Title: Consumer Tariff Amendments (powers a-e)	Impact Assessment (IA)
IA No: DECC0126	**Date:** 08/05/2013
	Stage: Final
Lead department or agency: DECC	**Source of intervention:** Domestic
Other departments or agencies:	**Type of measure:** Primary legislation
	Contact for enquiries: dawn.armstrong@decc.gsi.gov.uk

Summary: Intervention and Options

RPC: Green

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB in 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£0m	£0m	£0m	Yes	Zero Net Cost

What is the problem under consideration? Why is government intervention necessary?

The majority of gas and electricity consumers do not engage in the market, which leads to the market not operating effectively as it could, potentially resulting in higher prices for consumers. Factors that deter people include: proliferation of tariffs with complex structures (making it difficult for consumers to compare tariffs across the market) and lack of awareness of the savings to be made. Government intervention is needed to help inactive consumers benefit from cheaper tariffs and to prompt them to engage more widely in the market. Ofgem has published final proposals to limit the number of core tariffs that suppliers offer, move consumers on poor value "dead" tariffs to better value "open" tariffs, require suppliers to provide personal estimates on the savings consumers can make by moving to the supplier's cheapest tariff and offer a tariff comparison tool. The Government intends to support Ofgem in legislation to ensure Ofgem can implement the final proposals, without any undue delay.

What are the policy objectives and the intended effects?

The Government's objective is to encourage competition in the retail market through greater engagement by consumers more widely across the market, so that they can benefit from cheaper tariffs. The Government intends to achieve this through supporting Ofgem and ensuring their final proposals are implemented in the most timely manner. Proposals to move those consumers on poor value "dead" tariffs to better value "open" tariffs will ensure that consumers are not left indefinitely on more costly tariffs. Less complex and easily comparable tariffs, clear personalised information on bills and a tariff comparison tool will make it easier for consumers to compare tariffs across the market and should encourage greater engagement and increase competitive pressure on suppliers.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

This impact assessment examines the costs and benefits of taking primary powers. The impact of any specific interventions, if powers were exercised, would be examined separately, alongside any consultation on secondary legislation, with a full impact assessment. We have considered the following options:

-Option 1: "Do nothing". Government does not take primary powers.

-Option 2: Taking powers to limit the number of core tariffs suppliers can provide, prescribe features of tariffs and mandate suppliers to move customers on poor value "dead" tariffs to "open" ones, requiring suppliers to provide personalised information on bills about the cheapest tariff and use tariff comparison metrics for each tariff

Our preferred approach is to take forward option 2. We are looking to support Ofgem's work and to ensure Ofgem is not delayed or impeded in its attempts to simplify and improve access to the market.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 2018/19

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: .... Date: 08 May 2013

Summary: Analysis & Evidence

Policy Option 2

Description: Taking powers to limit the number of core tariffs suppliers can provide, prescribe features and mandate suppliers to move customers on poor value "dead" tariffs to "open" ones, requiring suppliers to provide personalised information on bills about the cheapest tariff and use tariff comparison tools for each tariff

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2013	Time Period Years 7	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 0	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised costs by 'main affected groups'

The estimated government staff and consultancy costs would be around £0.3m if the primary powers are exercised. This is not a direct cost of taking powers as they may not be taken forward and therefore this is not included in the table above.

Other key non-monetised costs by 'main affected groups'

There could potentially be costs to some players in the market if they believe that there is increased regulatory uncertainty due to the Government taking powers in this area.
Direct costs of specific interventions will be considered at the secondary legislation stage should that be necessary, potential high level impacts are presented in Annex A.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0		0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

N/A

Other key non-monetised benefits by 'main affected groups'

Taking powers to limit the number of core tariffs, prescribe features of tariffs and mandate suppliers to move customers on poor value "dead" tariffs to better value "open" ones, provide personal estimates of savings on bills from moving to cheaper tariffs and use a tariff comparison tool will provide a strong signal to suppliers that the Government intends to act should they seek to unnecessarily delay or impede Ofgem's implementation of its final proposals. This will increase certainty in the market that action will be taken and so may encourage early implementation by suppliers so consumers benefit more quickly.
Direct benefits of specific interventions will be considered at the secondary legislation stage should that be necessary. Potential high level impacts are presented in Annex A.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

Assumption that Government can successfully implement these obligations if needed. Also that there is uncertainty in the retail market partly due to the length of time Ofgem has been considering reform. By taking powers the Government is increasing certainty in the market that action will be taken, and we believe this outweighs any concerns that taking powers increases uncertainty.
Risk that following consultation Ofgem modifies significantly its proposals so they are not entirely compatible with the powers Government is proposing to take. This is mitigated by keeping the powers sufficiently broad to allow for a range of outcomes.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	Benefits: 0	Net: 0	Yes	Zero Net Cost

Evidence Base

1. This Impact Assessment (IA) examines the arguments for and against Government taking primary powers to limit the number of core tariffs that suppliers offer (including prescribing tariff types), require consumers on poor value “dead” tariffs to be moved to better value “open” tariffs, require bills to include personalised estimates of the savings to be made from moving to the cheapest tariff for the customer’s current payment method and the cheapest tariff overall and require suppliers to use a tariff comparison tool. The impacts of any specific interventions, if some or all of the powers are exercised, would be examined separately, alongside any consultation on secondary legislation, with a full impact assessment.

Background

2. Currently suppliers are free to determine the number of tariffs they offer, their structure, and how they apply any discounts or special offers. In terms of the structure of tariffs, some suppliers offer multi-tier tariffs (i.e. they charge a different, usually higher, per unit rate for the first set number of units used then a lower rate for the rest of the units used) and others favour a standing charge and unit rate structure. The sheer number of complex tariff structures and different ways in which discounts and special offers are displayed means it is extremely difficult for consumers to compare offers across the market.

3. In its Retail Market Review publications[1] Ofgem found that despite some suppliers taking steps to reduce the number of tariffs on offer there is still a baffling array of complex tariffs across the market to choose from. It also found that there are over 650 “dead” tariffs - these are tariffs that last for an indefinite time period that serve existing customers, but are not open to new customers. These tariffs make it harder for consumers to identify their own tariff, for example on a switching site list, and therefore make it more difficult to compare it with the current range of tariffs on offer. Ofgem’s analysis suggests that for the previous incumbent suppliers (those companies that inherited their customers when the gas and electricity markets were privatised) around one third of these “dead” tariffs are more expensive than the current standard variable rate the same suppliers offer to other customers.

