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27 March 2015

Dear Sir / Madam

### **Response to updated issues statement**

Citizens Advice and Citizens Advice Scotland (hereafter, 'Citizens Advice Service') hold statutory responsibilities to represent energy consumers in accordance with the Consumers, Estate Agents and Redress Act 2007.

This submission provides our response to the consultation on your updated issues statement published on 18 February. It is mostly non-confidential although there are short passages that we wish to remain confidential because they relate to enforcement cases. We therefore provide both a public version with minor redactions and a private version; the former may be published on your website.

We will provide detailed comment on each of the theories of harm in turn, but will first provide an overview of our key views on your findings and the areas where analysis should be further developed.

### **The way forward**

Your inquiry needs to deliver in two key areas.

The first is around public understanding and trust in the sector. The cost drivers behind price movements have been a source of near-constant public dispute for many years now, with the result that the vast majority of consumers, rightly or wrongly, simply no longer believe what

Patron HRH The Princess Royal

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energy companies have to say on the issue. A one-off conclusion that prices are, or are not, fair is unlikely to prevent the recurrence of dispute if the protagonists can simply dismiss it as outdated by subsequent events. So it is vitally important that the CMA's inquiry leaves behind a structural framework that can give the public enduring confidence that they are not being ripped off. If you cannot deliver this, your inquiry will have failed.

The second is on the essential nature of the service. Energy is not a luxury, therefore the market must work for all sectors of society. In essential services, there is always a risk that some competitive outcomes may clash with wider public policy objectives. For example, we recognise that the poorest consumers may sometimes be the most expensive to serve; it may therefore follow that a conclusion is reached that it is cost-reflective to charge them more for their energy. This may be a logical competitive outcome but it would not sit comfortably with wider public policy aspirations to reduce fuel poverty, or to protect vulnerable consumers. If your study suggests that the market will simply never wish to serve some consumers, or that it is unrealistic to think that some vulnerable consumers will ever be able to engage effectively with the market, we would encourage you to think seriously about what recommendations you can make to Government to help those consumers mitigate their financial distress. If your inquiry leaves some groups of customers behind it will also have failed.

In both of these areas, there is still much work to be done. Much of your work around margins is either redacted where it relates to actual supplier performance or bears considerable similarity with Ofgem's Supply Market Indicators ('SMI') - which have never been accepted by the major suppliers - where it is modelled. This combination of opaque actuals and transparent theoreticals is not ideal: consumers cannot see the former; suppliers will not accept the latter. You need to resolve these tensions otherwise there is a risk that your findings may neither equip the public with the tools they need to understand whether the prices they pay are fair, nor end the toxic cycle of claim and counterclaim that has plagued the sector for a number of years.

Your analysis suggests that there are a significant number of households who are relatively inactive, that the Big 6 may have unilateral market power over their consumers on standard variable tariffs, that profit margins are higher on those tariffs and that vulnerable consumers are disproportionately represented on such tariffs. It is a picture of a dysfunctional market where those most in need are worst served. Your next steps must remedy this situation.

*Core recommendations:*

- The inquiry needs to leave behind an enduring, undisputed, framework through which consumers can understand what goes into their bills and whether the profit margins energy companies are making are fair.
- It is imperative that you find means to get competition working for the most vulnerable consumers. If you cannot, you should consider what alternative means of protection can be provided.

## Other headlines

We broadly recognise your findings, which suggest deeper problems with the retail market than with the generation or trading sectors. At this time, your retail analysis appears to simply segment the market into switchers and non-switchers, without reference to the many subcategories that may exist within these groupings. For example, we see little or no reference to how the situation varies according to the type of metering (eg prepay or standard), by region or by vulnerability. You acknowledge that your 'initial views on retail theories of harm are at an earlier stage of development than those relating to wholesale electricity and vertical integration' but that you intend to publish provisional findings in May. We note that your published timetable suggested they would be published in either May or June. While we recognise there is great public interest in this case we encourage you to take the time you need here; we are concerned that publishing in May might not leave you adequate time to bolster your retail analysis to the point where you can reach firm conclusions or suggest robust remedies.

Your analysis, like so many before it, suggests a large tranche of the public are fundamentally disengaged from the market, with vulnerable consumers disproportionately represented within that group. While you are yet to propose remedies to this situation, we would caution you to be mindful that informational remedies and behavioural 'nudges' have been tried in this sector before without any great success - indeed, switching rates have declined over time. As an essential service, it is imperative that the market meets the needs of all consumers, and not simply the savvy switchers. If you cannot bring forward a convincing means by which to engage the disengaged, we think you should consider whether social tariffs or some other form of backstop protection should be offered to vulnerable consumers. To prompt thinking on what form this could take, we commissioned a report from the Centre for Sustainable Energy that we append to this submission. You should also give more consideration as to whether non-price remedies can alleviate consumer distress. The most obvious of these is energy efficiency, where we retain concerns that both the means by which schemes are paid for (through bills rather than taxes) and the mechanism by which they are delivered (through suppliers, who are both untrusted by the public and subject to a chronic conflict of interest when it comes to facilitating demand reduction) are suboptimal.

Away from vulnerable consumers, the problems in the retail market appear most acute in the small business segment. We were surprised by the scale of your evidence of overcharging within that segment - margins appear unsustainably high, indeed even suppliers own analysis appears to acknowledge this<sup>1</sup>. It is unclear whether issues with relatively low engagement levels and high deemed contract or out-of-contract rates are the primary drivers of these higher margins. You should consider measures to improve price transparency and a ban on rollover contracts in order to improve outcomes for small business consumers.

In our view, poor transparency on supplier costs has been a major causal factor of the breakdown of public trust in the sector and the unhealthy pattern of claim and counterclaim that

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<sup>1</sup> For example, you note an E.on internal document commenting that 'the majority of groups are well above where you'd expect the [gross] margins to sit in a completely rational market.'

has come to surround profit and pricing announcements. In a previous submission, we challenged the CMA to find a way to end this picture of opacity and dispute - suggesting that if it recurs once the investigation has finished that an opportunity will have been lost. Your publications provide few clues on where you may be going on this, but we note that much of your margin analysis bears considerable similarity with Ofgem's Supply Market Indicators ('SMI') - and that the sector has spent much of the past few years rubbishing the SMI at every available opportunity. We think you need to give more active thought to how you will leave behind the tools by which consumers can understand what goes in to their bill, and whether the price they pay is fair.

Away from retail, you identify inefficiencies in the EMR framework for delivering CfDs that we recognise and agree with. We would like to see you deliver practical changes to that framework to maximise the amount of decarbonisation that consumers receive for their money. We are less convinced that the capacity market is competitive than you are. We consider that it discriminates against demand side response, that the grandfathering of terms offered to those winning long-term contracts will distort the market, and that both the absence of (meaningful) penalties for non-delivery and lack of incentives to respond to fast moving crises may limit its usefulness to consumers.

In terms of the process followed, we would like to express our dismay at the truncated period of consultation and the sheer volume of redactions during this consultation round. The lag time between the first working paper being published and the last has been four weeks, almost the entirety of the consultation window. Many papers were not available until several weeks after the updated issues statement. Because the main paper relied on, and refers to, analysis in the working papers many stakeholders will have been waiting for those papers to reach views and to comment upon them. Within the working papers the volume of redactions has been so substantive as to render some papers almost wholly meaningless - the 'Descriptive statistics - retail' paper is probably the worst example of this, though 'Profitability of retail energy supply' and 'Market power in generation' are not far behind. We recognise you need to find a balance between disclosure and maintaining commercial confidentiality. But you also need to meaningfully consult. This requires you to give stakeholders enough information on which to form a view, and enough time in which to analyse and respond to this information. You also need to be aware that one of the principal problems the inquiry needs to solve is giving the public confidence that the prices they pay are fair. This is going to be a hard ask if almost any data item that would help to inform that view is redacted. We hope you will find a better balance in future consultation rounds. If you cannot associate specific financial data with a named party, you should at least consider whether it can be published on an anonymised basis or whether ranges (maximum, minimum and mean) can be given.

## **Theory of harm 1: market rules and regulatory framework**

### **The capacity mechanism**

We disagree with your assessment of the Capacity Market as 'broadly competitive' and consider that it includes a number of design flaws that are likely to unnecessarily increase consumer bills, distort the market, or result in it failing to cost-effectively tackle the problem it is intended to solve: keeping the lights on.

The capacity market provides that different contract lengths can be offered to different types of plant depending on whether they are new (up to 15 year contract), refurbishing (up to 3 year contract) or pre-existing (1 year contract). These contracts are grandfathered in order to provide investor certainty; i.e. a generator winning a 15 year contract will receive the same price for its capacity in all 15 years. While this may provide investor certainty, we consider it likely that it will distort the market. This is because in later years of the scheme different plants will be receiving different levels of payment in relation to the same product - capacity - in the same year. Each will seek to top-up its capacity revenues by selling their output on the wholesale market, but the achievable market price will be similar for plant with equivalent capabilities even if their capacity revenues are very different. It is very likely that this will result in a pattern of windfall gains and losses. In extremis, this may cause real problems at such time in the future that the capacity mechanism is withdrawn. From that point, we will see generators dependent on an energy-only price in competition with others who still have a number of years of guaranteed capacity revenues locked in under a 15 year grandfathered contract. This may disincentivise new investment in capacity at that point as it may not be able to achieve its marginal costs - because pre-existing plant with grandfathered contracts is dampening the wholesale price.

The capacity market is only suited to trying to keep the lights on in a slow moving crisis. The trigger for exposure to penalties, or over-delivery rewards, is based on National Grid issuing a warning of likely insufficient margin at least four hours in advance. We have practical experience of scenarios where this simply would not have helped. For example, in a two and a half hour period on the morning of 11 February 2012 around 3.5GW of generation fell off the system<sup>2</sup>. The situation became so acute that National Grid instructed five distribution network operators to initiate demand control measures; thankfully no consumers were actually cut off. Crucially, there was nothing like four hours advance warning of the severity of the problem.

In our view, when combined with the increasing volumes of inflexible generation on the system, this emphasises the need to be able to signal the value of flexible plant and demand side response. We think this is better achieved through cash-out reform than through the capacity market because the need to convince inflexible generation to participate in the latter has resulted in the development of rules that would make it of limited use in resolving fast moving problems. Cash-out is better suited to rewarding flexible capacity than the capacity market can

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<sup>2</sup> 'Saturday 11 February 2012,' a presentation by National Grid to the Electricity Operational Forum. <http://tinyurl.com/nu3ww6o>

be because it rewards only those who are capable of responding quickly - of having bids or offers accepted by the system operator - rather than rewarding everybody.

