Title:

Third Package: Articles concerning customers right to switch energy supplier within 3 weeks and receive final account closure within 6 weeks of switching

Lead department or agency:

Department for Energy and Climate Change

Other departments or agencies:

Impact Assessment (IA)

IA No: DECC0003

Date: 14/01/2011

Stage: Final

Source of intervention: EU

Type of measure: Legislation

Contact for enquiries:
Marina.Pappa@decc.gsi.gov.uk
Luke.Davison@decc.gsi.gov.uk

Summary: Intervention and Options

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

Article 3(5a) of the Electricity Directive and Article 3(6a) of the Gas Directive requires Member States to ensure that where a customer, while respecting contractual conditions, wishes to change supplier, the change is effected within three weeks. In addition, Annex 1 (j) of both the Electricity and Gas Directive require that consumers receive a final closure account following any change of natural gas/electricity supplier no later than six weeks after the change of supplier has taken place.
There is currently no obligation on suppliers to ensure these requirements are met. It is therefore necessary for Government to put in place new Licence Conditions in order to comply with these new requirements.

What are the policy objectives and the intended effects?

These measures are designed to improve the switching process for consumers. High levels of switching are associated with greater competition in the market, which should result in better outcomes for consumers and suppliers. Eventually we would expect higher levels of switching to be associated with more innovation and a greater number of products on offer leading to greater efficiency in the market.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

Two main options have been considered: Option 1 involves requiring suppliers to specify in contracts with customers a period of 14 calendar days for domestic accounts (from the date the contract has been agreed) in which customers can decide whether they want to proceed with the contract. The contract will specify that unless the customer cancels or there are extenuating circumstances, the supplier will be obliged to switch the customer within 21 days of the end of that period. Energy suppliers, guided by Ofgem, will be required to make some improvements to their systems and processes to ensure that progressively more people are able to switch within 21 days. Ofgem's guidance on system improvements should ensure a reasonable balance between switching times and overall customer benefit. Option 2 involves requiring suppliers to stipulate in contracts with customers that they will switch customers within three weeks, starting from the day the customer receives the terms and conditions (i.e no cooling off period is included).
Our prefered option is Option 1 as this option achieves a similar level of benefits as Option 2 while maintaining consumer protection, and imposing lower costs on industry. Both options include a new Licence Condition and an additional requirement on suppliers to close a customer's account within six weeks after they have switched to a new supplier.

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	Please refer to over-arching IA
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	No

Ministerial Sign-off For Final stage Impact Assessments:

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: Charles Hendry Date: 12/01/2011

Summary: Analysis and Evidence — Policy Option 1

Description:

Licence condition to require suppliers to include in the contract with customers a term to say that unless there are extenuating circumstances, they will start supplying electricity or gas to the new customer within three weeks of the end of the cooling off period. Suppliers to be required to make improvements to their systems and processes to ensure that as many people as possible are able to switch within these timescales.

Price Base Year 2010	PV Base Year 2010	Time Period Years 1	Net Benefit (Present Value (PV)) (£m)		
			Low: -2.5	**High: -1**	**Best Estimate: -1.75**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	1	1	N/A	**1**
High	2.5		N/A	**2.5**
Best Estimate	1.75		N/A	**1.75**

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

We would expect this option to impose some administrative costs on gas and electricity suppliers in order to improve their systems and processes. There will also be a small administrative costs in amending their standard terms and conditions. None of these exact costs are known. However, the costs of improving systems are estimated at around £1.5m to cover initial system changes and ongoing costs arising from increased information checking at early stages of the switching process[1]. We would expect the cost of amending terms and conditions to be no more than £0.5m. This upper bound estimate is based on an assumption of a one-off increase in costs of £0.01 per customer bill.

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

There will be some costs to Ofgem from monitoring the Licence Condition and working with the suppliers on guidance setting out what changes need to be made to the current systems and processes.

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

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

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

It has not been possible to fully quantify the benefits of faster switching. However, we would expect there to be a direct benefit to switching customers who could take advantage of their new gas and/or electricity tariff in a reduced time although we recognise that this would be a transfer. As an illustrative example, a customer moving from a standard tariff to some of the best direct debit tariffs around could reduce their annual bill from £1190 to £950. Therefore a consumer could save an additional £4.60 for every week gained in the faster switching process.