4. Another barrier to engagement in the market is the lack of clear information on energy bills and other communications from consumers. Consumers need to have access to clear information that enables them to engage with the market with confidence and make accurate decisions about their tariff options. Since its initial probe into the retail energy market in 2008, Ofgem has introduced a number of requirements on the quality of information suppliers provide to their customers. From July 2010 new licence conditions were introduced requiring suppliers to include on all bills information on the customers tariff, their energy consumption for the last 12 months and the projected costs. Also, from July 2010 suppliers were required to issue an annual statement to all customers. This contains all the information required on bills plus the principal terms and conditions of the tariff and any premiums or discounts as compared with the supplier’s standard monthly direct debit tariff. This information is only provided once a year and does not necessarily refer to the cheapest tariff for the supplier.

5. In September 2011 the Government secured the agreement of the six major energy suppliers to:
   - write to 8 million bill customers to inform them about the savings they could make by paying by direct debit; and,
   - insert relevant information on all energy bills from autumn 2011 to inform customers on steps available to secure the best tariff.

6. In April 2012, the Government reached a further voluntary agreement with the six largest energy suppliers for them to provide an annual communication to all customers helping them to identify what the best tariff options are for them and how to get them. More recently some suppliers have also simplified and reduced the number of tariffs they offer.

7. Despite these initiatives the majority of consumers remain disengaged, giving the large incumbent suppliers a competitive advantage over new entrants. The six large established suppliers benefit

[1] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=460&refer=Markets/RetMkts/rmr and http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20Impact%20Assessment%20for%20domesitc%20proposals.pdf

from a large base of “sticky” customers (customers who have either never switched or have given up switching). This makes it more difficult for new companies to enter the market as they have to offer large discounts to incentivise consumers to switch and the large suppliers can subsidise cheap offers to attract new customers through their large base of sticky customers.

8. Ofgem’s review of the retail market began in 2010 with Ofgem publishing its initial findings and proposals in March 2011. Ofgem concluded that the market was not working in the interests of consumers as well as it might. One of the reasons for this was the proliferation and complexity of tariffs making it difficult for consumers to shop around and compare deals across the market. Ofgem subsequently published detailed proposals for consultation in December 2011 on tariff simplification in its next iteration of the Retail Market Review. While stakeholders welcomed the aims of the proposals, the majority had concerns about the details of proposals[2]. Ofgem reconsidered its proposals in the light of responses and produced a revised set of proposals, published 26 October 2012[3]. During this period Ofgem carried out extensive consumer research to inform the proposals and carried out further analysis of the likely impact of its proposals. Following consultation on these proposals, Ofgem published final proposals on 27 March 2013[4].

9. Ofgem has set out a range of proposals to simplify tariffs and provide clearer information to consumers to prompt them to engage in the market and to make it much easier to compare tariffs and identify the best deal for them. These include:
   - Limiting suppliers to four core tariffs per fuel
   - Prohibiting poor value “dead” tariffs
   - Requiring suppliers to provide personal estimates on bills and other communications of the savings consumers can make from moving to the supplier’s cheapest tariff for their current preferences and the cheapest tariff overall
   - Requiring suppliers to use a Tariff Comparison Rate (TCR) for all tariffs, so consumers can compare tariffs on a like for like basis.

10. The proposals require suppliers to limit the number of core tariffs they offer, prescribe that all suppliers must offer at least one standard variable rate tariff per fuel (and per time of use meter) and require that suppliers transfer customers on poor value “dead” tariffs to better value “open” tariffs. Ofgem has proposed that suppliers be restricted to four core tariffs. Figure 1 is Ofgem’s schematic to show how many tariffs each supplier could offer. This clearly simplifies the decision making process to have 4 core tariffs for each fuel, and then a constant charge variation depending on Online/Offline, payment type and then the same constant bundles (e.g. boiler care) to opt for on top of all types of tariffs. There will still be a number of tariff variations to suit different consumer preferences, however, there would be a simplified set of options at each decision point when switching.

Figure 1. Effect of Ofgem’s proposals in the number of core tariffs available – see Ofgem’s Retail Market Review Chapter 2

Fuel	Core tariffs		Online/Offline		Variation by payment type*	Plus dual fuel discounts, and bundles offered across all tariffs
Electricity	4	**Each of the ‘core’ offers available both online and offline.**	8	**Equal and cost-reflective adjustments to core tariff’s charges reflecting payment type.**	24	
Gas	4		8		24	
Total	8		16		48	

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[2] See Chapter 8 Retail Market Review Impact Assessments for details of the developments since the original proposals here: http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20Impact%20Assessment%20for%20domesitc%20proposals.pdf

[3] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Updated%20domestic%20proposals.pdf

[4] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20domestic%20proposals.pdf

11. In order to promote engagement Ofgem is proposing that suppliers should provide consumers with personal estimates on bills and other consumer communications of the savings they can make by moving to the cheapest tariff for their current preferences and the cheapest tariff overall. The personal estimates will also help consumers engage more widely in the market as they will contain accurate information about the consumer's current tariff and consumption rates.

12. Ofgem is also proposing to introduce a Tariff Comparison Rate (TCR) as a common currency for market wide comparisons for energy prices – similar to the annual percentage rate (APR) for loans and mortgages. Suppliers would be required to express each tariff they offer as a single number for an average user. It is intended that the TCR will be included in consumers' bills and other forms of communication such as the annual statement. The TCR will be displayed in all advertising materials for each tariff.

13. These measures outlined by Ofgem are key to achieving Government's aim of ensuring consumers obtain the lowest tariff by raising engagement in the market through simplification and by prompting consumers to act. Ofgem's principal objective is to protect the interests of both existing and future energy consumers. Ofgem has a comparative advantage in carrying out analysis on retail markets and has undertaken a range of consumer research to understand the behavioural aspects acting on the demand side of the market, as well as analysis of the levels of engagement by consumers and of competition amongst suppliers in the retail market. Ofgem has carried out an in-depth review of the retail market taking forward analysis of proposals that aim to encourage and equip consumers to get the best deal from the energy market, whilst consulting with all groups to ensure that all impacts in the market are considered. For further information and impact assessment of Ofgem's proposals that we are supporting please see Ofgem's Retail Market Review document and impact assessment (available here: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=460&refer=Markets/RetMkts/rmr).

