

Electricity

Last reading	This reading	Electricity
Tariff - Standard Electricity / Monthly Direct Debit		
19/01/10 54083 Actual	02/07/10 56011 Actual	1000 units
02/07/10 56011 Actual	12/07/10 56226 Estimate	84 units

Your Supply Number

S	01	801	100
	21	0000	1745 283

Gas summary

Last reading	This reading	Gas used
s / Monthly Direct Debit		
25/03/10 9408 Estimate		Calorific Value 39 197 (100s cubic = 6208 kWh)
02/07/10 9540 Actual		Calorific Value 3 132 (100s cubic = 4160 kWh)
12/07/10 9544 Estimate		Calorific Value (100s cubic = 127 kWh)

Reforming retail energy markets

Tom Papworth & Patrick Day with Josh Thomas

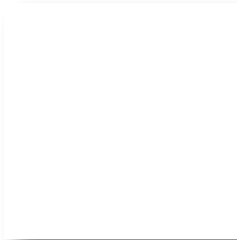
CENTRE:FORUM



Debit account

Reforming retail energy markets

Tom Papworth & Patrick Day
with Josh Thomas



About the authors

Tom Papworth is Associate Director for Economic Policy at CentreForum. He holds degrees from the Universities of London and Kent and has over 15 years' public policy and research experience, having worked for government, the private sector, policy institutes and membership organisations. His CentreForum publications include 'The path to IPO: funding SME jobs and growth' (February 2013), 'The business case for immigration reform' (December 2013), 'SMEs and Health & Safety' (February 2015) and 'The liberal case for aviation' (March 2015).

Patrick Day holds a BA (Hons) in Economics and a Master's in Public Policy from the University of Reading. He has worked as a policy caseworker and researcher for a Member of Parliament in his home county of Somerset and in Westminster, and for a non-departmental public body of the Department for Environment, Food and Rural Affairs. He co-authored 'The liberal case for aviation' (March 2015).

Josh Thomas graduated from the University of Warwick in 2014 with a first in Politics. Since graduating he has worked as a summer associate at Covington & Burling LLP, for OxAID and for the Migrants Resource Centre. He conducted research on aviation and regional policy for CentreForum in early 2015. He co-authored 'The liberal case for aviation' (March 2015).

Acknowledgements

The authors would like to thank Russell Eagling, Tom Frostick and Nick Tyrone for their editing and thoughtful comments. The views expressed here, and any errors, are the authors' responsibility alone.

CentreForum is grateful to comparethemarket.com for its support in commissioning this project.

Published April 2015 CentreForum

This work is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License.

For more information visit creativecommons.org

■ Contents

1 – Introduction	4
2 – Barriers to consumer engagement	11
3 – Mechanisms for overcoming barriers to consumer engagement	19
4 – Improving consumer understanding	21
5 – Summary and recommendations for reform	27

■ Introduction

“I would encourage all customers to look again at their tariffs and see if they can switch to a cheaper tariff. It is important that consumers have the power and information to be able to switch accounts. We are encouraging that by simplifying the tariff structure”

– **Michael Fallon, Minister of State for Business and Enterprise, 2013¹**

Any well functioning market depends on efficient interactions between consumers and suppliers. The energy market is no exception. On the supply side, competition between energy suppliers drives suppliers to provide electricity and gas as efficiently and innovatively as possible. Competition policy has traditionally been focused on the supply side.²

The demand side is also crucial, as consumer engagement in the buying process helps drive competition. Well informed and rational consumption decisions reward suppliers that best satisfy customer needs. But it requires strong engagement. If consumers do not make active choices based on the specifics of competing suppliers’ offers, the incentive for suppliers to offer the highest quality service at the lowest price breaks down. Lack of engagement thus reduces the extent to which competition, and the market more generally, can deliver better outcomes.

In the next section we examine the scale of the problem to determine if (and to what extent) there is a failure in the demand side of the market. We will then look specifically at some of the barriers to greater engagement. We then review progress made so far to overcome these barriers. Finally we conclude with some recommendations for how existing market reforms should be overhauled.

1 See www.dailymail.co.uk/news/article-2453472/Boycott-greedy-energy-firm-SSE-urges-Tory-energy-minister-Michael-Fallon.html

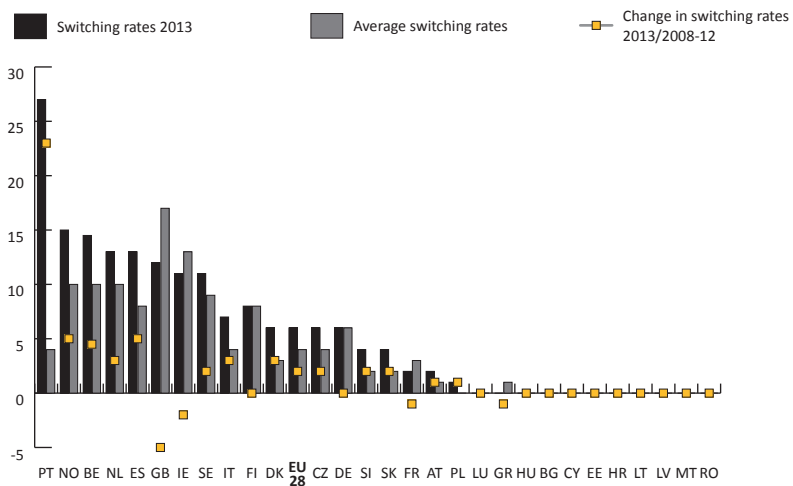
2 Office for Fair Trading, ‘What does Behavioural Economics mean for Competition Policy’, 2010.