We note that a key objection to marginal cash-out (and therefore in favour of capacity markets) is 'a critique of the theory of energy-only markets that energy companies would plausibly not believe that they would be allowed to charge extreme prices in these extreme circumstances.'<sup>3</sup> We do not find this argument compelling, at least in relation to household and small business consumers. No household or small business consumer is exposed to spot prices; as you highlight elsewhere, domestic retail prices typically only change every seven to nine months<sup>4</sup>. It is unlikely that these consumers will be aware that generators or suppliers are experiencing a particularly expensive (or cheap) day in balancing demand; the chance of public outcry (or applause) is therefore very limited. This situation may differ for heavy industrial customers, although in some cases this could be as beneficiaries depending on whether their processes are amenable to providing demand side response.

The capacity market appears to discriminate against demand side response by only providing for one year contracts where up to 15 years are available for generators, and because the volumes of contracts available appear highly uncertain when compared to generation. The Secretary of State has the ability to scale back auctions at the year ahead stage ('T-1'). In practical terms, this may mean the year-ahead auction is used to mop-up any forecasting error that has become apparent from the four year ahead auction ('T-4') - indeed, this is acknowledged as such by DECC and by a member of the Panel of Technical Experts advising the Government<sup>5</sup>. Because demand side response will be participating at year-ahead stage, it is more exposed to this (volume) curtailment risk than generation is.

The chance of errors, and the inefficiencies that result from this, are unnecessarily exacerbated by the bulk of capacity being purchased four years in advance of the delivery year. This timescale was chosen because it was considered to be the minimum necessary to bring forward a new CCGT, though the majority of pre-qualified plant participating in the (first) auction is pre-existing and does not appear to need that lead time. Required capacity may alter very rapidly. For example, following the onset of the financial crisis, UK electricity consumption in 2009 was 6.2% below the 2008 figure, and it has stayed at broadly the same level since<sup>6</sup>. If the capacity mechanism had existed at the time, one could reasonably speculate that it would have over-procured not simply for 2009, but also for 2010, 2011 and 2012 given its foundation on T-4 forecasts. To try to recover its position, it is likely that little (or no) T-1 capacity would have been procured for those years. Because volumes needed at T-1 are inherently likely to be influenced by scale of forecasting error in T-4, capacity providers who can only participate at T-1 may be less bankable.

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<sup>3</sup> Paragraph 64 of your paper on Wholesale Electricity Market Rules.

<sup>4</sup> Paragraph 45 of your paper on price announcements.

<sup>5</sup> See Chapter 3 of the Energy and Climate Change Committee's March 2015 report on the Implementation of Electricity Market Reform. <http://tinyurl.com/l5lhxqa>

<sup>6</sup> DECC's Digest of UK Energy Statistics Table 1.1.5. <http://tinyurl.com/ohog5sq>

We think greater parity between generators and demand side response could be achieved, and the risks of over-procurement could be reduced, if a greater proportion of capacity purchases were held back to the year ahead auctions. Competitive distortions could also be reduced if there were equivalence in the contract duration available to generation and to demand side reduction. We would not support 15 year contracts for either, because of the concerns on grandfathering expressed earlier in this section, but commensurate terms should be offered to both megawatts and negawatts.

We note, and agree with, the concern expressed in paragraph 102 and 103 of the Capacity working paper that there is an absence of downside in participation of the capacity mechanism that may encourage unreliable plant to participate. Because the worst case penalty scenario is capped at the annual payments a generator is due to receive, the scheme appears to be upside-only. When combined with the lack of incentives to respond to a fast moving crisis detailed above, this creates some risks that consumers could be left paying for an insurance policy that would not actually pay out - keep the lights on - if needed. It is possible that this absence of risk may have played a part in the lower than expected clearing price being achieved in the 2018/19 auction that you observe; a perception that the scheme offers “free money” is likely to drive participation.

### **Contracts for difference (“CfDs”)**

We agree with your expression of concern that elements of the CfD allocation process may restrict the use of competition in setting the strike price, and that the ability of the Secretary of State to award contracts outside of a competitive process brings ‘risks that such contracts will unduly raise prices for consumers.’

We consider there is already strong evidence that this is not simply a risk but a very real problem. The National Audit Office considered the process followed in offering contracts to eight large renewable projects outside the competitive allocation process in its June 2014 report, ‘Early contracts for renewable electricity.’<sup>7</sup> Its opinion was critical,

*‘the scale of early contracts for renewables, awarded without competition, may have increased costs to consumers. The Department proceeded with the FIDeR scheme to secure continuing investment in new renewable generation, despite acknowledging that competitive pricing might reveal subsequently that its administratively set strike prices in some cases were too high. It is not clear that the full scale of these commitments was needed so soon to meet the UK’s 2020 renewable energy target. The early contracts have committed 58 per cent of the funds available for renewables Contracts for Difference to 2020-21.’*

The Public Accounts Committee<sup>8</sup> has been similarly critical,

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<sup>7</sup> National Audit Office, ‘Early contracts for renewable electricity,’ 27 June 2014. <http://tinyurl.com/lx6wey8>

<sup>8</sup> Public Accounts Committee, ‘Early contracts for renewable electricity,’ 3 October 2014. <http://tinyurl.com/m6e7d7l>

*'Quite simply, the Department failed to defend consumers' interest under the terms of these contracts. What is now needed is a shift to full price competition, contracts which allow some claw-back for consumers of any excessive profits, and a balance of technologies which hits climate targets at least cost for consumers.'*

In February 2015, we saw the results<sup>9</sup> of the first competitive allocation process for CfDs and these suggest that the prices achievable through competitive tendering may be considerably lower than the administrative strike prices that DECC has considered necessary to bring forward new projects. The clearing price for solar came in at up to 58% lower than the price would have been without competition, offshore wind at up to 18% lower and onshore wind at up to 17%. DECC acknowledged that 'in total, over 2GW of new capacity could be built, costing £110m per year less than it would have without competition.'

We would like to see competitive tendering used by default in setting strike prices for low carbon technologies going forward, rather than by exception as has largely been the case to this point. This should help to deliver better value for money, and increased carbon abatement, for consumers investment in these technologies.

We would also like to see the CMA give consideration to how decisions are made on the balance of (CfD) funding that is made available to more mature, versus less mature, low carbon generation technologies. Different technologies will mature at different rates, some will do so quickly while others may never reach grid parity. As a consequence, DECC is in the position of making calculated gambles on which to support and with how much funding. At present, the majority of funding goes towards the least mature technologies, with much lesser funding available for the more mature technologies like onshore wind and solar.

We cannot see evidence that DECC has in place a robust and objective methodology, or consistent philosophy, for how it decides to allocate funding between different technologies. The current approach of prioritising the least mature appears likely to defer carbon savings to a later period than may be achievable if more mature technologies were chosen. This may mean that consumers need to spend more in future periods than would otherwise be the case in order to deliver the same level of emissions savings. If enhanced funding is needed to bring less mature technologies to market, we would welcome the CMA's views on whether bill levies are the most appropriate means to provide it or whether another mechanism is better placed to stimulate innovation.

We agree with the general observation that CfDs should reduce the cost of capital that generators face in making low carbon investments, and that this should be passed on to consumers. However we note that you do not comment on the effect that the CfD regime may have on other parts of the energy supply chain that sit between generators and the final consumer, most notably suppliers. In some areas, CfD scheme design appears to unnecessarily increase the risk faced by suppliers, and therefore the costs that are passed on to consumers. For example, suppliers are obligated to not simply lodge collateral against their

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<sup>9</sup> DECC, 'World-leading auctions to provide major green energy boost,' 26 February 2015. <http://tinyurl.com/qczytma>

expected CfD liabilities but to also fund additional headroom for the CfD counterparty so it can meet its debts as they become due. We understand that this arose because the Treasury took the view that the CfD counterparty should not be allowed to borrow or to roll-over surpluses or shortfalls in funding between years. But it could be more efficient for the counterparty to arrange this headroom than for the many individual suppliers to do so. Asking suppliers to fund it upfront may also create competitive distortions given that their access to working capital, and its cost, may vary.

### **Other policy costs**

Your papers make little reference to any consequential impacts on competition that may be caused by supplier obligations to deliver energy efficiency policies, beyond a passing reference to the possible impacts of exemptions set out in the working paper providing case studies for new entrants.

We consider that there are broader competitive issues at play beyond the exemptions issue. Obligating energy companies to deliver energy efficiency measures is a fairly fundamental conflict of interest given their core business is selling power or gas. This may create perverse incentives on them. Given that effective delivery of policy may result in demand destruction that hurts their bottom line, it may be in their interests - and not in those of the public - to either not comply, or comply late, with efficiency obligations. There is practical evidence of this happening: British Gas, Drax, GDF Suez, Intergen, Scottish Power and SSE all failed to meet one or more of their CERT or CESP targets by the statutory deadline. In at least one of those cases, this appears to be the result of deliberate non-compliance, with the company taking the view that its fiduciary responsibility to its shareholders to make money trumped its legal obligations to deliver demand reduction<sup>10</sup>.

The incentive to avoid, rather than deliver, demand reduction may also impact on the relative positioning of the companies. For example, the political row over price rises in Autumn 2013 resulted in a watering down of the Energy Company Obligation. But at the time of the policy change, the major suppliers were in very different places in the progress they had made on scheme delivery. E.on was by a significant distance the furthest advanced in its delivery of ECO obligations<sup>11</sup> and made comments at the time criticising the prospect of reduced targets<sup>12</sup>.

*‘But E.on chief executive Tony Cocker said: “Let’s not tinker with Eco too early; you don’t change the rules half-way through the game.” [...] Don Leiper, E.on energy efficiency director, said: “ECO is effectively a legal obligation, which we are almost half-way through. We think it is poor practice to change legislation half-way through. It could send a “poor signal” and deter investors.’”*

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<sup>10</sup> [X]

<sup>11</sup> The changes to ECO were announced on 2 December 2013. The progress of the suppliers in complying with their obligations at the end of November 2013 are shown in Ofgem’s ECO compliance update issue 6, January 2014. <http://tinyurl.com/plbwgqe>

<sup>12</sup> ‘E.on breaks ranks over green levies,’ Daily Telegraph, 16 November 2013. <http://tinyurl.com/oysn5ne>

The inference is that E.on, which had clearly been trying to comply with the targets, considered itself competitively disadvantaged compared to competitors which had not, by the relaxation of targets under lobbying pressure from other suppliers. In effect, E.on would be penalised for trying to comply with the ECO targets, while its competitors were rewarded for having delayed work. This seems like a clear competitive distortion.

The behaviour of other suppliers in relation to explaining the cost of delivering social and environmental obligations has been problematic and underlines the wider transparency problems that blight the sector. We remain concerned that the conflict of interest in delivering energy efficiency creates a perverse incentive on suppliers to talk up the costs of scheme delivery and to apportion more of the blame for retail price inflation on such schemes than is tenable.