Problem under consideration

14. In a perfectly competitive market both consumers and suppliers have full information on anything that might influence their respective decision-making processes, for example supplier costs, alternative products and prices. However, where a party has incomplete information, they are at a disadvantage in the market. At present, suppliers are better informed than individual consumers, particularly domestic consumers, leaving consumers at a competitive disadvantage[5].

15. The fact that the majority of customers do not shop around to seek out the best deals and that suppliers can differentiate their offers between new and existing customers means there is less pressure on suppliers to compete (see Box 1) than in a perfectly competitive market. Suppliers currently compete only for the minority of customers that shop around, making market entry by new suppliers difficult. This potentially results in higher prices for the majority of consumers that do not engage, some of which remain on poor value "dead" tariffs.

Box 1: Impact of consumer disengagement on competition

Consumers play a key role in a well functioning market. Through their active participation and choices in the market, consumers put pressure on suppliers to offer the products that consumers want at competitive prices. However, 'sticky' customers can create for suppliers a degree of slack, and reduce the incentive to drive down costs and to innovate to meet consumers' preferences, potentially leading to higher prices for consumers. In order to be active, consumers need to have a clear understanding of how to access, assess and act on market information to choose the best product and tariff.

[5] Ofgem's Retail Market Review – Impact Assessment for the dinal domestic proposals, : http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20Impact%20Assessment%20for%20domesitc%20proposals.pdf

When suppliers make excess profits or act inefficiently, this should incentivise new entrants into a market. However, consumer disengagement puts new entrants to the retail market at a potential disadvantage. Any new entrant has to offer larger discounts to incentivise consumers to switch compared to a more competitive market. New entrants have no sticky customers that were inherited at the time of market opening as the incumbents do, they have had to compete to gain all their customers and so all their customers are [or at least were at one point] active in the market. The customers of new entrants are more likely to switch than those of incumbents, and therefore new entrants cannot segment their customers in the way incumbent suppliers can.

This market structure enables the incumbents to offer more competitive tariffs to those who do switch whilst keeping the tariffs of sticky customers higher (see Annex B paragraph 85). The fact the large incumbent suppliers are able to undercut new entrants due to their more profitable large 'sticky' customer base makes new entrance difficult. This increases the incumbents' market power and leads to potentially higher prices.

16. The reasons for this lack of engagement (see Box 2) include the proliferation of tariffs and complex tariff structures which make it difficult for consumers to compare tariffs and understand which offer the best value for them and the lack of clear information on bills. Another factor is a lack of awareness that cheaper tariffs exist[6]. Many consumers are not confident enough to engage in the market and/or are put off by the perceived hassle and time it takes to switch supplier. Others may be aware that there are savings to be made but in the absence of a specific prompt or trigger to act, stick with the tariff they are already on[7].

Box 2: Barriers to effective consumer engagement

Ofgem has carried out consumer research and analysis to assess the barriers to consumer engagement which they have presented in the recent RMR document[8]. The barriers to engagement that Ofgem identified are:

- Complex tariffs – the number of different tariff structures on offer are confusing, with complex structures, including multi-tier tariffs and various discounts applied. This puts off many consumers from searching, leads some consumers to abandon their search, may result in an increased frequency of poor switching decision and contributes to a lack of trust in the industry.
- Inadequate information – there is evidence to suggest that consumers find information that they are sent from suppliers difficult to understand and use, particularly for vulnerable customers.
- Lack of trust and poor supplier conduct – there is evidence that the overall perception of the energy industry is fairly negative, and suggests that consumers believe suppliers make it deliberately difficult to switch supplier.

Behavioural economics also suggests that consumers have:

- Limited capacity to assess complex information, or 'bounded rationality', when making decisions on switching. Time and attention are a scarce resource for an individual and so use rules of thumb when the information they need to assess is complex; this often results in non-optimal decisions.
- 'Status quo bias' – consumers have a tendency to not change from what they are currently doing unless they face strong reasons to do so.
- Loss aversion – consumers feel more strongly about losing rather than gaining value, and therefore could be less likely to switch for fear they may be worse off.
- High discount rate – consumers put more weight on the costs/hassle of switching than the gains they could achieve over a longer time period by switching.

Source:
-'What can behavioural economics say about GB energy consumers?' Ofgem March 2011
http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Behavioural_Economics_GBenergy.pdf
-'Assessing the effectiveness of potential remedies in consumer markets' OFT April 2008,
http://oft.gov.uk/shared_oft/economic_research/oft994.pdf

17. The evidence provided by Ofgem in the Retail Market Review is clear that the majority of consumers do not engage in the energy market and are paying more than they would be if they were on a lower available tariff. Action is therefore needed to ensure the majority of customers are placed on the

[6] SPA Future Thinking, 'Options for cheapest tariff messaging on customer communications; Report of qualitative research', 2012
[7] SPA Future Thinking, 'Options for cheapest tariff messaging on customer communications; Report of qualitative research', 2012
[8] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20domestic%20proposals.pdf

cheapest tariff that meets their preferences and to drive customers to engage more actively in the market. By improving accessibility of information and comparability of tariffs, Ofgem's proposals give consumers the tools they need to participate more effectively in the market. If successful, consumers will be in a better position to choose the best products and tariffs for them.

18. Following the RMR consultation period, which closed on 23 April 2013, Ofgem is considering responses to their consultation. Final proposed licence modifications to give effect to the proposals are expected to be issued in early May 2013. Under the licence modification process energy suppliers have 56 days in which to apply to the Competition Commission to appeal Ofgem's final decision. Most of the relevant measures should therefore be in place by June or July 2013 if suppliers do not appeal Ofgem's final licence modification decisions.

19. However, if suppliers appeal to the Competition Commission, the appeal process can take up to 5 months. If Ofgem were to lose the appeal it would have two options:
    - re-consult on amended licence modifications; the length of time this would take would depend on the extent to which they differed from the original proposals; or,
    - abandon the proposals.

20. There is a risk that Ofgem's final proposals are delayed or are abandoned due to an appeal. If so, the majority of consumers would then continue to pay more than they would under an alternative and more appropriate tariff, and customer engagement in the market would not improve. As a result, the potential to improve the functioning of the retail energy market would be foregone.

21. If this occurs it would take time to pass primary and secondary legislation to enable for Government to intervene. This would result in any potential benefits to consumers being delayed unnecessarily.