Customer engagement with the retail energy market

Rates of switching are one indicator of the extent of competition, and particularly of consumer engagement, in a market.³ The Department for Energy and Climate Change (DECC) acknowledges that levels of switching in energy, alongside low levels of trust and consumer satisfaction, are “a serious concern” and that, as a result, “consumers were less well served than they would be in a more competitive market”.⁴

Switching rates in the UK are relatively high but have been falling in recent years. Figures 1 and Figure 2 (overleaf) provide a comparison of switching rates across Europe for electricity and gas respectively.

Figure 1: Switching rates for household electricity consumers across Europe



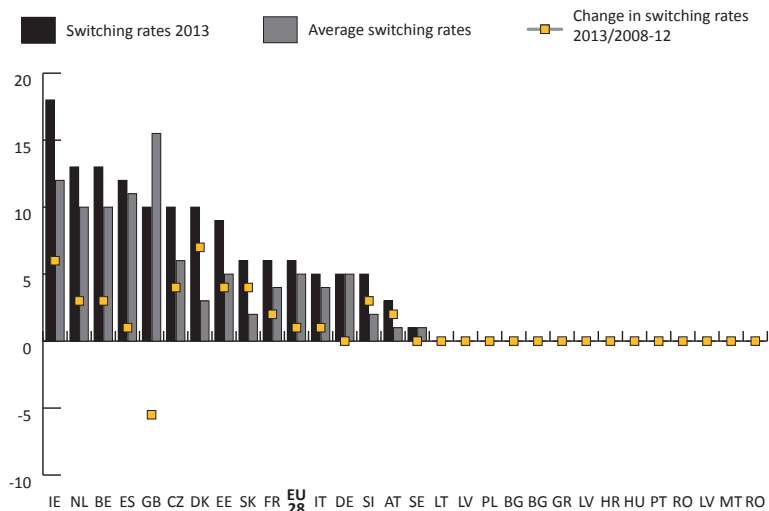
Source: ACER/CEER, 2014⁵

3 Ofgem, ‘State of the Market Assessment’, 2014

4 CMA, DECC submission to Energy Market Investigation’, 2014.

5 ACER/CEER, ‘ACER/CEER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets in 2013’, 2014

Figure 2: Switching rates for household gas consumers across Europe



Source: ACER/CEER, 2014⁶

While the UK had the highest rates of switching during the period 2008-2012, there has been a substantial subsequent decline. This has not solely been due to increased levels of switching in other energy markets. The number of customers switching energy suppliers in the UK has been falling since 2008.⁷ In 2014, 13% of customers changed energy supplier.⁸ 62% of people have never switched energy provider.⁹ Less advantaged groups are particularly unlikely to have switched; those on standard credit or using a pre-payment meter (PPM) are more likely not to have switched, as are over 65s, social grades C2DE and BME groups.^{10 11}

Inertia is not the result of ignorance. Only 9% of energy customers are unaware that switching is possible; even among those who have not switched, only 16% did not know they could. Rather, there is a widespread belief that switching is a hassle (30%) and that there is little difference

6 Ibid.

7 There was actually a statistically insignificant rise in 2014.

8 Ipsos MORI, 'Consumer engagement with the energy market: tracking survey 2014', 2014.

9 Ibid, p 10, 1.13

10 Lumping BME groups together is problematic. Not all BME groups are less advantaged. However, for most BME groups, including the most populous groups, poverty rates are higher than among "White British" residents. See <http://www.irr.org.uk/research/statistics/poverty/>.

11 Ipsos MORI, 'Consumer engagement with the energy market: tracking survey 2014', 2014.

between suppliers (21%).¹² Which? estimates that savings can be as high as £245, while Ipsos MORI (2014) find that switchers themselves expect to save on average £167.¹³

In 2014 TNS BMRB conducted a survey of 6,151 energy consumers on behalf of Ofgem (henceforth TNS, 2014).¹⁴ Using its results we can make some useful inferences about the level of engagement by UK consumers in the retail energy market.

TNS (2014) categorises 19% of consumers as “unplugged”, referring to customers who “are aware of some of their options or may have glanced at a bill but have showed [sic] little further interest in the energy market”. But an even larger number of customers do not respond to direct and important contacts from energy providers. Almost a third (31%) of consumers do not recall receiving a bill in the previous year, and almost half (45%) do not recall receiving an annual statement. Of those who did recall receiving either correspondence, fewer than half (42%) read it in detail, while 10% did not read it at all.

There is some evidence that less routine communications elicit a higher level of engagement. For example, 51% of customers read an end of fixed term tariff notice in detail compared to barely two fifths (41%) who had a detailed read of a bill, direct debit or prepayment statement, an annual summary, or a price increase notification letter. However, as we note below, this does not necessarily translate into action.

35% of consumers compared their tariff during 2013-14, of whom 9% of customers compared their tariff but did not subsequently change providers. It is not possible to conclude from this that the 9% were thwarted in their efforts, however; a more likely explanation is that approximately a quarter of those who were active found that their existing tariff and provider were the best available to them.

Of greater concern is the fact that customers were not always able to tell *after the fact* whether they had been successful in their attempts to save money. Ipsos MORI (2014) found that a fifth of those who had switched did not feel that they were paying less than they would have if they had not switched. TNS (2014) found that almost a fifth of those who sought to save money by changing tariff or supplier could not be sure whether

12 Ibid.

13 Which, ‘How to cut your energy bill’, 2015, available from: <http://www.which.co.uk/energy/saving-money/guides/how-to-cut-your-energy-bill/10-ways-to-save-on-energy-bills/> (accessed 25/02/2015); Ipsos MORI 2014

14 TNS BMRB, ‘Retail Market Review Baseline Survey – Report prepared for Ofgem’, 2014, p 54

they had actually achieved a short or long term saving. GfK (2015) found that 16% believed they did not make the saving they expected, of which

- 22% saved money (but not the amount they expected)
- 49% said it made no difference
- 20% felt they ended up paying more money.¹⁵

Overall, 14% of customers switched supplier, and 16% changed tariff within their existing supplier, over the period 2013-14.¹⁶ Correspondence from energy providers clearly drives action. TNS (2014) found that “nearly 34% of those who read their annual summary at least review[ed] how much they are paying on their current tariff as did 30% who recall receiving a bill or statement.” Of those that sought to change tariff/supplier to save money, a fifth were prompted into action by a price increase notification, a tenth by a bill and a tenth by the end of a fixed term tariff notice.