There may be additional, intangible benefits to consumers as these measures are designed to improve the switching process for consumers which could lead to greater competition in the supply industry.

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

There is a risk that suppliers do not improve their systems and processes fast enough or that despite changes the percentage of customers who are switched within three weeks does not improve or does so only marginally.

Impact on admin burden (AB) (£m):			**Impact on policy cost savings (£m):**	**In scope**
New AB:	**AB savings:**	**Net:**	**Policy cost savings:**	Yes

[1] Estimates were made based on data provided by energy companies in relation to complying with other obligations

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			Great Britain		
From what date will the policy be implemented?			03/03/2011		
Which organisation(s) will enforce the policy?			Ofgem		
What is the annual change in enforcement cost (£m)?			N/A		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			No		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	
Does the proposal have an impact on competition?			Yes		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:** N/A	**Benefits:** N/A	
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	**Micro**	**< 20**	**Small**	**Medium**	**Large**
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Set out in the table below where information on any SITs undertaken as part of the analysis of the policy options can be found in the evidence base. For guidance on how to complete each test, double-click on the link for the guidance provided by the relevant department.

Please note this checklist is not intended to list each and every statutory consideration that departments should take into account when deciding which policy option to follow. It is the responsibility of departments to make sure that their duties are complied with.

Does your policy option/proposal have an impact on…?	Impact	Page ref within IA
Statutory equality duties[2] Statutory Equality Duties Impact Test guidance	No	N/A
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	6
Small firms Small Firms Impact Test guidance	No	N/A
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	N/A
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	N/A
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	N/A
Human rights Human Rights Impact Test guidance	Yes	8
Justice system Justice Impact Test guidance	Yes	8
Rural proofing Rural Proofing Impact Test guidance	No	N/A
Sustainable development Sustainable Development Impact Test guidance	No	N/A

[2] Race, disability and gender Impact assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to GB only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

Use this space to set out the relevant references, evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Please fill in **References** section.

References

Include the links to relevant legislation and publications, such as public impact assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
1	European Commission Impact Assessment on Third Legislative Package
2	Consultation on the Implementation of the EU Third Internal Energy Package
3	EU Third Package Consultation Stage Impact Assessment
4	DECC's Call for Evidence

\+ Add another row

Evidence Base

Ensure that the information in this section provides clear evidence of the information provided in the summary pages of this form (recommended maximum of 30 pages). Complete the **Annual profile of monetised costs and benefits** (transition and recurring) below over the life of the preferred policy (use the spreadsheet attached if the period is longer than 10 years).

The spreadsheet also contains an emission changes table that you will need to fill in if your measure has an impact on greenhouse gas emissions.

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y_0	Y_1	Y_2	Y_3	Y_4	Y_5	Y_6	Y_7	Y_8	Y_9
Transition costs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Annual recurring cost	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total annual costs	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Transition benefits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Annual recurring benefits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Total annual benefits	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

* For non-monetised benefits please see summary pages and main evidence base section

Microsoft Office Excel Worksheet

Evidence Base (for summary sheets)

Issue

Article 3(5a) of the Electricity Directive and Article 3(6a) of the Gas Directive require Member States to ensure that where a customer, while respecting contractual conditions, wishes to change supplier, the change is effected within three weeks.