Rationale for intervention

22. Intervention is needed to ensure that the majority of disengaged customers benefit from cheaper tariffs, by providing clearer comparable information on tariffs, helping and encouraging them to engage in the market and to make better decisions, and by requiring suppliers to move customers on poor value dead tariffs to better value open tariffs. Ofgem has published proposals to simplify the market and make it easier for consumers to compare tariffs. The Government intends to support Ofgem in legislation to ensure Ofgem can implement the final proposals without undue delay, increasing the likelihood and timeliness of significant consumer benefits through enhanced competition.

Policy objective

23. The Government's policy objectives are to:
    - encourage competition in the retail market through greater engagement by consumers more widely across the market, so that they can benefit from cheaper tariffs;
    - ensure that inactive consumers are on the cheapest tariff that meets their preferences; and,
    - drive engagement in the energy market by prompting consumers with information on the savings they can make and making it easier for them to compare tariffs across the market.

24. These objectives can be met by Ofgem's Retail Market Review proposals. The proposals to limit the number of core tariffs that suppliers may offer and to set rules on how discounts and special offers are to be applied will enable consumers to compare tariffs across the market more easily – see Figure 1 above. Coupled with its proposals to ban poor value "dead" tariffs, limiting the number of core tariffs suppliers may offer should result in the majority of inactive consumers being placed on the cheapest tariff that meets their current preferences (payment method and whether they have chosen a fixed price fixed term tariff, green or a standard variable rate tariff).

25. Ofgem's proposals to limit the number of core tariffs, provide personal estimates on bills of the savings customers can make from moving to the cheapest tariff and the tariff comparison metric will make it easier for consumers to compare tariffs across the market and drive engagement. Increased engagement should lead to greater pressure on suppliers to compete by innovating and keeping their tariffs as low as possible.

26. The Government is determined during this period when household budgets are under substantial pressure, timing is very important in ensuring consumers are not paying unnecessarily high prices for their gas and electricity. Therefore the timeliness of these proposals is vital, and so taking powers now is of upmost importance.

27. This impact assessment examines the costs and benefits of taking primary powers. The impacts of any specific interventions, if some or all of the powers are exercised, would be examined separately, alongside any consultation on secondary legislation, with a full impact assessment. For further information and impact assessment of Ofgem's proposals that we are supporting please see Ofgem's Retail Market Review document and impact assessment.

Description of options considered

28. We have considered the following options:

- Option 1: "Do nothing". Government does not take primary powers on consumer tariffs.
- Option 2: Taking powers to limit the number of core tariffs suppliers can provide, prescribe features and mandate suppliers to move customers on poor value "dead" tariffs to "open" ones, requiring suppliers to provide personalised information on bills about the cheapest tariff and use a tariff comparison tool for each tariff.

<u>Alternatives to regulation</u>

29. The Government has in the past reached voluntary agreements with the large suppliers on a range of issues. For instance in April last year the Government reached agreement with the suppliers that they would give consumers information on the best tariff for them and this information is already appearing on consumers' bills. Some suppliers have also acted voluntarily to simplify tariff structures and reduce the number of tariffs they offer. While this is welcome, they have taken different approaches, and there is inevitably a lack of consistency, which means consumers still find it extremely difficult, if not impossible, to compare tariffs across the market.

30. The Government has considered whether it could achieve its objectives by reaching a voluntary agreement with suppliers to:

- reduce the number of core tariffs they offer;
- transfer customers from poor value "dead" tariffs to better value "open" tariffs;
- provide personalised information on bills about the cheapest tariff; and,
- use a tariff comparison metric for each tariff, so consumers can compare tariffs on a like-for-like basis.

31. However, a voluntary agreement is unlikely to be able to deliver the level of consistency necessary across suppliers for consumers to be able to compare tariffs more easily. Ofgem's proposals set out the number of core tariffs suppliers will be able to offer alongside rules on how discounts and special offers may be applied. Their proposals requiring suppliers to provide personal estimates to consumers on the savings they can make by moving to the cheapest tariff and the tariff comparison metric would not be effective unless suppliers follow the same methodology for calculating savings and deriving comparison metrics for each tariff. It would be extremely difficult to reach the level of prescription necessary to allow for easy comparison of tariffs across the market through voluntary agreement. Nor would a voluntary agreement provide the certainty we are seeking that consumers on poor value "dead" tariffs would be transferred to better value "open" tariffs that meet their payment preference.

32. Voluntary agreements work best when businesses are agreeing to abide by a general principle or a few simple rules. However, the proposals we are seeking to ensure are implemented will be necessarily detailed and in some aspects prescriptive. It may be possible to broker an agreement with suppliers that they limit themselves to a set number of core tariffs. But reducing the number of tariffs alone would not be sufficient to drive consumer engagement. Consumers need to be able to compare tariffs across the market and this will require defining what constitutes a core tariff, including how discounts and special offers may be applied. Reaching a voluntary agreement on detailed rules of how tariffs should be defined across the 15 current domestic suppliers would be extremely difficult, if not impossible.

33. Similar problems would be encountered in relation to the proposals for a tariff comparison tool and the requirement for suppliers to provide personalised information on bills and other communications about the savings to be made from moving to the supplier's cheapest tariff. In order for consumers to derive maximum benefits suppliers would need to follow the same methodology to calculate a tariff comparison metric for each tariff and for consumers' personal estimates of the savings they would make from moving to the supplier's cheapest tariffs. Only if all personal estimates and tariff comparison metrics are calculated in the same way will consumers be able to use them to compare tariffs across the market.

34. A voluntary agreement would not deliver any certainty that the proposals would be implemented effectively or consistently across all suppliers. It would also cut across the proposals Ofgem have put forward. We are looking to support Ofgem's work.

Cost-benefit analysis

35. This section first describes what might happen under "Do Nothing" and then examines the costs and benefits of Option 2, relative to doing nothing. The cost-benefit analysis focuses on the "direct" impacts of taking primary powers, i.e. the costs and benefits that can be attributed to the act of introducing primary legislation alone [Annex A sets out the high-level impacts of potential interventions that might achieve our objectives]. The impacts of any proposed interventions would be examined more fully, alongside any consultation on secondary legislation, with a full impact assessment. For further information and impact assessment of Ofgem's proposals that we are supporting please see Ofgem's Retail Market Review document and impact assessment.

Option 1: Do nothing

36. This section considers the direction of travel of retail electricity and gas supply, assuming Government does not take powers to improve consumers' engagement with the market. In summary it is likely that Ofgem will deliver the Government's objectives, however, there is a risk that the implementation of their proposals is unduly delayed. This would put the potential benefits to the market from more engaged consumers at risk. These potential benefits include potentially lower prices for the majority of customers due to a more competitive market, as discussed in Box 1.

37. As set out in the background section at present suppliers are free to:

- offer as many tariffs as they like;
- determine the structure of tariffs (i.e. whether they offer multi-tier rates or a standing charge and unit rate); and,
- apply discounts and special offers as they wish.

Suppliers are not under any obligation to provide personal estimates of the savings consumers can make by moving to the cheapest tariff that meets their preferences or to use a tariff comparison tool.

38. Consumers are free to move suppliers and choose from the tariffs that are offered. However, over the last year the number of consumers switching supplier has dropped (see Annex B for a summary of Ofgem analysis, including a summary of consumer research), though suppliers inform us that the number of customers switching tariffs whilst staying with their supplier is increasing. One supplier has indicated that around 25% of its customers changed tariff last year, though it is not clear whether this figure includes customers whose fixed term tariffs have ended. Nonetheless, we are concerned that the apparent lack of consumer engagement across the market risks higher prices due to lower competitive pressure.

39. Ofgem has consulted on proposals to reform the domestic retail energy market. In its latest set of Retail Market Review publications, published 27 March 2013,[9] Ofgem set out a range of proposals to simplify tariffs and provide clearer information to consumers to prompt them to engage in the market and to make it much easier to compare tariffs and identify the best deal for them. These include:

- Limiting suppliers to four core tariffs per fuel (see Figure 1 and paragraph 9 above);
- Prohibiting poor value "dead" tariffs;

[9] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Final%20domestic%20proposals.pdf

- Requiring suppliers to provide personal estimates on bills and other communications of the savings consumers can make from moving to the supplier's cheapest tariff for their current preferences and the cheapest tariff overall; and
- Requiring suppliers to use a tariff comparison rate for all tariffs, so consumers can compare tariffs on a like-for-like basis.

40. This proposed package clearly simplifies the decision making process to have 4 core tariffs for each fuel, and then a constant charge variation depending on payment type and then the same constant bundles (e.g. boiler care) to opt for on top of all types of tariffs. There will still be a number of tariff variations to suit a range of different consumer preferences, however, there would be a simplified set of options at each decision point when switching.

41. In coming to a final decision regarding the appropriate level of prescription of core tariffs and allowable variations, Ofgem will need to balance the potential benefits from increased consumer engagement and competition against any potential stifling of tariff innovation by suppliers and hence consumer preferences.

42. Ofgem's consultation closed on 23 April 2013. Final proposed licence modifications to give effect to the proposals are expected to be issued in early May 2013. Under Ofgem's proposal all measures should be in place by the end of March 2014if suppliers do not appeal Ofgem's final licence modification decisions. However, as discussed in paragraphs 18-20 above, suppliers have the right to appeal (if they have sufficient grounds) which would result in delay, and in the case of a successful appeal Ofgem would have to re-consult or abandon the proposals. This would also result in a longer period of uncertainty of what is expected of suppliers.

43. If the Government does nothing, there is an increased risk that Ofgem's final proposals are unduly delayed or impeded. The majority of consumers would continue to pay more than they need to and customer engagement in the market would not improve, with little prospect of suppliers being subject to greater competitive pressure to keep prices as low as possible.

Option 2: Taking powers to limit the number of core tariffs suppliers can provide, prescribe features and mandate suppliers to move customers on poor value "dead" tariffs to "open" ones, requiring suppliers to provide personalised information on bills about the cheapest tariff and use a tariff comparison tool for each tariff

44. The Government proposes to take enabling powers in the Energy Bill to require suppliers to:

    - Limit the number of "open" core tariffs that suppliers may offer (the precise number would be set out after a further consultation in secondary legislation, as would the definition of a core tariff);
    - Prescribe features of the tariffs suppliers may offer (again the detail of what would be prescribed would be set out in secondary legislation after a further consultation);
    - Transfer customers on poor value "dead" tariffs to better value "open" tariffs;
    - Give consumers personal estimates of the savings they can make by moving to the supplier's cheapest tariff; and,
    - Use a tariff comparison metric for all tariffs, so tariffs can be compared across the market on a like for like basis.

45. This will be a strong signal from the Government that it intends to legislate to ensure the necessary reforms are in place to meet its policy objectives as detailed above. This will reduce the risk of appeal purely to achieve a delay in implementation and help ensure the measures are in place as quickly as possible. Suppliers are more likely to work constructively with Ofgem knowing that the Secretary of State is prepared to act. It may encourage suppliers to adopt the measures in advance of implementation, and therefore bring forward the benefits to consumers.

46. If a power is not taken now and instead delayed, an appropriate primary legislative vehicle may not be readily available. This would significantly delay any government intervention to put proposals through, in the event that Ofgem is unduly delayed or impeded in implementing their final proposals. This would result in any potential benefits to consumers being delayed unnecessarily.

47. Also, the Government is determined to ensure that at this time when household budgets are under substantial pressure, timing is very important to ensure consumers are not paying unnecessarily high

prices for their gas and electricity. Therefore the timeliness of these proposals is essential, and taking powers now is of upmost importance.

48. The powers are drawn fairly broadly in order to ensure consistency with Ofgem's final proposals. There may be concern on the part of the suppliers that the powers may be used after Ofgem has implemented its proposals to pursue wider objectives. We are proposing to include a sunset clause on the powers to mitigate any costs arising from uncertainty to business that they may incur costs in addition to those arising from Ofgem's proposals.

49. Also, there is already uncertainty in the energy retail business that has been created by a long RMR process. The Government taking these powers should increase certainty in the market that measures will be taken and incentivise players in the market to work with Ofgem to improve the energy retail market. We believe this added certainty in the market that action will be taken, and would outweigh any concerns that taking powers increases uncertainty. The estimated government staff and consultancy costs would be around £0.3m if the primary powers are exercised. This is not a direct cost of taking powers as they may not be taken forward and therefore this is not included in the cost benefit tables in the summary sheets.

50. These costs are based on the estimated work that would be needed to make a full assessment of the impacts of all measures proposed in secondary legislation if deemed necessary. If secondary legislation is needed, Government would work with Ofgem and carry out a full assessment of the impacts of any measure taken forward. This would include a full analysis on both the competition and consumer impacts. Utilising evidence and analysis already available and carrying out further analysis as necessary.

51. The competition assessment of the impacts of limiting the number of core tariffs would consider the benefits that may arise from any increased consumer engagement as well as assessing potential unintended consequences e.g. limiting the choice to consumers too much could actually lead to disengagement due to suppliers appearing the 'same', consumer preferences not being fully satisfied or suppliers' ability to innovate is stifled.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

52. This impact assessment examines the costs and benefits of taking primary powers.

53. This package of primary powers is to support Ofgem's RMR proposals to ensure that Ofgem is not unduly delayed or impeded in implementing their reforms. These measures will help sticky consumers get the cheapest tariffs and engage more widely in the market.

54. Ofgem have carried out research and presented this in their recent RMR documents, and previous documents available. The relevant documents have been referenced in this IA with links, and key evidence summarised in Annex B.

55. Any specific interventions are not yet formulated, and so it is not possible to assess the actual impacts of these beyond the high level assessments presented in Annex A. For further information and impact assessment of Ofgem's proposals that we are supporting please see Ofgem's Retail Market Review document and impact assessment.

56. The impact of any specific interventions, if powers are exercised, would be examined separately, alongside any consultation on secondary legislation, with a full impact assessment.

Risks and assumptions

57. A key assumption is that the Government can successfully implement these obligations if needed. Also, there is uncertainty in the retail market due partly to the length of time Ofgem has been considering reform. By taking powers the Government is increasing certainty in the market that action will be taken, and we believe this outweighs any concerns that taking powers increases uncertainty.

58. There is the risk that following consultation Ofgem modifies the proposals and they are not entirely consistent with the powers Government is proposing to take. We believe this risk is mitigated by keeping the powers sufficiently broad to ensure consistency is maintained.

59. There is an assumption that a full analysis will support final decisions, whether by Ofgem or DECC through secondary legislation, setting out that the benefits outweigh the costs of any intervention. For example, in setting the level of the cap it is set in a way that means the benefits from increased simplicity and consumer engagement are not offset by consumers finding their choice of tariff limited in a way that affects their welfare, or the ability to innovate by suppliers is stifled thereby damaging competition.

Direct costs and benefits to business calculations (following OIOO methodology)

60. This impact assessment examines the costs and benefits of taking primary powers.

61. This package of primary powers is to support Ofgem's RMR proposals to ensure Ofgem is not unduly delayed or impeded in implementing these important reforms. These measures will help sticky consumers get the cheapest tariffs that meet their preferences and engage more widely in the market.

62. There could potentially be costs to some players in the market if they believe that there is increased regulatory uncertainty due to the Government taking powers in this area. However, there is already uncertainty in the energy retail business that has been created by a long RMR process. By taking these powers the will increase certainty in the market that the measures will be implemented and incentivise players in the market to work with Ofgem to improve the energy retail market.

Wider impacts

63. This impact assessment examines the costs and benefits of taking primary powers which do not have any wider impacts.

64. The wider impact of any specific interventions, if powers were exercised, would be examined separately, alongside any consultation on secondary legislation, with a full impact assessment.

Specific impact tests

<u>Competition impacts</u>

65. Primary legislation is not expected to have significant direct impacts on competition. Encouraging competition through encouraging consumer engagement is one of the policy objectives and is considered throughout the evidence base in this IA. The potential impact on competition will be considered in more detail if secondary legislation is introduced.

<u>Small and micro business impacts</u>

66. Primary legislation is not expected to have significant direct impacts on small or micro businesses. The potential impact on small and micro businesses will be considered in more detail if secondary legislation is introduced.

<u>Equalities</u>

67. Primary legislation is not expected to have any differential impacts on the basis of the protected characteristics. We will consider equality impacts in more detail, if the Secretary of State decides to use primary powers.

<u>Human Rights</u>

68. To the extent that human rights may be engaged, we consider the approach to be compatible with the Human Rights Act 1998.

<u>Other specific impacts</u>

69. Primary legislation is not expected to have any differential impacts in the following areas: wider environmental impacts; greenhouse gas impacts; health impacts; justice impacts; rural proofing impacts; and, sustainable development impacts.

Post-implementation Review

70. The Secretary of State would examine the direction of market travel and Ofgem's decision on interventions before deciding whether to exercise his/her powers, and if so, what intervention to take. Exercising the powers themselves would likely be subject to a sunset or review clause. We envisage that monitoring and enforcement of any intervention would be the role of Ofgem, and that further details of the monitoring and evaluation process would be made available at a more advanced stage of policy development.

Summary and preferred option with description of implementation plan

71. Our preferred approach is to take forward option 2: Taking powers to limit the number of core tariffs suppliers can provide, prescribe features of tariffs and mandate suppliers to move customers on poor value "dead" tariffs to "open" ones, requiring suppliers to provide personalised information on bills about the cheapest tariff and use a tariff comparison tool for each tariff.

72. We are looking to support Ofgem's work and to ensure Ofgem is not unduly delayed or impeded in its attempts to simplify and improve access to the market and increase certainty that in the retail market reform will be taken forward.

73. This impact assessment examines the costs and benefits of taking primary powers. The impact of any specific interventions, if powers were exercised, would be examined separately, alongside any consultation on secondary legislation, with a full impact assessment.

Annex A: Impacts of potential secondary legislation

74. The Government's objectives can be met by Ofgem's RMR proposals. We are taking powers to support Ofgem, to strengthen their hand and ensure that their final proposals are not unduly delayed, or impeded. Therefore if Ofgem implements proposals successfully these powers may not lead to secondary legislation. For further information and impact assessment of Ofgem's proposals that we are supporting please see Ofgem's Retail Market Review document and impact assessment.

75. If powers were exercised, any specific interventions would be examined fully, alongside a secondary legislation stage consultation document, with a full impact assessment. This annex sets out indicative high level impacts of any potential secondary legislation, but actual impacts will depend on the specific measures which are not known at this time. Ofgem have published an impact assessment for their final proposals.