There is also evidence that price comparison websites (PCWs) promote action. For example, while 39% of those who conducted some comparison activity used a PCW, of those who switched 44% used one (TNS, 2014).

While overall levels of customer engagement are still good by European standards, there are clear barriers to greater consumer activity. There is also concern that the situation has been getting worse in recent years. In the next section we examine some of the barriers that may impede greater customer engagement.

15 GfK, ‘Energy Market Investigation: A report for the Competition and Markets Authority by GfK NOP’, 2015

16 There is a small overlap in these two groups.

Case study: Danish energy market

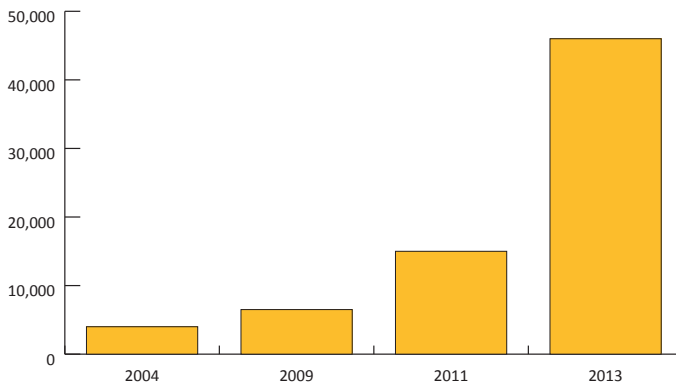
The Danish retail market for electricity and gas is fully liberalised, allowing consumers to switch freely. The Danish Energy Regulatory Authority (DERA) regulates prices, but Gaspoint Nordic, the Danish gas exchange, also facilitate increased competition on the wholesale market. All customers in Denmark have a default supplier with obligation to supply based on geographic area.

In 2010, 85.5% of household consumers and 34.3% of business consumers were still on the default 'obligation to supply' tariff.

^[1] Households' willingness to switch is closely linked to significant price differentials. In the absence of marked price differences, many households remain with their current supplier (as seen in the above statistic where households are far less likely to switch than businesses).

Following liberalisation in 2003-4 all suppliers could attract consumers from any region. To switch, consumers had to request a change of supplier six to eight weeks before the change was enacted. The new supply agreement would then come into effect from the first day of the calendar month.

Figure 3: Number of households changing supplier



Source: VaasaETT, 2012

Figure 3 show that the initial market liberalisation did not result in large scale switching, mainly due to a lack of consumer awareness.

^[1] To increase awareness, Energinet.dk introduced Gasprisguiden. This served as a price comparison tool, and still operates today with

gas suppliers listing their prices. In 2004 there were six commercial gas suppliers. In 2014 there will be 17 active suppliers (pending the launch of one new supplier), according to Energinet.dk's register of authorised 'players'.^[2]

[1] VaasaETT, 'World Energy Retail Market Rankings', p.30, 2012.

[2] Energinet.dk, 'Gas retail market 2004', available from: <http://www.energinet.dk/EN/GAS/Aktuelle-temaer-ny/Gasdetailmarkedets-10-aars-foedselsdag/Sider/Gasdetailmarkedet-anno-2004.aspx> (accessed 25/02/2015).

■ Barriers to consumer engagement

There are a variety of psychological, socioeconomic and technological barriers which inhibit customers from engaging in the market. Barriers tend to be more common among those who are disabled, low earners, single parents, elderly, or who have learning difficulties or poor command of English. Those on low incomes are the very customers who have most to gain from switching.

According to the Office of Fair Trading, “for consumers to drive competition in the way described above, they ideally need to:

- access information about the various offers available in the market
- assess these offers in a well-reasoned way, and
- act on this information and analysis by purchasing the good or service that offers the best value to the customer.”¹⁷

The presence of these three elements in the market provides a framework whereby well informed, rational consumers, and vigorous competition, drive suppliers to maximise efficiency and to continually innovate. Consumers in the energy market benefit through downward pressure on bills, better service and greater choice.¹⁸ However, they also help to distinguish three discrete areas where customer engagement can break down.

Firstly, customers may be unable to access information. In the past this may have involved difficulties finding out about competing offers and poor response times to letters and telephone calls. The challenge

17 Office for Fair Trading, ‘Governments in markets: Why competition matters - a guide for policy makers’, 2009

18 Ofgem, ‘Wholesale power market liquidity: statutory consultation on the ‘Secure and Promote’ licence condition’, 2013, available from: <https://www.ofgem.gov.uk/ofgem-publications/84508/wholesalepowermarketliquiditystatutoryconsultationonthesecureandpromotelicencecondition.pdf>

today is around the extent to which individuals are able to access the huge amount of information that is now available online. As energy suppliers shift increasingly to digital channels of information provision and customer service, those who are either not online or who are not confident with digital channels risk being excluded.

Secondly, customers may be unable to assess the information they have. The ability to process information is a crucial factor in determining customer behaviour. Even if customers are able to access information, it does them (and the competitive process) no good if they are unable to use the information they have. This may result from poorly presented or deliberately confusing information. Alternatively, the barriers may be psychological, cognitive or rooted in lack of confidence. Traditional models of market behaviour assume that actors have an infinite capacity to absorb and assess information. In reality, individuals have a limited capacity to absorb new information, are affected by how information is presented, and are risk averse (OFT, 2010).

Thirdly, having accessed and assessed information about current and competing offers, there may be reasons why customers still do not act. These may include a lack of confidence that other offers/providers will in fact be better, the time taken to switch, confusion over tariff names or simply a lack of confidence in their own capacity to manage the process.