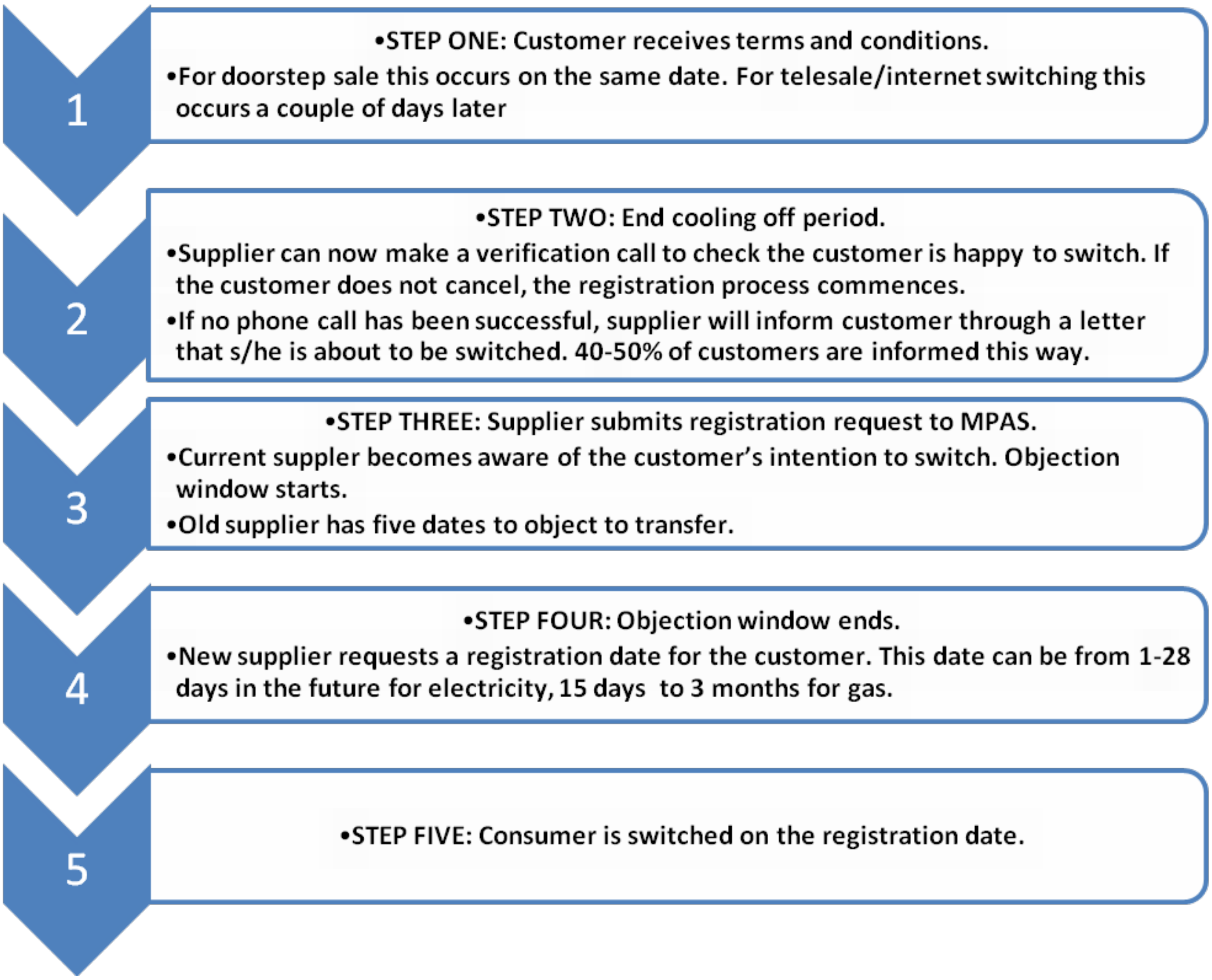
In addition, Annex 1 (j) of both the Electricity and Gas Directives require that consumers receive a final closure account following any change of natural gas/electricity supplier no later than six weeks after the change of supplier has taken place.

These measures are designed to improve the switching process for consumers. High levels of switching are associated with greater competition in the market, which should result in better outcomes for consumers.

Background

The UK currently has the most competitive market in Europe with high levels of customer switching per month. Evidence suggests that, on average, 400,000 electricity and 300,000 gas customers switch supplier every month. Most customers are switched within 4-6 weeks of receiving terms and conditions.

The process for switching currently looks like this:



Options

Two main options have been considered:

- Option 1: Licence Condition requiring suppliers to give customers a contractual right specifying that following a period of up to 14 calendar days (from the date the contract has been entered into, meaning agreed with the supplier), customers will be switched within 3 weeks unless the following extenuating circumstances apply;

  - the former supplier has prevented the Proposed Supplier Transfer because of outstanding debt as part of the Customer transfer blocking
  - the customer has initiated, and has not withdrawn, a request for a Supplier Transfer in respect of another supplier
  - the supplier does not have all of the information required in order to complete the Supplier Transfer and:

    (i) the supplier has taken all reasonable steps to obtain the missing information from the Customer and the Customer has not provided that information, or the information provided is incorrect; and

    (ii) that information is not readily available to the supplier from another source; or
  - the supplier is prevented from completing the Supplier Transfer due to any other failure /circumstance caused by the Customer.