Consumers

76. The measures should make it easier for consumers to engage in the market, by simplifying the choices and comparison between tariffs (whilst still having the popular tariffs available), being incentivised by understanding the savings they could make, and therefore putting competitive pressure on suppliers to act in the most efficient way and compete for consumers with products and prices they want, potentially lowering prices for consumers and producing a net benefit for society.
77. There could also be some small familiarisation costs from the changes in tariffs for consumers, although efforts would be made to keep these to a minimum. Consumers will also be offered less choice in tariffs, however, any measures would consider the need for the space for innovation and meeting the needs of consumers' and varied preferences.
78. However, there is a risk that a cap on the number of tariffs is set such that some consumer preferences are no longer satisfied. This could result in a welfare loss for these consumers as they move to a less preferred tariff. This risk, along with other risks and unintended consequences, will be considered, and mitigation methods applied at the time of any secondary legislation
79. There could also be distributional benefits to consumers due to a transfer from energy suppliers arising from more competitive tariffs. Also there could be distributional impacts between consumers, with benefits to the more vulnerable in society who are less likely to switch, and more likely to be on poor value "dead" tariffs. This would be a transfer away from those presently active in the market who benefit from the very cheapest available tariffs at present, which may be less likely to be available when these measures take effect and more switching occurs.

Suppliers

80. There is the potential for suppliers to benefit from consumers' empowerment, building confidence and trust in the market, and improving brand and energy industry image. Also, suppliers should benefit from a level playing field on which to compete for consumers. This would involve some distributional impacts between suppliers, potentially transfers from incumbent suppliers to small suppliers as the incumbents will no longer be able to benefit from the majority of consumers not engaging in the market.
81. Suppliers would need to deploy resources to develop new tariff strategies to take account of the more limited space for innovation. There would be familiarisation costs with new regulation, resources needed to action the requirements of the regulation including the cost of IT, printing and staff time. There would also be costs to suppliers which would be transferred to consumers, arising from more competitive tariffs that are being offered due to increased competition in the retail market.
82. We do not expect these proposals to result in any reduction to the cost structure of supplying energy. Any reduction in average tariff prices would be a result of greater competitive pressure from increased switching. If there is not an increase in switching from any proposals, then these proposals would be likely to result in average prices staying the same, but some distributional impacts between consumers, from the active to inactive consumers.

Risks

83. There is the potential for unintended consequences of potential measures. Such risks could be consumers not increasing engagement in the market from mistakenly believing that they are on the cheapest tariff in the market due to these reforms or confusion created by a tariff comparison tool. There could also be the increased risk of tacit collusion due to a reduced number of core tariffs, or

potentially a lack of innovation in the market. All risks and unintended consequences would be considered, and mitigation methods applied at the time of any secondary legislation

Annex B: Summary of Evidence and Analysis from Ofgem

Competition Analysis

84. Ofgem presents evidence on the current state of competition in the domestic electricity and gas retail market alongside their updated proposals. This is briefly summarised below; further detail can be found in the Retail Market Review[10].

Switching Suppliers, Tariffs and payment methods

85. “Sticky” customers (indicated by low levels of switching) make it difficult for new entrants to attract a customer base. Ofgem’s tracker survey shows just 13% of gas customers and 14% of electricity customers switched their supplier in 2011, which is a decline below the level of 2010. This is a third year of decline for gas customers and a fourth year of decline for electricity customers[11]. In addition, among those who did not switch supplier in 2011, only 12% of both gas and electricity customers switched their tariff or payment method between January 2011 and March 2012 (when the survey was conducted). Almost two thirds of consumers claim to have never switched energy supplier. This is likely to be an underestimate but reflects the perceptions of consumers that they are inactive in this market. The Quarterly Energy Prices[12] publication by DECC shows that in December 2012, 38% of electricity customers were still with their home supplier, whilst 41% of gas customers were[13].

Market share and market power

86. The combined share of the six largest energy suppliers account for more than 98% of the domestic energy market. Due to the transition from monopoly provision, each of the major suppliers have an incumbent or legacy customer base – British Gas was the supplier of gas for all customers in GB and the other large suppliers all have legacy electricity customers in the regions where they were the sole supplier. There are around nine small suppliers who make up the rest of the market.

87. Ofgem use the OFT market concentration measures, which show that the single-fuel gas market is highly concentrated and the duel-fuel and single-fuel electricity are concentrated.

Churn: suppliers and customer types

88. Incumbents can segment the market between their less active legacy customer and their more active new customers. Ofgem state that electricity customers of new entrant suppliers switch at three times the rate of the incumbents’ customers and gas customers of new entrant suppliers switch over six times the rate of the incumbent’s customers, see Figure 2 below.

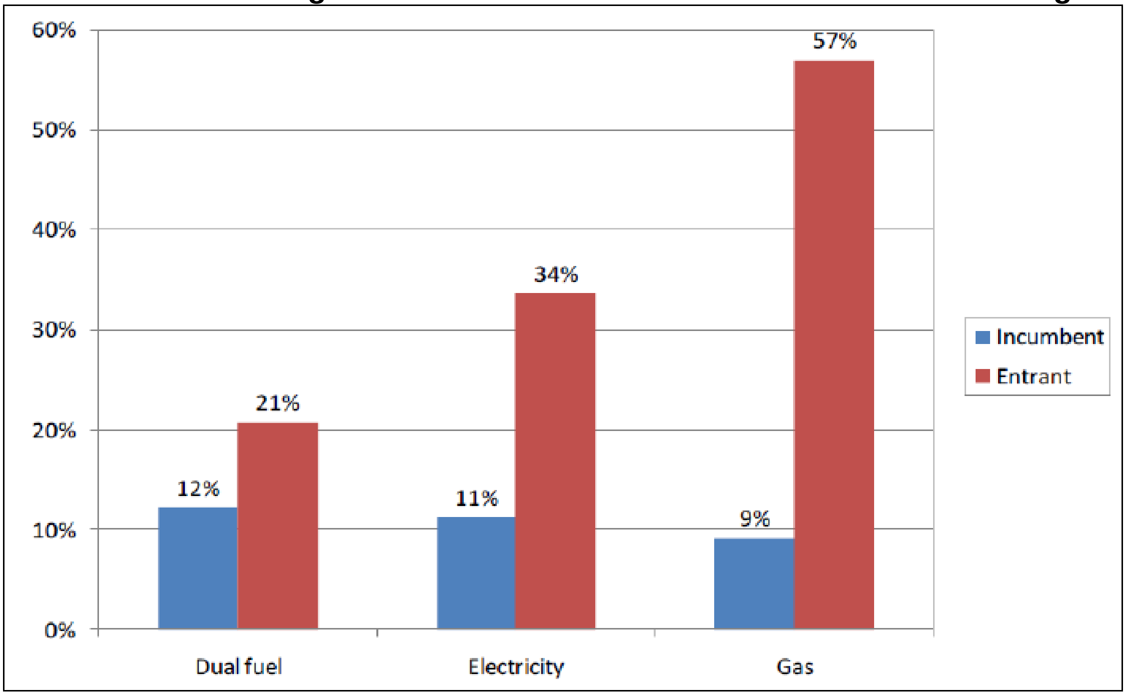
[10] The Retail Market Review – Final domestic proposals, April 2013 and Updated domestic proposals, October 2012 available here: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=460&refer=Markets/RetMkts/rmr and http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=300&refer=Markets/RetMkts/rmr

[11] Ofgem highlight that the main reason for this could the voluntary cessation of doorstep selling from suppliers.