It is important to note that an inability or failure to access, assess or act upon information affects not just *the* customer, but *all* customers. Identifying and taking advantage of the most appropriate offers on the market is what drives the competitive process. Any reforms that can improve access, assessment and action will help drive the competitiveness of energy markets, improving customer experiences and reducing costs.

Barriers to access

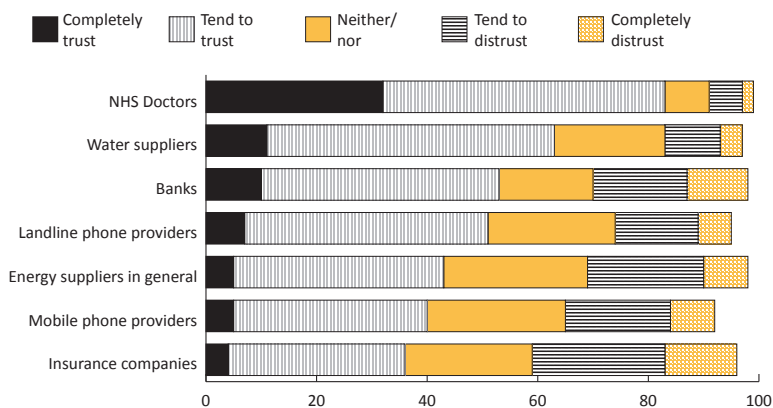
The most obvious barrier to access is awareness. As noted above, 9% of the population are unaware that they are able to switch providers. Others may be unaware of the potential savings involved. The UK Regulators Network observe that “If a consumer is unaware they even have a choice then by default they are unlikely to be engaged.”¹⁹ But secondary factors such as levels of education and command of English may also be important.

19 UK Regulators Network, ‘Consumer Engagement and Switching – statement’, 2014, p 14

Psychological barriers, reputation and trust

Psychological barriers may affect engagement as well. Some consumers deliberately avoid the switching process. These may result from bad experiences of switching in the past: 26% of consumers claim they would not switch again having done so previously.²⁰ Alternatively, customers may have negative preconceptions about how difficult the process may be.

Figure 4: Extent to which consumers trust or distrust providers to be fair in their dealings with customers or citizens



Source UKRN via TNS BMRB, 2014²¹

A further psychological barrier to access – or rather, even to attempting to engage with the switching process – results from low consumer trust in energy providers. Energy is ranked among the UK’s least trusted sectors.²² Figure 4 compares the public’s views of seven different industries. 29% of customers report having either strong distrust or a tendency to distrust energy providers.²³

Misconduct and scandals may have fed this lack of trust. Energy providers have been accused of widespread misselling, contributing to supernormal profits despite warmer weather and lower wholesale prices

²⁰ Ofgem, ‘State of the Market Assessment’, 2014, p 34.

²¹ TNS (2014). Figures do not total to 100% because ‘don’t know’ responses have been removed.

²² Business Green, ‘Energy is UK’s ‘least trusted’ sector’, 2014, available from: <http://www.business-green.com/bg/analysis/2342342/report-energy-is-uks-least-trusted-sector> (accessed 20/02/2015)

²³ UK Regulators Network, ‘Consumer Engagement and Switching – statement’, 2014. p16, Figure 3 (via TNS BMRB, Retail Market Review Baseline Survey, 2014 p 54, Figure 4.6)

in recent years. Examples of malpractice include tariffs being switched without permission, sales representatives underestimating the price of a new tariff, consumers being sold a tariff that was not fully explained, and the lowering of direct debit prices to make a switch seem cheaper.²⁴ As set out in Table 1, all of the “Big 6” energy providers were found to have misold products, creating an impression among consumers of endemic untrustworthiness.²⁵

Table 1: Fines/nominal repayments levied on the “Big 6” energy companies

Provider	Fine (or nominal repayment)
E.ON	£12 million
npower	£3.5 million
Scottish Power	£8.5 million
EDF	£4.5 million
SSE	£10.5 million
British Gas	£1 million

Source: Ofgem

It is important to note, as does OFT (2010), that markets are adept at finding solutions to these problems: “Reputation, learning effects, intermediaries, the media, and even firms themselves, can all help to solve market problems arising from consumer biases” (OFT 2010). Thus reputational barriers do not necessarily require regulatory solutions.

Internet access and confidence

The internet is increasingly important as a means of accessing information about existing and potential energy providers. Nearly four in ten consumers (39%) who undertook some comparison in 2013-14 used online price comparison websites (PCWs), and consumers with regular internet access are more likely than those without regular access to have switched previously (TNS, 2014).

24 Money Saving Expert, ‘Energy mis-selling’, 2015, available from: <http://www.moneysavingexpert.com/utilities/Energy-mis-selling-complaints> (accessed 20/02/2015)

25 The media furore over the actions of energy providers actually caused a spike in switching in late 2013. However, this increase was not sustained and switching rates resumed their overall decline, leading Ofgem to question the longevity of the media and politically fuelled consumer switching trend. Ofgem, ‘State of the Market Assessment’, 2014, p 61

Yet the very ubiquity and importance of the internet as a channel for accessing information creates a substantial barrier for a large minority of individuals and households that are unable to access information digitally.

The problem is partly physical. 4.2 million households (16%) do not have internet access.²⁶ While smartphones are more common, the feasibility of using an internet compatible phone is dependent upon signal availability, and there are a number of signal “blackspots” situated around the country, particularly in more rural areas.²⁷

However, a greater barrier may be confidence in using online channels. In 2014, 6.4 million adults (13%) had never used the internet.²⁸ Moreover, many internet users lack the basic skills necessary to access energy market information. BBC (2014) reports that 20% of UK adults lack basic online skills.²⁹ These people may be able to access and use the internet for certain narrow tasks, but be unable (or are not confident enough) to access information about their energy use, their tariff and the options available. Those who are affected by lack of internet access or skills include (but are not limited to) the elderly and low income consumers.³⁰

Barriers to assessment

It is common to assume that difficulties assessing offers and prices result from a lack of information or choice. However, too much information is equally deleterious to assessment, and it is interesting to note that more than twice as many consumers complain about their being too *much* choice (32%) than complain about there being too *little* (14%). What is more, those who believe that there is too much choice tend to be those one would assume were best placed to assess information – they tend to be internet users, from higher social grades who pay by direct debit and have recent experience comparing and switching (TNS, 2014).