- Option 2: Licence condition to require suppliers to give customers a contractual right that they will be switched within three weeks of the day the customer receives the new terms and conditions (ie. no cooling off period is included)

In addition, both options will include a Licence Condition requiring suppliers to send their customers a final bill within six weeks of the date the customer has transferred to a new supplier. As this measure already occurs in practice, we expect the costs and benefits to be minimal and have not explored any further options with this requirement.

The preferred option is Option 1. We believe this option achieves a similar level of benefits as Option 2 while imposing lower costs on industry compared to Option 2. This is because Option 1 requires the industry to make some changes to their systems and processes rather than overhauling them, as longer term the introduction of Smart Meters will capture most of the benefits of these measures.

Benefits

For the purposes of evaluating costs and benefits a baseline of no action taken is used. Great Britain has an active energy supply market, and the level of consumer participation is amongst the highest in the world. Switching has been allowed in Great Britain since the opening of energy supply markets for domestic and small business consumers in the late 1990s. These measures are designed to ensure quicker switching, rather than to enable greater amounts of switching. The measures apply to both domestic and non-domestic consumers. For non-domestic customers where a cooling off period is agreed as part of the contract (unlike the domestic contracts, suppliers are not required to offer a cooling off period to non-domestic customers), the 21 days begins at the end of that cooling off period, which should not exceed 14 calendar days. Otherwise for non-domestic consumers the 21 days begins once the contract is entered into. Although the impact assessment focuses on the benefits to domestic consumers, we would expect the same benefits to apply to non-domestic consumers as well.

There are two sources of benefit from these measures to improve switching. Firstly, there is a direct benefit to consumers who are switched faster than they would have been otherwise. Assuming that these customers switch to a more beneficial tariff, these customers then receive a direct benefit in terms of the energy and service received under their new tariff earlier than they would have otherwise, although we recognise that this is mostly a transfer since while the customer benefits the previous energy company loses. Some part of this saving may be a resource cost saving if a cheaper tariff is offered because of some cost advantage in providing that tariff. Option 2 will have a larger benefit to consumers as it will result in faster switching. The benefits of Option 1 are lower as switching takes longer than with Option 2.

It is difficult to quantify the size of this direct benefit. Evidence from Ofgem's Energy Supply Probe (2008) suggests that approximately 60%[3] of consumers reduce their bills as a result of switching and achieve an average net saving range from 1 to 2 per cent for gas customers and 3 to 4 per cent[4] of electricity customers. However this suggests that 40% of consumers do not switch to more favourable tariffs. This is further complicated by the fact that under current arrangements most customers are switched within 4-6 weeks of receiving their terms and conditions. We are unable to estimate what percentage of customers would receive any benefits and the evidence suggests that the overall direct benefit to consumers from these measures could be small. To illustrate: if a consumer moved from a standard tariff to one of the best available direct debit tariffs their annual bill would change from £1190 to £950. The consumer would save an additional £4.60 for each week earlier that the switch was completed.

The second source of benefits which may arise from a quicker switching process are the more intangible benefits associated with improved competition.

The questions for a competition impact test provided by the OFT are, whether the proposed policy would:

1. Directly limit the number or range of suppliers?
2. Indirectly limit the number or range of suppliers?
3. Limit the ability of suppliers to compete?
4. Reduce suppliers' incentives to compete vigorously?

We do not consider that our proposals would restrict competition, therefore a full competition impact test has not been completed. However, this policy could have positive competition impacts.

Consumer switching is a powerful driver of competitive energy supply markets. By switching suppliers, consumers can act as a competitive constraint on suppliers' pricing and provide strong incentives on suppliers to reduce costs, improve service and develop innovative products. The options will reduce the time it takes to switch for some customers; however the overall effect on the level of switching is expected to be small.