[12] https://www.gov.uk/government/statistical-data-sets/quarterly-domestic-energy-price-stastics

[13] However, of those with the home supplier, some could have switched away and switched back again.

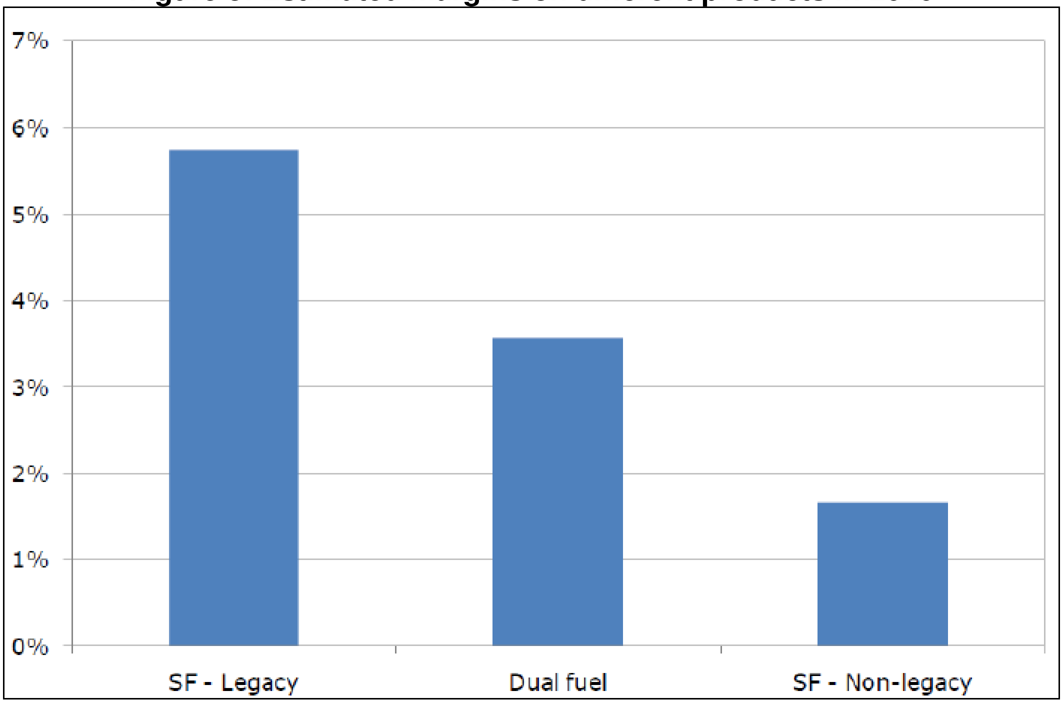
Figure 2: Annual churn of region incumbents and entrants between March and August 2010[14]



Margins: incumbent suppliers and their customers

89. The six largest suppliers make a higher margin on the fuel that they are an incumbent for – which suggests they have a degree of market power because these consumers are less likely to switch to a new supplier. The estimated margin earned in 2010 from single fuel (SF) legacy customers[15] is more than 5% which is significantly higher than duel fuel customers (less than 4%) or single fuel non legacy customers (less than 3%), see Figure 3 below. This in turn partly reflects the impact of selective online discounts, which reduce the margin earned from some active customers. In addition, the Energy Supply Probe in 2008 found that historically the major suppliers charged higher prices to customers in the region they were the incumbent supplier for than customers from other regions.

Figure 3: Estimated margins on different products in 2010



[14] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/The%20Retail%20Market%20Review%20-%20Updated%20domestic%20proposals.pdf
[15] British Gas in the case of gas and the remainder of the incumbent suppliers in the case of electricity.

Vulnerable consumers and switching

90. Ofgem's tracker survey suggests that consumers who could be vulnerable are more likely to say they have never switched. Non-switchers are more likely to lack internet access, belong to the least affluent social groups (DE), live in rented accommodation and live in rural areas, be from black & minority ethnic backgrounds and pay their bills by standard credit or pre-payment meter. This indicates that more vulnerable consumers are still with their incumbent supplier and therefore are likely to be in the group that suppliers charge higher prices to and make a higher margin from.

<u>Consumer Research in Ofgem's Retail Market Review</u>

91. Ofgem commissioned various new consumer research reports as part of the RMR process which used a variety of qualitative research methods, including individual and group interviews and larger workshops. Together these provide useful insights into how to encourage effective engagement in the energy market. Some of the main findings of the reports are summarised below; more detail on the research can be found in Appendix 6 of the October 2012 RMR consultation[16] and the specific reports can be found on the RMR website.

- Many consumers find choosing a tariff difficult, time consuming and complicated and some feel that the savings may not make the effort worthwhile. Findings from the March 2012 Consumer First Panel[17] show that confusion about what was on offer was a significant barrier for consumer engagement. Many panellists found the choice between so many options the source of their confusion and some panellists believed tariff proliferation proved suppliers are not acting to help consumers. In addition, the complexity of tariffs added to confusion and therefore disengagement, with the lack of standardisation found to discourage cross market comparisons.
- Overall, participants found comparison guides could be used to help choose the cheapest tariff for them. However, the research did not find any format that performed substantially better than the others.
- The majority of participants thought that a tariff comparison rate could make it easier to pick the best tariff for them.
- Participants preferred communication that was short, using simple language and personalised to them. Only key information such as amount to pay would be read.
- Participants generally preferred information on both the cheapest tariff for their current payment method and the cheapest tariff overall to be included.

[16] See Appendix 6 - Recent Consumer Research in the RMR Supplementary Appendix document available here: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=300&refer=Markets/RetMkts/rmr

[17] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Consumer%20engagement%20with%20the%20energy%20market,%20information%20needs%20and%20perceptions%20of%20Ofgem.pdf