Psychological barriers to assessment include the complexity of bills and difficulties obtaining clear like for like price comparisons. A significant

26 The ONS reports that “22 million households (84%) had Internet access in 2014”. ONS, Internet Access - Households and Individuals, 2014, 07 August 2014.

27 Ofcom, ‘Measuring mobile broadband performance in the UK – 4g and 3g network performance’, 2014.

28 ONS, ‘Internet Access Quarterly Update’, Q1 2014, 14 May 2014

29 BBC, ‘BBC Basic Online Skills – May 2014’, November 2014, available from: <http://downloads.bbc.co.uk/aboutthebbc/insidethebbc/whatwedo/learning/audienceresearch/basic-online-skills-nov-2014.pdf>

30 The Poverty Site, ‘Lacking Consumer Durables’, 2002, available from: <http://www.poverty.org.uk/11/index.shtml>, (accessed 25/02/2015)

cause of this is the number and complexity of tariffs offered by energy providers, ranging from fixed and dual fuel tariffs to online and green energy tariffs.³¹ These tariffs do not necessarily exist merely to confuse; there are obvious efficiencies to combining electricity and gas billing, direct debiting, and fixing a price over a period, while some options (such as buying energy solely from renewable sources) are designed to appeal to niche customers.

However, the complexity of tariffs confuses some consumers and makes like for like comparison a daunting prospect for others.³² The terms and conditions contained within tariffs, including unclear cancellation procedures, serve as a mental block to switching.³³ Burying price structures and products in cryptic terminology makes it difficult for consumers to compare offers between providers. The OFT has described this as a contributing to a “confusopoly”³⁴ as it both reduces confidence in particular tariffs and deters customers from attempting to switch tariff.

To assess and compare the varying tariffs accurately, consumers require “fairly good numeracy skills.”³⁵ Poor numeracy skills are likely to foster a lack of confidence in the switching process. The Financial Services Authority linked levels of lower engagement in the retail investment market with lower than average levels of risk tolerance, financial capability, education, and income.³⁶ Similar processes may affect energy markets. It is likely that those who could most benefit from switching were least able to actualise these savings.

Lack of internet access also affects consumers ability to assess information. Limited or no internet access hinders the ability to compare different tariffs. To assess the number of different tariffs by any means other than PCW would prove incredibly time consuming and complicated.

Barriers to action

Having accessed and assessed information, consumers still need to act. Consumers appear to be deterred by contract lock ins, and high charges or “early termination charges”, that are not made clear on bills or in other forms of correspondence.³⁷ 60% of consumers’ state contract terms as a

31 Which, ‘Energy tariffs explained’, 2014, available from: <http://switch.which.co.uk/energy-advice/energy-tariffs-explained.html>, (accessed 19/02/2015)

32 UK Regulators Network, ‘Consumer Engagement and Switching – statement’, 2014

33 Ibid

34 Ibid

35 Ibid

36 Financial Services Authority, Consumer purchasing and outcomes survey 2010, 2011.

37 UK Regulators Network, ‘Consumer Engagement and Switching – statement’, 2014

reason why they do not switch, while 40% cite cancellation charges.³⁸

Those who rent property are amongst the least likely to switch as some renters do not fully understand their tenancy agreements.³⁹ Common reasons renters give for not switching include believing they are unable to switch due to being in debt to their supplier, or a belief that their tenancy prohibits them from switching (eg that they would need to gain the landlord's permission).⁴⁰

Technological barriers are again important. Lack of internet access hinders the ability of consumers to manage their account online. Online account management, which includes setting up online payments, provides consumers with a clearer means of communication with their provider, as well as allowing the potential for the consumer to input their usage on a semi regular basis in order to insure against the volatility of being in credit or debt to their provider come the end of the year. This would be of particular use to low income consumers who cannot afford to be in debt, especially if renting property, as this would actually hinder their ability to switch providers.

Case Study: German electricity market

The German retail electricity and gas markets were deregulated in 1998. This opened the market to competition between regional, national and international suppliers. Consumers in the market are free to switch between suppliers, and also able to choose between the type of energy – ie nuclear, solar and so forth.

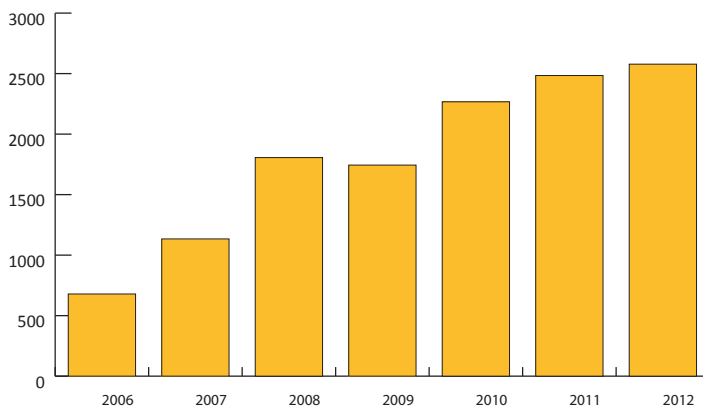
The market was slow to develop after its liberalisation despite the large number of energy providers, which reached 88 in 2012.^[1] Regional markets were dominated by incumbents and competition appeared weak. In 2009, close to 90% of these suppliers had no customers outside their area.^[2] However recent market opening to meet EU legislative requirements has been accompanied by a wave of activity from consumers. Figure 5 (overleaf) shows the number of households switching suppliers from 2006 to 2012.^[3]

38 Ibid.

39 One needs to be careful of lurking variables however. Renting may merely be a proxy for other factors because those that are renting are (inter alia) also poorer, less well educated and less likely to have internet access. However, as there are clear reasons (some of which are cited above) why renting would affect switching it is reasonable to assume that not all of the correlation is explained by these lurking variables.

40 UK Regulators Network, 'Consumer Engagement and Switching – statement', 2014

Figure 5: Number of German households switching provider 2006-2012



Source: Federal Network Agency (Bundesnetzagentur), 2012

The Federal Network Agency (Bundesnetzagentur) – the German regulatory office for electricity and gas – has worked to achieve greater consumer engagement which is likely to have contributed to an increase in supplier (Figure 5). For instance, regulatory change has enabled consumers to switch supplier within three weeks. This process took an average of 5-8 weeks in 2011.^[4] A range of comparison sites listing all available offers also increase confidence in like for like comparison.

[1] London Economics, 'Energy Retail markets Comparability Study. A report for DECC', 2012

[2] FNA, 'Monitoring Report', 2010

[3] FNA, 'Monitoring Report', 2012

[4] International Energy Agency, 'Empowering Customer Choice in Electricity Markets. Information Paper', Douglas Cooke, 2011

■ Mechanisms for overcoming barriers to consumer engagement

Ofgem conducted its Retail Market Review (RMR) in 2013. Following the RMR, a number of reforms were implemented to make information on tariffs and bills simpler, clearer and fairer. Through these reforms Ofgem hoped to widen consumer engagement and boost competition by:

- Improving customer trust with their own supplier, and the wider market
- Improving customers' understanding of the energy market
- Simplifying tariff choices for consumers.⁴¹

Improving customer trust

Ofgem enforces a “standard of conduct” for interactions with consumers to ensure that consumers are treated fairly. Furthermore, new rules on the terms of contracts with consumers have been implemented. A fixed term contract can no longer be automatically rolled over to a new fixed term contract. Fixed term contracts are commonly accompanied by termination fees and are therefore more difficult to switch from. Instead, consumers are automatically switched to the cheapest variable tariff with that supplier, allowing the customer to switch at any time without charge. This should reduce the number of consumers being caught out by missing their transfer window and, as a result, also improve confidence in fixed term tariffs. Consumers also receive price protection while they consider their switching options.

Ofgem are also moving to eliminate “dead” tariffs which are no longer offered by suppliers. The Department for Energy and Climate Change (DECC) found a third of these to be “poor value”.⁴² Suppliers will have to

41 Ofgem, ‘Domestic Retail Market Review Evaluation – a proposed way forward’, 2014

42 House of Commons Library, ‘Simplifying Energy Tariffs’, SNSC-6440, 2014

check annually to ensure any customers who remain on a dead tariff are not paying more than the supplier's cheapest variable tariff. Dead tariffs may only continue to operate if they are cheaper than the cheapest "live tariff" with the supplier. The first of these checks will have to be made by 30 June 2015, significantly reducing the number of poor value dead tariffs in the market and therefore helping to moderate mistrust.

Price comparison websites (PCWs) provide the opportunity to leverage consumer trust from other markets into the energy market. However customers are also reticent about PCWs. Only 55% of consumers are confident that they could get the right deal for their energy supply using a PCW.⁴³ The Ofgem Confidence Code may alleviate this concern. This list of accredited PCWs aims to assure consumers that these PCWs provide accurate, up to date information and list all available tariffs in the market irrespective of commission structures between suppliers and PCWs.⁴⁴

43 GfK NOP, 'Energy Market Investigation. A report for CMA', 2015

44 It should be noted that some PCWs do adhere to the Confidence Code, but use a tariff database and/or price calculators from an existing accredited site and are not listed for this reason. Ofgem seek to find a sustainable solution to include all suppliers who are behaving in accordance with the Confidence Code but not using its own database or price calculator.

■ Improving consumer understanding

Cheapest Tariff Messaging (CTM)

A number of regulations to the information provided on bills, statements and notifications have been introduced since the RMR. Firstly, suppliers must include Cheapest Tariff Messaging (CTM) on page one of all bills. Under the heading “Could you save more?” consumers now find personalised information explaining how much consumers could save by switching tariffs with their current suppliers. Tariff cost is the most important “trigger” to engagement in the energy market, and as such CTM is designed to “prompt them [consumers] to consider their options”.

^{45 46}

Price Increase Notification (PIN) and annual statements

Consumers will also receive a Price Increase Notifications (PIN) and annual statements as stand alone documents, in a standard format and only containing relevant account information.⁴⁷ This aims to make information about tariff cost, usage and price increases easy to understand, thus giving consumers greater propensity to make an active and confident decision about their tariff.

Tariff Comparison Rate (TCR)

Suppliers are required to publish standardised tariff information on correspondence to allow easy like-for-like comparison. The Tariff Comparison Rate (TCR) is currently required on bills. It standardises the energy tariff into a single unit rate (p/kWh), based on average consumption, and enables an “at a glance” comparison of tariffs similar

⁴⁵ TNS (2014); Ipsos Mori (2014); GfK (2015)

⁴⁶ Ofgem, ‘The Retail Market Review – Implementation of Simpler Tariff Choices and Clearer Information’, 2013

⁴⁷ Ofgem, ‘Domestic Retail Market Review Evaluation – a proposed way forward’, January 2014

to the APR interest rate.⁴⁸

There are substantial problems with the TCR, however. It is calculated using an average annual consumption figure for all consumers and so could mislead those whose usage is substantially different from the average. For example, customers with low consumption habits may benefit from a lower standing charge (p/day) and higher unit rate (p/kWh), though the TCR would present this as a higher-cost tariff. Almost all respondents to the RMR were in favour of a price comparison tool. However, “the majority raised concerns about the proposed design of the TCR” on the grounds that it would be confusing and ineffective.⁴⁹ For example, the TCR unit p/kWh may cause confusion with the real unit rate which is also measured in p/kWh.

We also find inconsistencies in calculations of information provided to customers. Methods to deduce this TCR vary from supplier to supplier. Regulation on whether to include VAT, and whether to use all discounts available or only those specific to the consumer, is loose.

Tariff Information Label (TIL)

A Tariff Information Label (TIL) must be made available by an energy supplier on request, on the supplier’s website and prior to entering a contract.⁵⁰ TILs are standardised in format and allow consumers to read exactly how their energy bills are calculated on a monthly and annual basis.⁵¹ All the information needed to make a fully informed like-for-like comparison between tariffs is contained here. It also mirrors the format of information provided by PCWs, easing the switching process for consumers.

The TIL is the most comprehensive information tool. However, once a customer is in a contract they will only see a TIL if they actively seek to do so. This acts as a barrier that may limit the potential of the TIL.⁵² Ofgem requires that the *information contained within* the TIL be communicated to customers, but *not necessarily in the TIL format*.

48 The TCR simplifies an energy tariff into a single unit rate taking into account unit rate, standing charge, an average consumption figure, discounts and VAT.

49 Ofgem, ‘The Retail Market Review – Final domestic proposals. Consultations on policy effect and draft licence conditions’, 2013

50 Made a requirement as of 31 March 2014 following RMR

51 TIL includes tariff name and type, payment method, unit rate (p per kWh), standard rate (p per day), tariff end date, price guarantee date, exit fees, discounts, additional products included and assumed annual consumption (for low, medium or high assumed consumption) to forecast estimated annual and monthly costs and a TCR.

52 ‘Signposts’ to this information provided on bills and statements - as required following the RMR - may reduce ‘search costs’ but not eliminate them

Instead of the TIL, customer may find this information littered across various communications in different formats. This search cost remains a barrier to consumer engagement.

Personal Projection

A Personal Projection is also required on communications. This provides consumers with a tailored estimate of the costs of a tariff over the next 12 months using previous energy usage or the supplier's estimate of it. This metric was introduced to "help consumers make accurate comparisons between suppliers on a like for like basis".⁵³

Calculations of the Personal Projection are not standard. Calculations can vary between suppliers and comparison sites. For example no regulation exists on whether suppliers should account for seasonal variations in consumption. Comparisons using this tool should therefore be made with caution.

Simplifying tariff choices

Suppliers are now limited to offering four gas and four electricity "core" tariffs at any point in time. Tariffs have also been limited to one pricing structure. Suppliers will only be allowed to price their tariffs as a unit rate (p/kWh) supplemented by up to two cash discounts – one for dual fuel and one for managing accounts online. This helps reduce the time and complexity consumers face when comparing potential tariffs, and improves confidence that they are comparing tariffs accurately on a like for like basis.⁵⁴ However, some suppliers argue that being limited to offering four core tariffs inhibits innovation and their ability to price differentiate. This, in turn, could reduce competition and consumer engagement.⁵⁵

Consumers receive personalised notification 42-49 days before the end of their fixed tariff, or on changes to their dead tariff. This aims to allow consumers to understand and evaluate their options at the end of a tariff contract, without a termination fee.

The simplification of tariff choices has not been entirely successful and in some instances this reform has led to even greater complexity. Since limiting suppliers to four core tariffs per fuel, some suppliers have taken

53 Ofgem, 'The Retail Market Review – Implementation of Simpler Tariff Choices and Clearer Information', 2013

54 Ibid.

55 Ofgem, 'State of the Market Assessment', 2014

to frequently replacing tariffs. Consumers enquiring about tariffs offered under CTM on their bills may find that the tariff is already obsolete. Furthermore, each iteration of the tariff is individually named based on the version and date of introduction. These may share the same umbrella name on bills, statements and notifications while being differentiated by a specific suffix. When attempting to switch, customers often need to provide their current tariff name. Yet they can be faced with hundreds of tariff variations and no understanding of which one is theirs. This newfound complexity may only add to the mistrust and apathy that Ofgem is seeking to overcome.

Increasing awareness and tackling vulnerability

Alongside the RMR, Ofgem has launched awareness campaigns such as “Be an Energy Shopper”. Through public relations and digital media, consumers have been directed to an online guide which explains how recent changes to the energy market can help consumers compare tariffs and get a better deal on their gas and electricity bills.

Ofgem also pays particular regard to “vulnerable” consumers who are “significantly less able than a typical consumer to protect or represent their interests in the energy market; who are significantly more likely than a typical consumer to suffer detriment, or for whom detriment is likely to be more substantial”.⁵⁶ Ofgem aims to identify and tackle vulnerability in the energy market and review this work programme annually. However, as discussed above, the “unplugged” consumers most disengaged in the energy market represent one fifth of the market. Vulnerable consumers are a substantial part of this group.⁵⁷ These are groups that are not being properly protected by current regulatory action.

Moving to next day switching

Ofgem wants consumers to be able to reliably switch supplier the next day. By replacing the existing network run gas and electricity switching services with a new centralised switching service, Ofgem proposes to deliver next day switching for consumers by 2019.⁵⁸

56 Ofgem, ‘Consumer Vulnerability Strategy’, 2013

57 TNS (2014); Ipsos Mori (2014)

58 Ofgem, ‘Moving to reliable next-day switching’, 10 February 2015

Smart metering

Smart metering offers significant potential for consumers to become more informed about their energy consumption, more trusting of suppliers and more confident to switch tariffs. The roll out is expected to be complete by 2020 and smart meters will also have replaced all pre-payment meters.⁵⁹ Consumers will be armed with precise, real-time usage information, instead of estimated bills. DECC anticipates that consumers “would become more conscious about their energy use... and begin to look at how they could reduce energy use and save money”.⁶⁰ Consumers on pre-payment meters represent a much higher proportion of the “unplugged” consumers, for whom smart meters could offer significant improvements (TNS 2014).