Any increase in the level of switching could also have an effect on prices, although in this case this will be very small. Overall, we would expect there to be downward pressure on prices as firms attempt to hold on to their existing customers who are now more likely to switch. However, they may also be less willing to offer low prices to attract new customers. This is because they are less likely to be able to prevent them from switching again in the future, limiting the rents that can be extracted.

It is important to note that some of the benefits associated with these measures are going to be realised with the introduction of smart meters in the next few years regardless of the implementation of these measures.

Costs

The majority costs of these measures will depend on the option taken forward, as such each option will be examined separately in this section.

- Option 1: Licence Condition requiring suppliers to give customers a contractual right that following a period of up to 14 calendar days (from the date the contract has been entered into, meaning agreed with the supplier), customers will be switched within 3 weeks unless there are the extenuating circumstances

  Responses to the Call for Evidence and the subsequent consultation have suggested that suppliers and bodies involved in the switching process could adjust their switching process to accommodate switching within three weeks of the end of the cooling off period at some considerable cost, especially for gas customers. As discussed, there will also be a requirement on suppliers to make some changes to their systems to increase the number of people who switch suppliers within 3 weeks. There may also be monitoring and enforcement costs to Ofgem.

  As this option represents lower cost to suppliers compared to Option 2 but similar benefits to consumers, this is our preferred option and has been covered in more detail in the 'Summary:

[3] Ofgem Supply Probe, Paragraph 4.18
[4] Ofgem Supply Probe, Paragraph 4.19

Analysis and Evidence: Policy Option 1' section of this impact assessment. As some of the benefits of these measures will be realised in the next few years with the introduction of smart meters, it is important to attempt to reduce the cost on suppliers at this stage.

- Option 2: Licence condition to require suppliers to give customers a contractual right that they will switch customers within three weeks of the day the customer receives the new terms and conditions (ie. no cooling off period is included).

  Option 2 would require a substantial change to the switching computer system (MPAS) including the suppliers' computer systems and those of other agents involved in the switching process. Responses to the Call for Evidence and consultation have suggested that these changes are likely to impose a one-off cost of several million pounds to suppliers, and we would expect these costs to ultimately be passed on to consumers in the form of increased bills. The industry is already committed to putting in place changes for the roll-out of smart meters and there is a risk that an option requiring them to overhaul their systems with a new one could lead to delays in this process, when ultimately smart meters will facilitate consumer switching.

  However there may be additional costs to starting the process without a cooling-off period. Around 8-10% of customers cancel their contract during the cooling-off period. There is a greater risk that without a cooling off period, there will be a higher rate of people who subsequently cancel. These requests will then need to be cancelled manually. Therefore there is an increased chance of erroneous switches. Responses to the Call for Evidence and consultation suggest that there could be increased numbers of erroneous switches (which have to be resolved manually at some expense) and increased numbers of customer complaints. This could lead to deterioration of the customer experience and may disincentivise customers to switch in the future. However, the scale of these effects is unclear.

For both options, there will be operational costs to suppliers from changing their systems (which are higher under Option 2). There will be an additional administrative cost to suppliers who will have to alter their standard terms and conditions to reflect the changes; however, we are assuming that this would be done as part of regular upgrades and therefore at little extra cost.

As mentioned above, a Licence Condition requiring suppliers to close a customer's account within six weeks of switching is not expected to have significant costs. It is already industry practice to close a customer's account within 6 weeks after switching and therefore there are no significant changes. There will however be a cost to Ofgem to monitor compliance with the Licence Conditions and, in respect of the requirement on switching, preparing guidance to energy suppliers. We anticipate that this will mainly involve extra administrative costs.

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

Justice System
The Third Package is broadening the scope of obligations on gas and electricity undertakings and hence Ofgem's enforcement regime. As part of this regime, we are extending the scope of civil and criminal offences therefore there is a likely impact on courts' resources.

Annexes

Annex 1: Post Implementation Review (PIR) Plan

Please refer to the overarching Impact Assessment.

Basis of the review:
Review objective:
Review approach and rationale:
Baseline:
Success criteria:
Monitoring information arrangements:
Reasons for not planning a PIR: