreement.
- (h) An order on gas and electricity suppliers with more than 50,000 domestic customers (and amendments to suppliers' standard licence conditions) (i) requiring such suppliers to make all their single-rate electricity tariffs available to all (existing and new) domestic electricity customers on restricted meters,¹³⁶⁹ and (ii) prohibiting such suppliers from making their single-rate electricity tariffs available to domestic electricity customers on restricted meters conditional upon the replacement of their existing meter.
- (i) An order on gas and electricity suppliers (and amendments to suppliers' standard licence conditions) requiring suppliers to (i) remind their domestic electricity customers on restricted meters, in their regular communications with them, that they have the option to switch supplier or to switch to a single-rate tariff without having to change their meter or incur replacement costs, (ii) provide their domestic electricity customers on restricted meters contact details for Citizens Advice, and (iii) provide, on a timely basis, Citizens Advice with the information it may reasonably require concerning customers on restricted meters in the format specified by Citizens Advice.
- (j) A recommendation to Citizens Advice to become a recognised provider of information and support to domestic electricity customers on restricted meters.

¹³⁶⁹ Including Economy 7 meters.

- (k) An order on gas and electricity suppliers (and amendments to suppliers' standard licence conditions) requiring suppliers to ensure that the annual bills paid by prepayment customers (assuming a pre-determined consumption level) do not exceed a specified benchmark reference level, for a period until the end of 2020.

The Microbusiness Weak Customer Response AEC

11.11 The remedies package proposed to address the Microbusiness Weak Customer Response AEC and/or the associated detriment is as follows:

- (a) An order on gas and electricity suppliers (and amendments to suppliers' standard licence conditions):
- (i) requiring suppliers to disclose the prices of all available acquisition and retention contracts to non-domestic customers falling within a defined category (the 'Proposed Segment') either through an online quotation tool made available on their website, or through one or more third party online platforms (and including a web link on their own website to direct non-domestic customers to such third party online platform(s));
 - (ii) requiring suppliers to disclose the prices of all their out of contract and deemed contracts on their websites;
 - (iii) prohibiting the inclusion of conditions in their existing and future auto-rollover contracts with microbusiness customers that:
 - prohibit the microbusiness customer from giving a termination notice up to the last day of the initial fixed-term period;
 - prohibit the microbusiness customer from giving a termination notice up to the last day of the fixed-term roll-over period; and
 - impose a termination fee and/or no-exit clause for the roll-over period;
 - (iv) prohibiting the transfer of microbusiness customers that have given a termination notice during the rollover period of an auto-rollover contract to a higher priced contract during the notice period; and
 - (v) prohibiting the inclusion of a condition in their existing and future out-of-contract, and evergreen contracts with microbusiness customers that include termination fees.

- (b) A recommendation to Ofgem to make any necessary minor consequential amendments to the suppliers' standard licence conditions.
- (c) A recommendation to Ofgem to establish an ongoing programme to identify, test (through randomised controlled trials, where appropriate) and implement measures to provide microbusiness customers with different or additional information with the aim of promoting engagement in the microbusiness segments of the SME retail energy markets.
- (d) An order on gas and electricity suppliers requiring the disclosure to Ofgem, subject to certain use restrictions, of (i) certain details¹³⁷⁰ of their microbusiness customers that have been on a default contract for three or more years (the 'Microbusiness Customer Data'); and (ii) updated Microbusiness Customer Data every six months, for the purposes of creating, operating and maintaining a secure cloud database containing the Microbusiness Customer Data for the purpose of postal marketing.
- (e) A recommendation to Ofgem to (i) create, operate and maintain a secure cloud database for the purposes of holding the Microbusiness Customer Data; (ii) hold the Microbusiness Customer Data; (iii) enter into agreements with suppliers including, access to, and use restrictions concerning the Microbusiness Customer Data; and (iv) provide access to the Microbusiness Customer Data by any rival supplier that has entered into such an agreement.

Governance AEC

11.12 The remedies package proposed to address the Governance AEC and/or the associated detriment is as follows:

- (a) A recommendation to DECC to initiate a legislative programme with a view to:
 - (i) deleting paragraph 1C from both sections 4AA of the Gas Act 1986 and 3A of the Electricity Act 1989; and
 - (ii) set up a clear and established process for Ofgem to comment publicly, by publishing opinions, on all draft legislation and policy proposals which are relevant to Ofgem's statutory objectives and

¹³⁷⁰ This would be the microbusiness customer's business name, billing address, consumption address, fixed telephone number, current supplier, name of their current contract, annual energy consumption, and MPAN/MPRN.

which are likely to have a material impact on the GB energy markets.

- (b) A recommendation to DECC and Ofgem to publish detailed joint statements concerning proposed DECC policy objectives that are likely to necessitate parallel, or consequential, Ofgem interventions, setting out (i) a proposed action plan for the regulatory interventions needed and responsibility for these, (ii) an estimated timetable, and (iii) where appropriate, a list of relevant considerations in designing the policy.
- (c) A recommendation to Ofgem to:
- (i) publish annually a state of the market report (the 'State of the Market Report') which would provide analysis regarding issues such as (i) the evolution of energy prices and bills over time, (ii) the profitability of key players in the markets (eg the Six Large Energy Firms), (iii) the social costs and benefits of policies, (iv) the impact of initiatives relating to decarbonisation and security of supply, (v) the trilemma trade-offs, and (vi) the trends for the forthcoming year;
 - (ii) create a new unit (eg an office of the chief economist) within Ofgem, which would build expertise across the different areas of the energy markets with a view to publish annually the State of the Market Report; and
 - (iii) modify the licence conditions of the Six Large Energy Firms' generation and supply licences by introducing requirements to:
 - report their generation and retail supply activities on market rather than divisional lines;
 - report a balance sheet as well as profit and loss account separately for their generation and retail supply activities;
 - disaggregate their wholesale energy costs for retail supply between a standardised purchase opportunity cost and a residual element; and
 - report prior year figures prepared on the same basis.

Codes AEC

11.13 The remedies package proposed to address the Codes AEC and/or the associated detriment is as follows:

(a) A recommendation to Ofgem to:

- (i) publish a cross-cutting strategic direction for code development (the 'Strategic Direction');
- (ii) oversee the annual development of code-specific work plans for the purpose of ensuring the delivery of the Strategic Direction;
- (iii) establish and administer a consultative board that would bring stakeholders together for the purpose of discussing and addressing cross-cutting issues;
- (iv) initiate and prioritise modification proposals that, in its view, are necessary for the delivery of the Strategic Direction;
- (v) in exceptional circumstances, intervene to take substantive and procedural control of an ongoing strategically important modification proposal, as appropriate; and
- (vi) modify the licence conditions of code administrators to introduce the ability for the administrator to initiate and prioritise modification proposals that, in its view, are necessary for the delivery of the Strategic Direction or to improve the efficiency of governance arrangements.

(b) A recommendation to DECC to initiate a legislative programme with a view to:

- (i) giving Ofgem the power to modify industry codes in certain exceptional circumstances; and
- (ii) making the provision of code administration and delivery services activities that are licensed by Ofgem and specifying that such licence conditions will include appropriate targets to incentivise code administrators to take on an expanded role to be able to deliver pursuant to the Strategic Direction.

Provisional decision on remedies

11.14 We have provisionally decided that we should introduce the package of remedies summarised in this section.

11.15 In our judgement, these represent as comprehensive a solution as is reasonable and practicable to the AECs and resulting customer detriment that we have provisionally found.

Next steps

- 11.16 The parties to this investigation and any other interested persons are requested to provide any views in writing, including any suggestions for additional or alternative remedies that they wish the CMA to consider, by 7 April 2016 either by email to energymarket@cma.gsi.gov.uk or in writing to:

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