Smart metering also allows consumers to switch products or suppliers quickly and remotely. Combined with other switching improvements, the roll out will help meet Ofgem’s 2019 goal to reduce switching time to 24 hours. DECC finds that trust towards energy suppliers has improved where smart meters have already been installed. More informed, trusting consumers faced with shorter switching times have significantly fewer barriers to engagement in the energy market. Thus, smart meters may prove hugely influential in improving consumer engagement, supply side competition and consumer outcomes.

Smart metering would also improve consumer engagement through PCWs. PCWs would, with permission, have instant access to consumer tariff and consumption information – all the information necessary to offer instant accurate quotes of all tariffs in the market. Consumer search costs of finding consumption information would be eliminated and it is expected that confidence that a switch will be successful in finding a better tariff would improve.⁶¹

One possible disadvantage of the smart meter is that it may enable suppliers to accurately identify the most “attractive” customers, and offer them better deals. This would allow them to offer worse deals to “unattractive” customers.⁶² However this is yet to be seen in practice and the appropriate use of smart meters to benefit consumers should be enforced by Ofgem.

59 DECC, ‘Smart Metering Implementation Programme. Second Annual report on the Roll-out of Smart Meters’, 2013

60 CMA, ‘DECC submission to the Energy Market Investigation’, 2014

61 DECC, ‘Smart Metering Implementation Programme. Second Annual report on the Roll-out of Smart Meters’, 2013

62 CMA, ‘UEA submission to the Energy Market Investigation’, 2014

Case study: smart metering in Italy

Italy has led the way in the EU with its smart meter roll out. First as an initiative by ENEL, Italy's largest power company, installations began 2000. The country was on track to complete the roll out to over 36 million consumers in 2011 (IEA 2011). Key functionality requirements include capacity to store hourly data; remote reading; remote activation; bi-directional data recording; capacity to change suppliers and products; and capacity to display consumption information. The Italian gas and electricity regulator is responsible for ensuring these performance requirements. As a result of smart metering, estimated bills are obsolete. Costs are reflected accurately through time of use metering. Furthermore, disconnection and reconnection is quick with a minimum level of service making supplier switching easier and enhancing competition.

QR codes

QR codes may provide an additional mechanism to support consumer engagement in the energy market. This technology will feature on supplier communications from June 2015 and should enable the automation of key tariff and usage data.⁶³ The search cost for a consumer finding their tariff information would be eliminated. Data would be automatically input to PCWs and lists of all available tariffs would be made available, instantly.

⁶³ A statutory requirement to provide key energy data in a machine readable image (QR code) on bills and statements to be implemented on 30 June 2015 (DECC)

■ **Summary and recommendations for reform**

Competition in energy markets is essential for driving down prices and driving up quality and standards. This requires, and has primarily relied upon, strong supply side competition. However, a fully functioning demand side, consisting of engaged and discerning consumers, is also vital. The UK has a vibrant energy market, evinced by the high levels of switching in the UK compared with other European markets. However, levels of switching have been on the slide for several years and the government and regulators acknowledge that the demand side could operate better.

Consumers face barriers accessing, assessing and acting upon information. The process is strongly dependent upon being able to access information online and use online tools to assess offers and initiate a switch. Customers who do not have internet access or are not skilled or confident enough to undertake the process are being left behind. Bad experiences with switching, with energy firms generally, or just the general reputation of the industry, deters some customers.

But perhaps the biggest barrier is the confusing plethora of tariffs and the obfuscatory way in which information is presented. Customers more frequently complain about receiving too much information, and having too much choice, rather than too little. Bills are complex and like for like comparisons difficult. The “confusopoly” prevents effective competition.

Ofgem has attempted to rectify this problem through its Retail Market Reform, but there are clear limitations to its effectiveness. An overhaul of some its recommendations would clearly benefit consumers.

- The Tariff Comparison Rate (TCR) can easily be misinterpreted as an accurate comparison tool for all consumers. It creates confusion in the market when comparing tariffs, undermining the aim of the RMR to make information on tariffs simpler and

clearer. **The TCR should be abandoned as a tool and removed from supplier communications.** Failing that, the appropriate use of the TCR should be communicated clearly – i.e. that it is only a suitable tool for the “average” consumer and should not be used in isolation.

- On the other hand, consumers would benefit from greater access to their TIL. **A one page Tariff Information Label (TIL) in a standard format should be mandatory on all key supplier communications.** This would enable consumers to make faster and more informed decisions.
- When fixed term tariffs come to an end, customers are notified of the fact and invited to switch (either within or between providers). If they take no action they are automatically moved onto the cheapest variable tariff. Customers on open ended tariffs do not enjoy the same notification, despite such notifications acting as a useful trigger, prodding customers to review their situation. **All customers should be notified on a regular basis that they are allowed to switch, and that there are potentially substantial benefits to doing so.** We have no firm view as to how frequently this should be but would suggest that the industry consider an annual correspondence.
- Problems associated with suppliers regularly changing tariffs, in order to adhere to the four core tariff limit, need to be addressed. **Tariff offers advertised under Cheaper Tariff Messaging (CTM) must remain on offer for a substantial period of time** to be an effective catalyst to engagement. To ease the switching process, **the complete tariff name should be provided clearly on all communications.** Consumer switching is often stalled when they have access only to the simplified umbrella name of their tariff. Regulation to display the complete tariff name would overcome this barrier to engagement that has developed since the RMR.

These improvements would ensure that consumers have all the information needed to make a switch. This information would also replicate the format of tariff information provided by price comparison websites. This would result in greater understanding among consumers, more effective like for like comparison and more confident switching.