To use a practical example of this, in its Autumn 2012 price rise announcement npower set a clear expectation that the introduction of ECO would cause it significant cost inflation in 2013 and that a need to cover these costs was a major causal factor of needing to hike prices:

*“There are three main reasons why customers' energy bills are rising, which are:*

- Implementing government schemes such as CERT/CESP/ECO. Costs for this area will be approximately double in 2013 when compared to 2011.*
- [...]”<sup>13</sup>*

By the end of November 2013, 67% of the way through the compliance period, it had only delivered 19% of its CERO and 23% of its CSCO obligations, though it had made more headway against its HHCRO target (86%)<sup>14</sup>. Contemporaneous data published by DECC and based on suppliers anonymous submissions, suggested that the ECO scheme remained on budget and that its costs were equivalent to the predecessor scheme, CERT<sup>15</sup>.

A large disconnect seems apparent between npower's projection of runaway ECO inflation in 2013 as a justification for price rises in autumn 2012 and the scheme coming in on budget per measure, but with the supplier being behind schedule on measures delivered, in 2013. We note that npower again blamed runaway inflation in policy delivery costs as a justification for price rises in autumn 2013<sup>16</sup>.

Away from explanations, and exemptions, and setting aside the clear conflicts of interest, there is also a wider question of whether suppliers are best placed to deliver energy efficiency schemes at all. At a simple level, energy supply has traditionally been a combination of a risk management function (hedging and trading) and a customer service and billing function. Delivering improvements to the built fabric of homes and buildings falls outside this skillset -

<sup>13</sup> 'Press release: npower announces changes to gas & electricity prices' npower, 12 October 2012. <http://tinyurl.com/bcref8k>

<sup>14</sup> Ofgem ECO compliance update issue 6, January 2014.

<sup>15</sup> DECC, 'Energy Company Obligation Delivery Costs,' October 2013. <http://tinyurl.com/q3d5dtr>

<sup>16</sup> "Our forward view of the energy market shows that there are three main reasons why customer bills are rising, these are: realising the full costs of implementing government schemes and policies. This forward view shows an increase of 31%. [...]" 'Press release: npower increases household energy tariffs from 1 December,' npower, 21 October 2013. <http://tinyurl.com/nmt4j7c>

indeed, the practical delivery of measures has been largely outsourced as a result. There is an apparent wide variance in the cost per measure delivered between suppliers which suggests wide gaps in competence at scheme delivery. The costs per lifetime tonne of CO<sub>2</sub> saved of the cheapest major supplier under the CSC component of ECO is less than half that of the most expensive supplier, while for the CSO is it more than a third less<sup>17</sup>. Significant disparities of this kind could affect positions in best buy tables, and influence competition.

Finally, the use of bill levies rather than taxation to fund social and environmental obligations exacerbates the impact of these costs on the poorest in society. Unlike taxation, where marginal tax rates increase with income, in energy, the proportion of income spent on energy increases as income falls. As the Energy and Climate Change Committee ('ECCC') has highlighted, 'the use of levies on bills to fund social and environmental programmes will add to the burden faced by energy bill payers, particularly in low-income households. Public spending is less regressive than levies in this respect.'<sup>18</sup> Energy is an essential service and consumers have seen huge increases in their energy costs in recent years; a consumer whose underlying energy usage has remain unchanged will on average have seen their electricity bill increase by 67%, and their gas bill increase by 114%, in real terms between 2004 and 2014<sup>19</sup>. This is causing financial distress and ever increasing numbers of households are approaching our bureaux for help<sup>20</sup>. In England, the fuel poverty gap exceeds a billion pounds a year and 2.28 million households are in fuel poverty<sup>21</sup>. The number of households in Wales in fuel poverty is growing, and its fuel poverty gap is widening<sup>22</sup>. Fuel poverty figures are deteriorating in Scotland, with 39.1% of all households in fuel poverty in 2013 - a 3.9% increase on the preceding year<sup>23</sup>. In all nations, fuel poverty figures are at unacceptable levels.

While paying for policies through bill levies may not appear to have an overt link to competition problems, it may indirectly affect public confidence in the market. Trust polling, summarised in one of the attachments to this submission, suggests that rising prices have been a major causal factor in the loss of public trust in the sector, and the choice to fund policies through bills not taxes has been a contributory factor to that inflation.

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<sup>17</sup> Correct as at the end of September 2014, based on DECC reporting of supplier submissions. See Table 1.13a, 'Domestic Green Deal, Energy Company Obligation and Insulation levels in Great Britain, Quarterly report,' DECC, 18 December 2014. <http://tinyurl.com/p7zugg6>

<sup>18</sup> The Energy and Climate Change Committee, 'Prices, profits and poverty,' 16 July 2013. Ibid.

<sup>19</sup> Source: tables 2.2.1 and 2.3.1 of DECC's Annual Domestic Energy Bills dataset. These figures are based on fixed annual consumption of 3,800KWh for electricity and 15,000KWh. There is evidence that underlying household demand decreased during this period (see, for example, DECC's 'Special feature - domestic energy bills in 2014,' 26 March 2015) which mean that the actual real terms bill increase may be lower than these figures. The causes of reduced demand are likely to include both positive factors, such as increased energy efficiency, and negative ones, such as increased financial distress.

<sup>20</sup> Citizens Advice Bureaux in England and Wales received 49,142 contacts in relation to fuel issues in 2013/14 – a 21% increase on the preceding year (40,560). In Scotland, the total number of energy issues brought to bureaux in 2012/13 was 9,869, a 4% increase on the previous year (9,500).

<sup>21</sup> The Fuel Poverty Gap is defined as the the amount by which the assessed energy needs of fuel poor households exceed the threshold for reasonable costs. Source of statistics is the 'Fuel Poverty Report - updated August 2013,' DECC.

<http://tinyurl.com/mprvk47>

<sup>22</sup> Source: 'Wales Fuel Poverty Projection Tool: 2011/12 Report,' 2013, Welsh Government. <http://tinyurl.com/q3koox9>

<sup>23</sup> Source: 'Scottish House Conditions Survey 2013: Key Findings,' 8 December 2014, The Scottish Government. <http://tinyurl.com/naz3zvf>

We would like you to consider in more depth whether suppliers are an appropriate vehicle to deliver energy efficiency schemes and the impact that this may have on the competitive landscape.

### **Theory of harm 2: market power in generation leads to higher prices**

We have a range of concerns that the designs of EMR policy instruments may unnecessarily drive up costs, but have outlined these in relation to theory of harm 1.

The Citizens Advice Service is committed to reflecting the different experiences of consumers in the devolved nations (and potentially the effect of devolved policy on the energy market). Your analysis should identify which, if any, of the potential changes to the devolution settlement currently under consideration (e.g. changes to the Welsh Government's energy consent granting powers recommended by the Silk Commission, and the changes proposed by the Smith Commission in relation to Scotland) might merit revisiting the findings of the current investigation in future.

There are already differences in responsibility and approach to energy policy in different parts of the UK and these differences will become more pronounced with further devolution. We would like the CMA to consider the potential impacts this could have on the energy market and how these may affect businesses, investors, regulators and consumers both on a national level and at a GB level. Particular consideration should be given to any effects, positive or negative, on the most vulnerable consumers and those in remote and/or rural areas.

### **Theory of harm 3a: opaque prices and low liquidity in wholesale electricity markets distort competition in retail and generation**

The updated issues statement frames its assessment of transparency issues solely through the lens of what this means to a market participant, and not in terms of what it means to be a consumer. We think this is an error, and that consumer perception of whether margins are excessive or not - indeed, of what margins are - is a causal factor of distrust in trust in the market that may more broadly affect consumer behaviour and impact on regulatory and investment risk in the sector. We discuss this matter in more depth under Theory of harm 4.

It is unclear to us whether liquidity problems within the wholesale power market have been resolved. The data you present, the data presented by Ofgem both in its recent liquidity update and that it provided during the course of its secure-and-promote project, and the anecdotal feedback we receive from market participants suggest that liquidity in the spot and prompt markets has improved in recent years and is probably adequate to meet the needs of most participants.

It is less clear whether liquidity further forward is adequate however. The data you provide in your working paper 'Descriptive statistics: generation and trading' suggests almost no trading more than 13 months out. It also suggests that bid/offer spreads in forward seasons are deteriorating, not improving, and are several times wider than those for gas (figure 23a). Wide bid/offer spreads can have the effect of acting as a transaction tax, deterring trading.

Because the biggest single cost component of a retail energy bill is the wholesale cost of the energy itself, the availability of products in the two are likely to interrelate. The typical acquisition retail product offered by smaller suppliers is a short term fixed price, fixed term deal, but we find it hard to tell whether the duration of these fixes is driven by the pattern of trading on the wholesale market (i.e. that fixes are not longer because hedging further forward than a year or so is difficult) or whether the pattern of trading is driven by the duration of these fixes (i.e. that people are not trading further out because they do not need to). Is the lower liquidity in the forward market driven by an absence of supply, or a lack of demand?

This may come to matter more if the relatively benign price environment in the wholesale market of the past three or four years comes to an end. Smaller suppliers appear to be relatively more exposed to the spot market than the larger players<sup>24</sup> and therefore could struggle to ride out any short term price spikes.

Your pricing strategies paper highlights that there are significant differences between the hedging strategies applied by the Big 6 suppliers in relation to acquisition tariffs when compared to standard variable tariffs. The price gap between their acquisition and standard variable tariffs is generally substantive; you note that 95% of customers could have saved between £158 and £234 depending on supplier in paragraph 16. This spread of achievable savings far exceeds the 3.3% Earnings Before Interest and Taxation figure you cite for the domestic energy market, and the average profit of £48 per customer in the most recently reported Consolidated Segmental Statements (for 2013). It suggests that profit margin varies considerably between different types of customer.

There are several possible explanations for this:

- That large suppliers are predatory pricing, selling acquisition tariffs substantially below cost (indeed, we note this has been alleged by a small supplier<sup>25</sup>);
- That the cost to serve acquisition customers is objectively much lower than the cost to serve sticky customers, such that this differential is justifiable *on cost grounds*<sup>26</sup>; or
- That some consumers are so disengaged from the market that the large suppliers have unilateral market power in the standard variable tariffs market.

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<sup>24</sup> As figure 25 in the descriptive statistics paper highlights, they are also more exposed to cash-out prices, which suggests they find it more difficult to forecast demand and/or buy shape to meet this demand than larger players.

<sup>25</sup> 'Big energy suppliers loss-leading claims Ovo Energy,' Daily Telegraph 8 March 2015. <http://tinyurl.com/nhgnrip>

<sup>26</sup> It is important to be mindful that differentials that are justifiable on cost grounds may still not be justifiable on moral grounds in the views of many of the public. Polling for Citizens Advice Service, reported in section 5.2 of the attached CSE report, shows majority support for making cheaper (social) tariffs available to pensioners, the disabled and families on low incomes.

Your (published) work to date does not conclusively demonstrate which of these hypotheses is more plausible. We would like you to develop your thinking in this area for your provisional remedies and provide an analysis of how the cost to serve, and profit margin, differs between different segments of the retail market. This needs to go further than simply distinguishing between sticky and non-sticky customers and needs to also differentiate by other factors that could affect engagement, such as meter type, payment method and region or nation.

The gap between standard variable and acquisition tariff rates is so large, that we find it hard to avoid the conclusion that these consumers are fundamentally differently hedged. Your pricing strategies paper suggests that the Big 6 suppliers' 'median supply hedges were pretty similar' and that their 'market shares [...] appear fairly stable over time for both gas and electricity.' Given the scale of available savings achievable for customers who do switch, this calls in to question whether the approach to hedging for the standard variable tariffs is intended to be efficient (e.g. seeking to reduce standard variable costs) or is more driven by a desire to not be different to the peer group in order to maintain market share. One of the Big 6 appears to have acknowledged this in its evidence to you; 'we note SSE's comment made in 2012 that the narrow dispersion was evidence of firms not seeking to gain competitive advantage through the pricing of their standard variable tariff.' Why aren't the big suppliers seeking to outcompete each other on their hedge? Is that not evidence of tacit co-ordination? At the very least, it appears to be evidence of soft competition.

There are interactions between the liquidity of the wholesale market and the Offtaker of Last Resort ('OLR') provisions brought forward by DECC under EMR. In effect, the OLR provisions provide eligible renewable generators with some certainty that they will be able to sell their output on set terms if no-one else is willing to voluntarily enter into a Power Purchase Agreement ('PPA') with them. In effect, they provide developers with some assurance of bankable cashflows in order to give them the confidence to invest. That developers argued so vociferously to get such provisions in place may suggest problems in the PPA market.

There is something of a disconnect between your assessment of liquidity, which broadly concludes that it is adequate for the needs of independent suppliers and generators, and the views of those parties themselves, most of whom appear to consider that it is not<sup>27</sup>. It would be useful if you could set out in greater detail why you are in disagreement with those market participants, this is not clearly covered within the working paper.

We think there is also some cognitive dissonance between your view in paragraph 68 that 'regulations such as REMIT have been designed to identify abuse of market power and capacity-withholding. Penalties under these regulations will provide a further disincentive for parties to engage in UMP strategies' and your subsequent view in paragraph 73 that 'the anonymous nature of trading means that it is hard to associate a price outcome to the behaviour of a specific firm and therefore hard to target any punishment strategy.' This suggests that

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<sup>27</sup> Paragraph 40 of the liquidity paper states that 'Independent generators including Drax, ESB and InterGen all told us that there were limits to liquidity that affected their businesses.' Paragraph 39 states that 'Some, but not all, independent suppliers believed that liquidity was low, at least in particular products, as to impose additional risk and/or costs on them' but only identifies one independent supplier who disagreed with that view.

REMIT may be theoretically powerful but practically unenforceable. We would welcome any further thoughts you have on how the monitoring regime for market abuse could be strengthened to ensure that any instances of abuse can be identified and tackled.

**Theory of harm 3b: vertically integrated electricity companies act to harm the competitive position of non-integrated firms to the detriment of consumers, either by increasing the costs of non-integrated energy suppliers or reducing the sales of non-integrated generating companies**

We consider that this theory of harm is framed too narrowly, because it implies these are the only methods through which the competitive position of non-integrated firms can be harmed by the vertically integrated companies. In practice, the scope for harm or foreclosure is wider, particularly through retail pricing patterns and the ability to sustain higher margins that having a much larger proportion of sticky customers could facilitate.

We consider those matters further under Theory of Harm 4.

**Theory of harm 4: energy suppliers face weak incentives to compete on price and non-price factors in retail markets, due in particular to inactive customers supplier behaviour and/or regulatory interventions**

We have submitted a separate paper summarising consumer research on the retail market issues identified by the CMA. A common theme across all of our analysis is that different sub-markets of the energy sector are effectively independent of each other. Evidence also shows that the same groups of consumers are disadvantaged time and again by different aspects of the energy market, and by other markets in addition to the energy market.

These groups include people who:

- are on lower incomes and less likely to be working full time
- live in rented accommodation
- pay for their energy using PPMs
- do not have internet access
- are more likely to use electric heating
- are from the youngest or oldest age groups

The CMA needs to consider the market and appropriate remedies from the perspective of consumers in any or a combination of these circumstances – any solution which is accessible to these consumers is likely to work for other groups as well, whereas experience shows that solutions designed for the engaged majority have demonstrably not worked for the majority of those in vulnerable situations.

## Transparency on cost drivers

The updated issues statement, and its associated working papers, say very little in relation to transparency on the underlying costs driving retail energy bills. We think this is a gap that needs to be rectified, as it is a factor driving poor consumer trust in the sector. A theme that comes up repeatedly in consumer polling or surveys is a perception that suppliers are making excessive profits (for further detail, see attachment 2 on trust polling). This picture is likely to be reinforced by prominent public disputes on the scope for price cuts that have come to surround publication of Ofgem's Supply Market Indicators ("SMI") or the periodic rounds of price hikes or cuts. The Consolidated Segmental Statements do not fill this gap, as they are a picture of the past, not the present. In our experience, when retail prices move, the first question that people want to ask is: "is this change justified?" Tools that can enable an informed response to that question are limited, and disputed.

Historically, our predecessor organisations Consumer Focus and Consumer Futures produced regularly updated charts showing wholesale and retail price trends. These were formulated in response to wholesale price movements being the principal cause blamed for large retail spikes in 2008 and for many of the retail price movements in the following three or four years. We discontinued doing so after the SMI gained prominence, partially to avoid duplication or conflicting messages - which we think do not help consumer understanding - and partially because the source of blame for retail price movement has moved from wholesale prices to network and policy costs in recent years.

The Energy and Climate Change Committee conducted an in-depth study<sup>28</sup> of Prices, Profits and Poverty in 2013 and notably struggled to find convincing, contemporaneous data that would allow it to assess profits:

*'The actual level of profit in, for example, the energy supply arm is therefore difficult to establish. Greater transparency is urgently needed to reassure consumers that high energy prices are not fuelling excessive profits.'*

*[...] a lack of transparency around profit margins [has] fuelled deep mistrust among consumers [...] It is disappointing, for instance, that the big energy companies have not gone to greater lengths to explain the reasons behind price rises.'*

In principle, the SMI could provide a tool that answers these questions, and they are the nearest current proxy that is widely used in public debate. The SMI is a projection, not a forecast, but (in our view) it retains considerable value in getting a sense of the direction of margins, the cost drivers that may be driving that trajectory, and the scope (or lack of scope) for lower prices. But its use is disputed, and the supplier sector has devoted considerable energy to rubbishing the SMI and calling for it to be scrapped<sup>29</sup>. Energy UK has alleged that the SMI has been

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<sup>28</sup> Energy and Climate Change Committee, 'Prices, Profits and Poverty,' 10 July 2013. <http://tinyurl.com/ghvfnrt>

<sup>29</sup> For example, see the Energy UK press release, 'SMI: outdated, statistically biased and inaccurate,' 29 January 2015.

'consistently out over the last four years by as much as 200 per cent,'<sup>30</sup> while Ofgem's own analysis suggests that the difference between what the SMI projects and outturn results is limited, amounting to an £11 difference in pre-tax profits per customer in 2013<sup>31</sup>. It is hard to reconcile these two pictures.

Your analysis of the evolution of tariffs against expected direct costs appears to make heavy use of Ofgem's SMI methodology, alongside your own variant which appears to share its mechanistic approach, but is more volatile because a shorter hedge is assumed. Given the sector has never accepted the SMI as being informative, we see limited prospect that it will suddenly embrace either with open arms. We find this concerning, because we think the inquiry needs to leave behind an enduring mechanism for ensuring transparency on costs.

Responding to an earlier consultation round<sup>32</sup> we observed that,

*'The cost drivers behind price movements have been a source of near-constant public dispute for many years now, with the result that the vast majority of consumers, rightly or wrongly, simply no longer believe what energy companies have to say on the issue. A one-off conclusion that prices are, or are not, fair is unlikely to prevent the recurrence of dispute if the protagonists can simply dismiss it as outdated by subsequent events. So it is vitally important that the CMA's inquiry leaves behind a structural framework that can give the public enduring confidence that they are not being ripped off. If you cannot deliver this, your inquiry will have failed.'*

We retain this view. We wish to see you develop your thinking on what transparency tools should be put in place to ensure the public can be confident that they are not being ripped off. If you consider that the SMI, or some similar mechanism, is a useful tool - and your use of these measures yourself implies that you do - you need to definitively counter the industry's assertions that they are misleading. If you do not, you may simply leave the contemporary margins argument in the same place that you found it - which helps nobody, least of all consumers.

## **Price discrimination**

The updated issues statement suggests a causal factor of increasing retail margins may be the introduction of the undue discrimination licence condition (SLC25A) in 2009, and that you will consider this matter further. Paragraph 158 suggests a softening in competition for standard variable tariffs that 'broadly coincides with the introduction of the prohibition.' We recognise that SLC25A is something of a *bête-noire* amongst former regulators, being criticised heavily both at, and following its introduction. Indeed, we had our own reservations about its effectiveness, and supported it being allowed to lapse in 2012<sup>33</sup>. But we would caution against excessive focus on its effect because it appears something of a red herring.

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<sup>30</sup> Ibid.

<sup>31</sup> Ofgem. See Section 3, 'The revenues, costs and profits of the large energy companies in 2013,' 10 October 2014. <http://tinyurl.com/n97k6h4>

<sup>32</sup> See our 'Initial submission in response to "Energy Market Investigation: Statement of Issues," 14 August 2014.

<sup>33</sup> Consumer Focus, 'Response to consultation on the undue discrimination licence condition,' 10 April 2012. <http://tinyurl.com/n2iguuu>

The time series data you present in Figure 1, and Figure 2, suggests that margins, and spreads, did widen in 2009 - but that they had shown signs of widening before this in 2007. The most pronounced widening occurs later, in 2014, after the licence condition had been allowed to lapse. So the problem of diminishing competitive intensity appears to both predate and postdate the period where SLC25A was in place. It is quite possible it did not help, but a conclusion that it was, and remains, the principal cause appears speculative based on the data provided. It would be hard to separate the effect of this licence condition from other possible drivers that may create noise in the data<sup>34</sup>.

We would find it concerning if the outcome of your investigations into SLC25A were a view that the large in-area/out-of-area differentials that preceded its introduction were a good thing and should be re-introduced. We are mindful of the results of your analysis, and that of other surveys, that suggest those most likely to remain on standard variable tariffs are disproportionately likely to be vulnerable or struggling. The re-introduction of large in-area/out-of-area differentials would seem more likely to hurt than help them. It may make offers by small suppliers more attractive and help them to grow - because the saving they could offer versus the regional incumbent may become wider - but encouraging switching by aggravating payment distress among sticky customers would appear a highly undesirable and perverse outcome.

As your analysis highlights, there are clear differences in the cost base associated with standard variable and acquisition tariffs. Your analysis suggests that over the period Quarter 1 2012 to Quarter 2 2014, over 95% of the dual fuel customers of the Big 6 could have saved by switching tariff and/or supplier and that the average saving available to these customers was between £158 and £234 (depending on the supplier). Such savings far exceed the average margin per household. Given this is the case, this suggests that acquisition deals are either loss-leading or that their cost-to-serve of is markedly lower than that associated with standard variable tariffs. The reasons for this are not clearly articulated and we would welcome further analysis on the differential cost to serve between standard variable and acquisition tariff customers. It would be simplistic to suggest that sticky customers are high cost to serve - some will be, some will not - and in many areas their stickiness de-risks them; eg because future revenue is assured, and because it facilitate economies of scale in service delivery. It appears most likely to us that the biggest single factor driving different the scale of achievable savings on market leading tariffs is that they are hedged differently, with suppliers only purchasing ahead for the duration of the fixed term, but purchasing further ahead for their standard variable tariff customers. If this is the case, it calls into question whether the major suppliers are efficiently contracting energy for the bulk of their consumers. Given that wholesale costs are the biggest single component of an energy bill, around 43% on average according to Ofgem, we are surprised that there does not appear to be more evidence of large suppliers adopting different hedging strategies for their standard customers in order to compete on costs. We note, and recognise, the commentary in the pricing strategies paper that suggests that the focus of competition has moved away from

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<sup>34</sup> Other contributory factors could include the deteriorating profitability of the generation sector causing vertically integrated firms to seek comfort through higher rents in the retail sector, the price shock of 2008 causing a change in risk appetite or hedging strategy, declining liquidity in the wholesale markets, or the steady abandonment of doorstep sales following public pressure and a series of mis-selling scandals.

the standard variable tariff over time. The narrowing of competition to exclude the principal product does not appear to be in consumers' best interest.

Your profit margin analysis - insofar as we can understand it given how heavily it is redacted - appears still relatively limited in its scope. While you try to differentiate between the margin on fixed and variable tariffs it does not appear that you disaggregate the market into any more than those two segments. As we noted in our evidence session, and in the attached engagement paper, there are further sub-segments in the market - for example, the options available to (and engagement level of) prepayment meter customers are markedly different to those of direct debit customers.

It also appears that the analysis is all on a GB-wide basis, with no breakdown by region or nation. While the GB-wide market is dominated by the Big 6, in each of the 14 [power distribution] regions the market is more concentrated in the hands of a 'Big 2' - the successor firm to the former regional monopoly for electricity (which varies by region), and British Gas (trading as Scottish Gas in Scotland) for gas<sup>35</sup>. Given that market share is concentrated at regional level, not GB level, we think it would be appropriate to consider whether margins vary by network region.

Your analysis of margins notes that 'major firms generated higher gross margins on their standard variable (or variable) tariffs than on their other non-standard variable tariffs combined', without giving any sense of the quantum of this difference or any real sense of how this spread differs between the major suppliers. We urge you to try and provide more context in future publications as this hampers the understanding of stakeholders; if commercial confidentiality is the constraint here you should consider publishing anonymised data showing the range (minimum, maximum and mean etc).

A further statement that 'while the costs to serve may be higher for variable tariff customers than for fixed tariff customers, the size of the differences in gross margins would mean that the costs to serve variable tariff customers would likely need to be significantly higher than for fixed customers to explain fully the higher gross margins that we found for standard variable tariff customers' - implies this difference is substantive, and may not be justified by any differences in the underlying costs to serve those customers. You elsewhere note that, relative to those on fixed-price tariffs, customers on standard variable tariffs 'are less educated, less well-off, more likely to describe themselves as struggling financially, less likely to own their own home, less likely to have internet access, more likely to be disabled or a single parent.' Recent research by GfK for the Department for Business, Innovation and Skills reinforces the picture of vulnerable consumers being less well served by the market, with those in the most financially vulnerable grouping, 'Constrained strugglers', less likely to shop around than the average consumer and

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<sup>35</sup> Ofgem's 2014 State of the Market Assessment highlighted that on average, the electricity incumbents hold a 69 per cent share of supply for single-fuel electricity customers in their incumbent region. Centrica has a 72 per cent share of supply for single-fuel gas customers (para 4.20). On average, 48% of the electricity incumbents' customer base is made up of customers in their incumbent region(s) (para 4.18).

more likely to pay for their electricity through a non-standard means such as a prepayment meter<sup>36</sup>.

This coincidence of the highest margins being made on the most vulnerable customers is invidious and unsustainable when the product in question is an essential service; it is imperative that you find means to get competition working for the most vulnerable customers. If you cannot, you should consider what alternative means of protection can be provided; this could include options to reduce their exposure to energy *prices* (for example - a regulated backstop tariff. Some possible ideas on how this could be structured are included in the attached CSE report) or *volumes* (eg enhanced energy efficiency support to reduce their consumption levels).

### **Inactive consumers and the limitations of information remedies**

The CMA's initial findings highlight that sticky consumers are more likely to remain on standard variable tariffs and/or pay over the odds. The traditional approach taken over the years to try and tackle this problem has been to introduce new information remedies to help consumers better understand and engage with the market. In addition to the obligations flowing from the European Commission, Ofgem's Probe and Retail Market Review both introduced new information remedies to help tackle the problem of low engagement levels.

It is our view that the variation in experience and prices between different groups in the retail energy market is a result of there being, in effect, a number of different markets. At opposite ends of the spectrum, there is little if any overlap between the experience or market engagement of:

- a well-off, better informed consumer, living in a home he or she owns, using gas central heating, who is comfortable comparing energy deals on a comparison website and paying by direct debit; and
- a consumer on low or variable income, without internet access, who rents a property which has a prepayment meter fitted to clear or avoid debt, relying on electric heating on a complex time of use tariff, and for whom daily management of costs is a barrier to arranging direct debit payments - if he or she has a bank account at all.

The Citizens Advice Service considers that the reason for the differences in costs for consumers identified by the CMA are, fundamentally, that the current energy market works best for those who share the characteristics of the first group, but increasingly poorly for those who share more of the experiences of the second. The energy market is not an isolated example of this; consumers disadvantaged in one market are very likely to be similarly disadvantaged by others. While this is obviously beyond the remit of this inquiry, it is essential that the context is

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<sup>36</sup> Only 31% of Constrained Strugglers had checked whether they were on the best deal for electricity compared to 43% of the wider population. 31% of Constrained Strugglers paid for electricity by a non-standard method such as pre-payment meter, frequent cash payment or fuel direct/direct from benefits compared to 20% of the wider population who did so. Constrained strugglers, 'tend to have lower qualifications, belong to DE social grades (more than other groups) and find it hard to keep up with bills and commitments.' GfK NOP Social Research, 'Consumer Empowerment survey report,' March 2015. <http://tinyurl.com/kdmt028>

recognised when considering solutions, particularly any further information remedies. Further analysis is available in our supplementary paper on 'review of the retail market issues raised by the CMA.'

### *Energy billing*

In addition to our response to the updated issues statement, we have submitted a new report looking at the state of billing in the energy market, 10 years on from the energywatch super-complaint on bills.

The report makes several key recommendations:

- there should be a wholesale review of the content on energy bills
- suppliers need to be subject to sharper incentives on complaints handling
- consumer protections on billing need to be further strengthened

The billing report has found that over the last decade, more and more information has been added to energy bills either through regulatory requirements or voluntary arrangements (see appendix for chart). Individual changes to bills have helped consumers better understand aspects of their energy bills. But the wider impact of the changes in aggregate has been that the range and depth of information required in energy bills has increased considerably, meaning that bills themselves are now much longer than they were in the past.

Several years ago, our predecessor encouraged Ofgem to set up a working group with consumer bodies and energy suppliers to review the content on energy bills and explore whether some content could be revised or removed<sup>37</sup>. The group failed to achieve its original goals. The Retail Market Review has since added further content to energy bills. There is limited research available to date as to whether this new information is having a positive impact on consumer understanding and behaviours. We continue to believe that it would be appropriate to conduct a wholesale review of the content on energy bills.

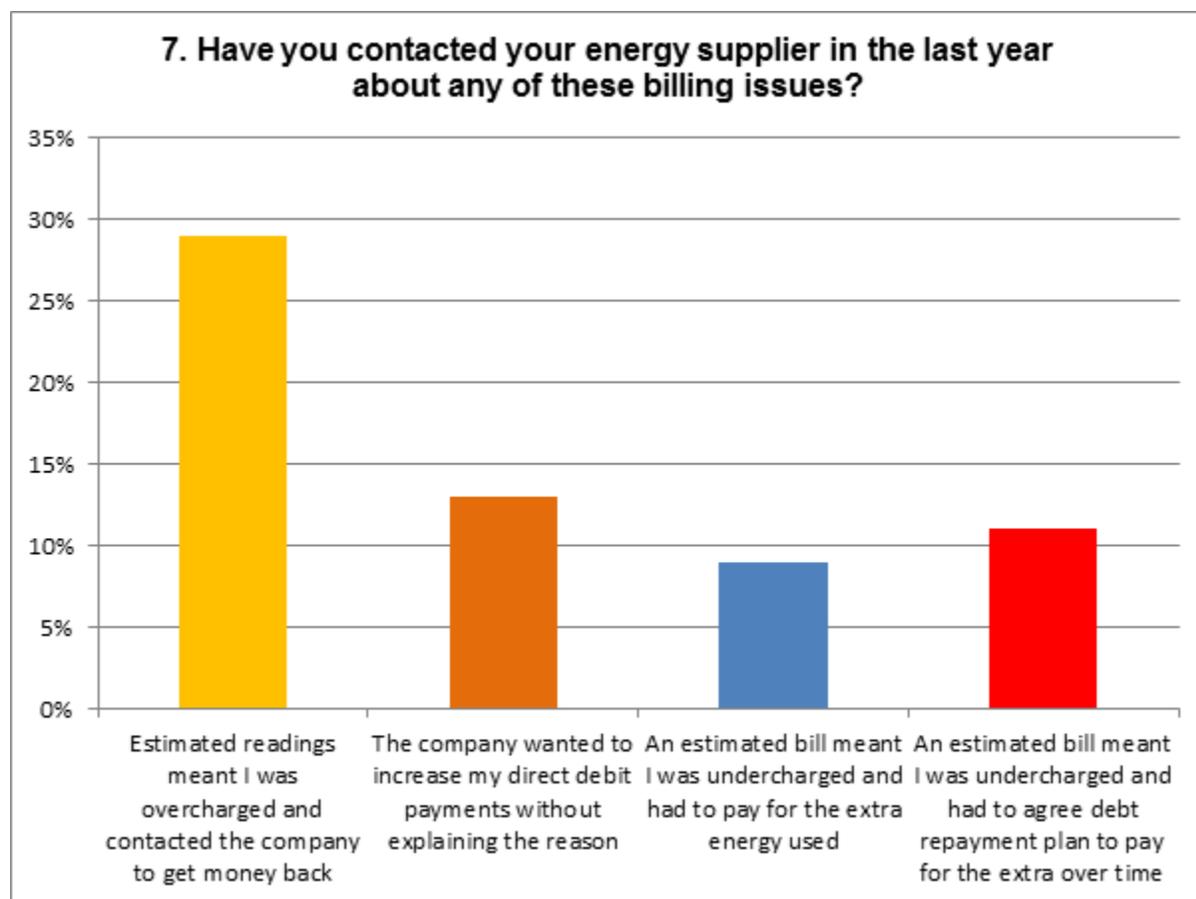
A second finding in our report has been that there does not appear to be sharp enough incentives on suppliers to drive down complaint levels. Ten years after the energywatch super-complaint, complaints about energy billing and associated processes remain the largest single source of direct and third party complaints, and, for at least some companies, constitute more than half of all complaints. While the pattern has varied between different suppliers since the beginning of 2013, when the data was first published, overall complaint levels across the industry have not changed significantly.

The level of direct complaints reported by energy suppliers themselves since the start of 2013 could be up to 20% of all domestic consumers annually. Our report has conservatively estimated that billing complaints handling alone costs energy companies of the order of £111-

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<sup>37</sup> The Consumer Bills and Communications' Round Table Group. <http://tinyurl.com/gbizqhy>

125m each year. The total cost of handling for all complaints would be somewhat less than double this, at around £200m taking account of the higher proportion of billing complaints dealt with by the Ombudsman. As highlighted by energywatch in 2005, complaints at these levels suggest systemic failings across the industry.



*TNS-BRMB for Citizens Advice: face to face poll of 2,053 respondents carried out between 30 January to 3 February 2015, N=1,171 weighted. 45% of respondents said DK / NA to this question, and so the total adds to 107%. It is likely the overlap was between responses 1 and 2*

Although detailed demographic data on the impact of billing problems is limited,<sup>38</sup> that which is available suggests strongly that consumers who are already disadvantaged in other ways – for example, because of income or poor literacy or numeracy skills – are those most likely also to be disadvantaged by poor billing practices.

Survey data shows that beyond price / different tariff options or moving home, poor service is the most common trigger for a consumer considering switching, albeit by a much lower margin<sup>39</sup>. However, surveys also show that despite being unhappy with the level of service received, consumers do not switch supplier.

<sup>38</sup> The main source of this information is Ofgem's 2014 report on energy company complaints handling: <http://tinyurl.com/msaggyt>  
<sup>39</sup> <https://www.ofgem.gov.uk/ofgem-publications/88375/customerengagementwiththeenergymarket-tracking-survey-2014-final-published-26-6-2014.pdf> - Poor service was 4th after moving home or wanting a fixed priced tariff. Q4 2014

GfK data had poor service at 14% versus lower prices (80%), capped/fixed price (22%) or dual fuel discount (19%). Consumers could choose more than one option so numbers add up to more than 100%.

The third finding is that while the introduction of smart meters aims to bring benefits to consumers through removing the need for estimated bills or physical meter readings, there is evidence to suggest that more attention is needed to billing practices to ensure that the promised benefits of smart meters – the end to estimated bills in the short term, as well as access to new dynamic tariffs in the longer term – are delivered in practice. Recent experience of migration of billing systems among four of the Big 6 suppliers creates particular concerns in this respect.

## **Smart meter rollout**

Citizens Advice Service believes that the rollout of smart meters could deliver significant benefits to consumers including better service as well as new innovative tools that could help re-engage consumers. The realisation of the three key benefits of smart metering identified in the updated issues statement - quicker switching, accurate billing and increased visibility of energy consumption - are all reliant on the effective implementation of smart metering.

### *Accurate billing*

An information request we carried out last year showed that a significant number of consumers with smart meters have received at least one estimated bill, with a small minority receiving multiple estimated bills following the installation of a smart meter<sup>40</sup>. We acknowledge that these results are based the foundation stage of the rollout and the introduction of the DCC should improve matters. However, it is also worth noting that the vast majority of suppliers are currently only installing smart meters in areas with strong wireless connections or connectivity.

Added to this, a recent poll from Smart Energy GB highlighted that only 76% of consumers who had a smart meter thought that their bills were accurate.<sup>41</sup> Our own polling evidence suggests that consumers will have a low tolerance of estimated bills post-smart, with 60% telling us they would be unsatisfied if they continued to receive estimated bills if they had a smart meter and 57% saying they would complain to their supplier if that happened.<sup>42</sup> Similar views were also expressed by participants in Ofgem's recent Consumer Panel research on smart billing.<sup>43</sup>

Given that accurate billing has taken centre stage in the promotion of the benefits of smart meters, the fact that some consumers continue to receive estimate bills even after their meters are installed is a worry.

The promise of accurate bills has a direct benefit to consumers, and an indirect benefit due to resultant falls in complaints and the cost of handling them.

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<sup>40</sup> Evidence available upon request. It has already been shared with Ofgem.

<sup>41</sup> Smart Energy GB, 'Smart Energy Outlook,' March 2015. <http://tinyurl.com/kwi2zcf>

<sup>42</sup> Poll of 2,000 consumers by TNS in January 2015. Full results available upon request.

<sup>43</sup> <https://www.ofgem.gov.uk/ofgem-publications/94017/panel3reportv5-pdf>

Current supplier commitments on billing that go beyond the licence requirements are provided for under the voluntary Energy UK Billing Code, but it only has five active members.

We are calling for a new code of practice on smart billing governance, underpinned by licence conditions, in order to minimise the consumer detriment associated with receiving estimated bills after having a smart meter installed. This would require suppliers to:

- Keep consumers with a smart meter informed when bills are not accurate, and take all reasonable steps to provide accurate bills by other means;
- Not back-bill consumers for more than one billing cycle after a smart meter is installed;
- Compensate consumers with a smart meter who do not receive regular accurate bills and ensure timely provision of opening and final bills;
- Provide consumers with opening and closing bills in a timely manner.

We think these additional protections could improve confidence and engagement in the market. By demonstrating that smart metering will deliver improved quality of service and stronger protections they could help to drive the uptake of smart meters, resulting in the benefits being felt quicker, and by a wider tranche of society, than may otherwise be the case.

#### *Putting consumers in control*

Alongside the opportunity to provide consumers with accurate bills and real time information on their energy usage, the rollout of smart meters offers the potential to develop future data-driven services. These services may be of significant future benefit to consumers if such a market is allowed to thrive. Key to this will be ensuring that consumers have ultimate control over their smart data and that energy suppliers are not allowed to become gatekeepers of this information.

There are two key policies that will help achieve this goal. First the existence of the consumer opt-outs down to monthly data collection and the need for an opt-in for anything more detailed than daily data - this provides the consumer with some leverage to help ensure that benefits are passed on in exchange for their valuable data. The second is the Consumer Access Device (CAD) which will allow consumers to access their detailed data and share it with trusted parties without their having to go through (or give the data to) their energy supplier.

In many cases energy suppliers will not be best placed to create or offer innovative new tools and applications founded on smart data, which have the potential to benefit consumers. This is particularly true for services like switching where supplier and consumer incentives are not aligned. A situation should not be allowed to develop where a supplier can either see that a consumer is considering switching and only then offer them a better deal or where a supplier can 'go slow' in providing data to a switching service to hinder the process. Consumers should ultimately be in control of where their data goes and with whom it is shared.

## *Ensuring the benefits are shared*

The Citizens Advice Service is concerned that consumers in vulnerable situations could miss out on the potential benefits of the rollout, which they will be helping to fund through their energy bills<sup>44</sup>. This is because many of this group will be in financial difficulty and have often reduced their use to a bare minimum and are unable to take up measures that would reduce their energy consumption whilst still allowing them to meet their basic needs. They face a number of barriers to the uptake of energy efficiency measures including lack of knowledge or awareness of options, high upfront costs, uncertain benefits<sup>45</sup>, complex finance or grant mechanisms, and disinterested landlords<sup>46</sup>.

The Government has tasked larger suppliers, and in turn, Smart Energy GB<sup>47</sup>

1. To build consumer confidence in the installation of smart meters.
2. To build consumer awareness and understanding of how to use smart meters and the information obtained from them.
3. To increase consumer willingness to use smart meters to change their behaviours so as to enable them to reduce their energy consumption.
4. To assist vulnerable, low income and prepayment consumers to realise the benefits of smart metering systems while continuing to maintain an adequate level of warmth and meet their other energy needs.

Given the scale of the task, the priority to date has been on the first two objectives, with a visible strategy to develop the third as the rollout gathers pace. We understand the fourth objective will be consulted on this year, with a strategy to follow. This follows DECC's research into early learning from the rollout<sup>48</sup> and research by NEA for the Citizens Advice Service<sup>49</sup>, which show a gap in support for vulnerable consumers and ways in which it can be filled.

Citizens Advice Service wants the Smart Meter Installation Code of Practice (SMICOP) to require individual suppliers to provide a dedicated service for consumers in vulnerable situations, in addition to making phone and web-based support available to all consumers. This service needs to incorporate a number of functions to make the most of this rare opportunity to help these consumers with their bills.

The functions could, and can, be delivered to the individual in line with those offered to consumers on the Priority Services Register<sup>50</sup>.

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<sup>44</sup> Citizens Advice Service, 'Developing an Extra Help Scheme for vulnerable smart meter customers,' September 2014.

<http://tinyurl.com/ohfpuhm>

<sup>45</sup> Consumer Focus, 'What's in it for me?', June 2012. <http://tinyurl.com/ksc7m5o>

<sup>46</sup> Consumer Focus, 'A private Green Deal,' December 2010. <http://tinyurl.com/p74zevj>

<sup>47</sup> DECC, 'Government response to the consultation on the Consumer Engagement Strategy,' December 2012.

<http://tinyurl.com/lcnh823>

<sup>48</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/407568/8\\_Synthesis\\_FINAL\\_25feb15.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407568/8_Synthesis_FINAL_25feb15.pdf)

<sup>49</sup> Ibid.

<sup>50</sup> Citizens Advice Service, 'Response to consultation on priority service register,' September 2014. <http://tinyurl.com/mwm9cba>

However, Citizens Advice Service is concerned that, whilst these can be delivered on a one-to-one basis, the supplier-led, competitive structure of the rollout means that broader opportunities for engaging consumers are lost. Some vulnerable consumers may not be able to assimilate information from a single one-to-one session, and may require longer-term provision of information and advice. Longer term support comes, of course, at a cost; but savings could be made where advice and information is provided through existing community networks, where the trusted nature of the provider, the communal approach to learning, and ongoing support could mean more benefits are realised. We think a coordinated approach is particularly likely to deliver efficiencies in areas where there is a high density of vulnerable consumers; where there is an existing framework for resident advice and information, such as in social housing; or where public or energy consumer funds (ie ECO<sup>51</sup>, Arbed<sup>52</sup>, Nest<sup>53</sup>, HEEPS<sup>54</sup>) are being spent on energy efficiency measures.

### *Improved service for prepayment meter users*

We recently published a research report<sup>55</sup> considering the causes and impact of self-disconnection by prepay customers that made four key recommendations. Of these, one has a strong competition dimension - to prioritise pre-pay options in the smart meter rollout.

In the longer term, it is essential to build solutions to end the short-term fixes such as providing emergency funds when there is a temporary crisis and a consumer cannot afford energy. There is a key question around where the responsibility lies when a consumer simply cannot afford to top-up their meter to access energy for heat and light. This is a problem that no short-term fix can address, and requires leadership from Government and regulators about the expectations on suppliers, and where their responsibility ends. We believe that PPMs are not suitable for vulnerable households who regularly self-disconnect. Further debate on this issue to develop longer term solutions for these households is urgently needed. It is essential that the Government takes a lead in this and works across departments to effectively support these customers.

Despite the potential for benefits from smart metering in terms of the ability to offer improved services such as new top-up methods or additional tariffs, current problems highlight that it is not enough to assume that smart meters will fix the issues that PPM users have. PPM consumers are an underserved segment of the market: characterised by limited innovation, poor service, weak competition and wider price differentials. Self-disconnection is the most visible indication of a market that is failing some consumers.

One of the key asks of our Fair Play for Prepay campaign<sup>56</sup> is all suppliers producing consumer offers for affordable and flexible pay as you go tariffs, to improve the service these consumers receive and reduce the prices they pay. The Government and regulators must work together to

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<sup>51</sup> The ECO places a requirement on larger energy suppliers to deliver energy efficiency saving measures in homes. For more information see Ofgem (2012) *Energy Companies Obligation*, <http://bit.ly/1whsxk3>

<sup>52</sup> For more information see the Arbed website, <http://bit.ly/1sJMr5J>

<sup>53</sup> For more information see <http://s.coop/1v2wx>

<sup>54</sup> For more information see <http://s.coop/1v2ww>

<sup>55</sup> 'Topping up or dropping out,' Citizens Advice, October 2014. <http://tinyurl.com/mbxleog>

<sup>56</sup> For more information on the Fair Play for Prepay campaign please see our website: <http://tinyurl.com/px9kopi>

ensure that the benefits of smart pay-as-you-go are delivered, alongside programmes to improve energy efficiency of homes and opportunities for income maximisation (for example benefits checks). It is essential to ensure that consumers who currently self-ration or are at risk of self-rationing in a way that might endanger their health and wellbeing do not use less energy than is necessary. The ability of smart meters to operate in either prepay or standard credit mode has some scope to remove some barriers to choice faced by consumers who may currently have to pay to get a standard credit meter installed if they currently have a prepay meter but want to switch to a pay-in-arrears tariff.

We note your view that smart meters ‘may also lead to a more active engagement in the market from a subset of customers, through ‘time-of-use’ tariffs, which give the opportunity and incentive to shift demand away from peak periods.’ While possible, this is not a foregone conclusion. Time-of-use is not a new product; multiple rate tariffs have been available for many years. Consumer Focus research in 2012 suggested that nearly two-fifths of consumers on Economy 7 tariffs did not use electrical storage heating or any additional electrical devices during off-peak hours and therefore might actually be better off on a single rate tariff<sup>57</sup>. More broadly, the ability of any household to shift load may be limited by factors such as health, property type, the presence or type of heating controls, working patterns or tenure. Those consumers who would benefit from a time of use tariff will need to switch to that tariff to realise this benefit - and as the inquiry highlights, large sections of the public are disinclined to switch.

The expression of these reservations is not intended to suggest that we think the roll-out of smart metering will have an adverse effect on competition - we do not. But we think that caution should be exercised before assuming that smart is a silver bullet that will solve many of the underlying problems in the market.

### **Energy tariff options for vulnerable consumers**

Given our concerns about the over-reliance on information remedies and nudges to tackle the problem of low engagement levels and the failure of the market to deliver suitably attractive tariff prices to certain groups of consumers<sup>58</sup>, the Citizens Advice Service wanted to explore what other options, including direct interventions, were possible and to understand what impact they could have on improving affordability for a target group of consumers.

The impacts that would have the most beneficial impact on these households would be to increase their incomes so they could adequately afford to pay their households bills. Efforts to improve the energy efficiency of their properties are also essential but did not form part of this research. As significant increases to benefits rates are unlikely, our research focussed on alternative options, all of which require varying degrees of intervention in the energy market.

The energy market for these consumers lacks competitive pressure and as the CMA has identified, prices remain higher than average. Fierce competition tends to be limited to the direct

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<sup>57</sup> ‘From devotees to the disengaged,’ Consumer Focus, October 2012. <http://tinyurl.com/8vmx3ot>

<sup>58</sup> The ‘unplugged’ group in Ofgem’s typology: TNS BMRB (2014), ‘Ofgem Retail Market Review baseline survey.’ Report for Ofgem

debit, online, fixed term tariff segment of the market, with the consumers unable to use this payment method having fewer attractive options available to them.

We commissioned the Centre for Sustainable Energy (CSE) to carry out an assessment of different tariff price supports along with modelling of the potential impacts on the energy bills of these households. The draft report has been submitted with this response.

The research scope was as follows:

1. Identify different options to address or mitigate current inequalities in the energy market that affect disengaged, vulnerable consumer group(s).
2. Critically appraise and assess options identified, reviewing each along several key dimensions including (but not limited to) consideration of: distributional impacts (winners and losers); policy costs and net benefits; political acceptability; industry admissibility and practical feasibility.
3. Examine options for a suitable proxy to identify a 'vulnerable' group of consumers.
4. Undertake modelling work to further explore the potential costs and benefits (distributional impacts) of options where considered appropriate, relevant and the data exists to do so.
5. Present robust evidence on the potential for each option to succeed in ensuring that the target group, in spite of a lack of engagement, would have access to more affordable energy and tariff options, framed within the regulatory context of the current GB energy market and political climate.

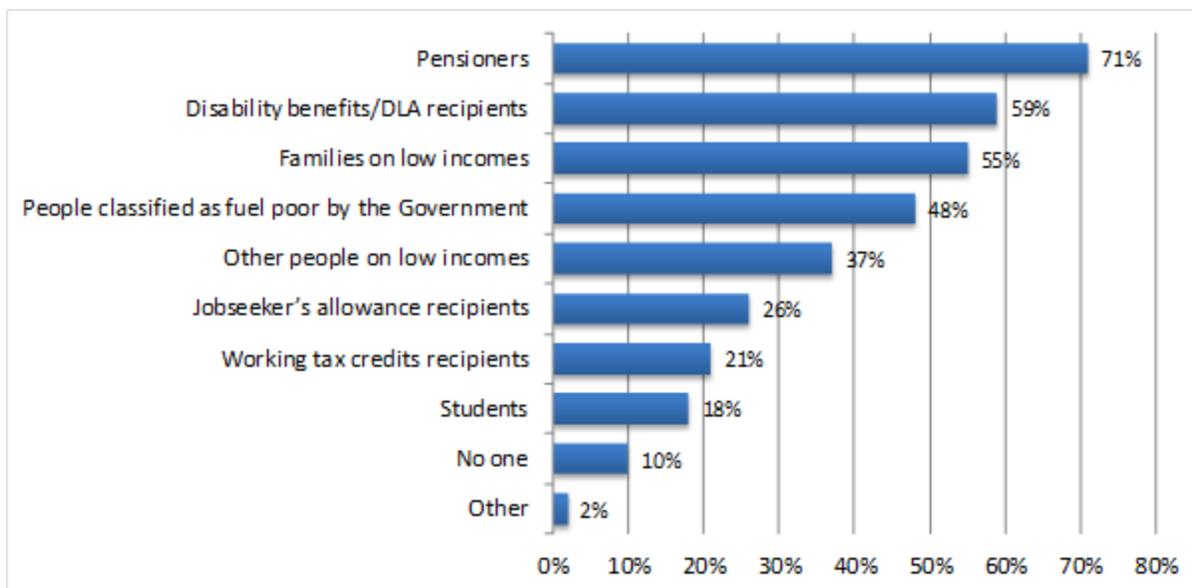
The proxy used for the research was the Cold Weather Payments recipients group<sup>59</sup>, who are more likely to have difficulties affording their energy bills and are less likely to have ever switched supplier.<sup>60</sup> Any tariff based intervention would be in addition to programmes seeking to upgrade their property's energy efficiency.

Based on omnibus polling carried out by the Citizens Advice Service in Autumn 2014, our chosen proxy group is a close fit with consumer views on which groups should benefit from additional tariff protection.

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<sup>59</sup> The current eligibility criteria for Cold Weather Payments are set out here. <http://tinyurl.com/mnbxchl>

<sup>60</sup> There is likely to be significant crossover with the groups that the CMA identified through its GFK survey as those who are more likely to be failing to switch eg those aged 65 or over, those in social accommodation, those with no qualifications and those on lower incomes.



*Groups of people believed to be most entitled to receive a special cheaper tariff price (Source: GFK omnibus survey for the Citizens Advice Service; multiple answers allowed, hence total exceeds 100%). Fieldwork carried out between 17 November and 9 December 2014. Sample size: 7,816.*

CSE held a January workshop with market participants, including a CMA representative, to discuss 10 potential options. Following the workshop, CSE carried out further modelling work on three options: a backstop tariff that would match the cheapest price offered by that supplier; an extended and enhanced Warm Home Discount scheme and removing social and environmental costs from the target group's bills. Key to each of these options was the expectation that the identified consumer would be automatically opted in to avoid creating another barrier.

The modelling work carried out by CSE is attached as an appendix and demonstrates the potential impact on the target group of households. This work is an initial exploration of the possible options and the impacts on the target groups. It has not been possible to model the likely impacts on consumer behaviour or supplier behaviour.

### **Price comparison websites**

We agree with the CMA that price comparison websites ('PCWs') are increasingly important in providing domestic customers with a means of participating in the energy market. Energy PCWs play a crucial role in helping consumers to engage in the market and make informed decisions about switching energy supplier. It is important that the websites deliver a reliable and trustworthy service to consumers, and are fully transparent about the service they provide. Any recommendations made by the CMA should not undermine the core consumer protection objective of ensuring consumers receive a reliable and unbiased service.

As identified in the working paper, the importance of PCWs to energy suppliers as a source of obtaining customers varies between suppliers. PCWs also face competition from other sales

channels for customer acquisition such as collective switching schemes and from suppliers' own websites and outbound telesales activity. The PCWs are competing against each other, have different market shares, and are targeting different market segments based on their business models. For example, some sites focus solely on the energy market, while others offer price comparisons across regulated markets (energy, financial services, communications) and unregulated markets such as holiday flights. The market is currently dominated by the so called 'Big Four', i.e. MoneySupermarket, GoCompare, Confused.com, CompareTheMarket, only one of which is accredited by Ofgem.<sup>61</sup> The specialist energy comparison sites have a much smaller share of the market<sup>62</sup>.

In addition, the quality of service provided by PCWs varies. For example, our mystery shopping research found that not all comparison websites performed equally well on reliability and transparency criteria, and the level of savings offered. Only 20 per cent of investigated PCWs offered a saving over and above what was available from suppliers' own websites.<sup>63</sup>

The Citizens Advice Service recognise the need to strike a balance between fostering trust and promoting confidence in the use of PCWs in the energy market, and ensuring that PCWs have a commercial incentive to remain in the market and help improve customer engagement. It is crucial, however, that the core consumer protection objective of ensuring consumers receive a reliable and unbiased service is not undermined in anyway.

There would arguably be greater consumer benefits associated with having a smaller number of PCWs offering a comprehensive, transparent and accurate service to consumers as opposed to a large number of sites offering partial comparisons at risk of being influenced by commission arrangements. It is worth highlighting that in many other European countries, equivalent price comparison services are operated on a not for profit basis by consumer groups or the national energy regulator to ensure the services provided by PCWs are impartial, reliable and accurate.<sup>64</sup>

#### *Whole of market versus partial comparisons*

In relation to the availability of whole of market comparisons, we are pleased that the regulator has strengthened the protections for consumers in this area. We would like to see the requirements strengthened further, with all sites defaulting to showing the entire market, instead of requiring consumers to choose between the two options. Behavioural economics research suggests that consumers are less likely to actively change default settings and companies exploit it to their advantage.<sup>65</sup> In addition, our own research indicates that consumers using PCWs have limited understanding about ranking criteria and the way suppliers included in the ranking are selected, and rely on PCWs to provide them with accurate and reliable

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<sup>61</sup> <https://www.ofgem.gov.uk/information-consumers/domestic-consumers/switching-your-energy-supplier/confidence-code>

<sup>62</sup> The exception are the sites which power the switching service used by the white label sites.

<sup>63</sup> <http://www.consumerfutures.org.uk/files/2013/05/Comparing-comparison-sites.pdf>

<sup>64</sup> In Austria, Belgium, France, Portugal, Slovenia, Spain and Sweden energy regulators run their own price comparison services to ensure information impartiality, reliability and accuracy. See Council of European Energy Regulators, 'Price comparison tools: case studies,' October 2011. <http://tinyurl.com/pnbapl3>

<sup>65</sup> <http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-1.pdf>

information.<sup>66</sup> Therefore, given the low level of consumer awareness of the implications of their decision, the burden should not be placed on consumers to make an active decision to show all available tariffs.

If the consumer's preference is to only see results for tariffs that they can switch to via the site – for ease of use - then we agree that this should be a proactive choice made by the consumer. We note that some sites have decided to default to show all tariffs on the market, although it is unclear whether this will be a permanent change to their process. We hope that other accredited (and unaccredited) sites will follow suit.

We acknowledge the concerns raised in the working paper by the CMA about the ability of suppliers to free ride via PCWs as a result of Ofgem's Code change. However, free-riding is a known risk of PCWs' business models, and some PCWs generate income not just through paid commission for a completed sale or switch, but also through advertising revenues, adverts and sponsored links. Some sites currently display all available tariffs by default.

Free-riding is also prevalent amongst consumers with many using sites to carry out a price comparison and then contacting their preferred supplier direct. Our research indicates that this behaviour is because some consumers are confused by the variation in displayed deals on PCWs, despite inputting the same search parameters.<sup>67</sup> The CMA survey evidence also highlights this issue, it suggests that one reason for checking multiple sites is to compare and verify results. As consumers do not trust one particular site, they feel the need to use several sites, or indeed revert to double checking results on suppliers' websites which is time consuming and not in their best interest.<sup>68</sup>

We believe that a requirement to bring all unaccredited energy sites within the Confidence Code scheme is likely to decrease the level of free riding by consumers. The reduction of data manipulation and bias will decrease the need to cross check information on multiple sites, and in turn will contribute to the rising consumer trust in PCWs. Although some energy suppliers may still choose to refrain from entering commission agreements with some PCWs, expanding the Confidence Code will introduce a fairer competition between accredited and non-accredited sites. We believe it will lead to improvement of the current market practices, as all sites will have to abide by the Code's rules, rather than the rules dictated by exclusive vertical agreements struck between suppliers and a handful of PCWs.

In addition, any potential reduction in the commission revenues from energy suppliers is also likely to lead to PCWs diversifying their revenue streams by developing new value added services of benefit to consumers.<sup>69</sup> This could also have a positive impact on service quality, as

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<sup>66</sup><http://www.consumerfutures.org.uk/files/2013/07/Price-Comparison-Websites-Consumer-perceptions-and-experiences.pdf>

<sup>67</sup><http://www.consumerfutures.org.uk/files/2013/07/Price-Comparison-Websites-Consumer-perceptions-and-experiences.pdf>

<sup>68</sup> Ibid

<sup>69</sup> The rollout of smart meters and easier access to granular consumption data is predicted to speed up innovation of intermediaries and the development of next generation intermediaries

PCWs will need to work harder to attract and retain customers, rather than purely focusing on chasing the commission from energy suppliers.<sup>70</sup>

If PCWs are required to show all tariffs by default there is a strong incentive for energy suppliers to compete more strongly on price. In the working paper, CMA evidence shows that the PCW channel is an important and essential route to market for some suppliers, especially in light of the demise of doorstep selling. Recent data from GfK shows that nearly 8 in 10 of internet switches are via comparison sites with 16% via own supplier sites.<sup>71</sup> Requiring PCWs to show all tariffs by default should encourage further competition amongst suppliers to be top of the table.

### *Expanding the scope of the Code*

Related to this is the need to bring all channels used by PCWs within the Code including telesales and, in the future, face to face sales. This view is shared by the ECCC, in their recent report they recommend that Ofgem applies the same level of transparency and accuracy requirements to telesales, collective switching schemes and face-to-face sales.<sup>72</sup> Expanding the Code will ensure consistency of results and provide reassurance to consumers that it is safe to engage with these sales channels. For households without internet access, these channels are the best way to obtain a comprehensive price comparison quote. We are aware that Ofgem is working on these issues and urge the regulator to move quickly on these areas. Additionally, as stated in our response to Ofgem's consultation *Domestic third party intermediaries: Confidence Code and wider issues*, we believe that consumers should receive the same level of protection and access to redress regardless to how they engaged with a TPI when switching energy supplier.<sup>73</sup>

The working paper acknowledges that each PCW cannot be expected to produce entirely consistent search results given the differences in methodology used. For example, calculating seasonal consumption values, as the regulator has not been prescriptive about how this should be done. We recognise Ofgem's decision to require accredited sites to use the Personal Projection methodology when calculating the cost for consumers of both current and potential new tariffs. We note that sites will be able to provide consumers with the option of alternative calculation methodologies and that sites can compare the relative cost of tariffs based on current prices only. We have recommended that Ofgem keeps a close eye on how this area manifests itself on sites as it could be an area for potential consumer confusion.

Ofgem, in their decision paper of January 2015,<sup>74</sup> state their intention to explore next steps regarding supplier-TPI information flows. The key barrier to new companies looking to enter this

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<sup>70</sup> We have illustrated potential scenarios on the development of next generation intermediaries in two reports: <http://www.consumerfutures.org.uk/files/2014/01/Next-Generation-Intermediaries.pdf> and <http://www.consumerfutures.org.uk/files/2014/01/The-Rise-of-the-Consumer-Empowering-Intermediary-Ctrl-Shift.pdf>

<sup>71</sup> GfK quarterly energy monitor, Q4 2014

<sup>72</sup> <http://www.publications.parliament.uk/pa/cm201415/cmselect/cmenergy/899/899.pdf>

<sup>73</sup> [http://www.citizensadvice.org.uk/index/policy/policy\\_publications/er\\_fuel\\_water\\_post\\_digital\\_telecoms/cr\\_fuel\\_water\\_post\\_digital\\_telecoms/citizens\\_advice\\_response\\_to\\_ofgem\\_s\\_consultation\\_on\\_domestic\\_third\\_party\\_intermediaries.htm](http://www.citizensadvice.org.uk/index/policy/policy_publications/er_fuel_water_post_digital_telecoms/cr_fuel_water_post_digital_telecoms/citizens_advice_response_to_ofgem_s_consultation_on_domestic_third_party_intermediaries.htm)

<sup>74</sup> <https://www.ofgem.gov.uk/publications-and-updates/confidence-code-review-january-2015-policy-decision>

sector is obtaining access to historical tariff data. Companies normally have to enter into arrangements with an existing PCW to get access to the data. If the data was freely available it could potentially lead to greater competition in this market and the development of innovative new services. Our suggestion concerning this issue is that Ofgem should publish all supplier tariff prices on its website.

Separately we would also like to see improvement in the price comparison quotes available on supplier websites. Some suppliers do not even quote against the consumer's existing tariff or have a much more simplistic means of estimating usage. We have already suggested to Ofgem that their next focus should be on ensuring suppliers provide an improved price comparison to address the gap between the two comparison methods.

In summary, our view is any proposals to weaken the consumer protection assurances of Ofgem's existing Code risks undermining further consumer engagement with the energy market. Any policy interventions taken by the CMA need to lead to better outcomes for consumers and increased consumer confidence in PCWs. Furthermore, we want to see the protections available to consumers in the energy sector expanded out to other regulated markets, as opposed to a reduction in the current protections. For example, our mystery shopping survey indicated that PCWs accredited by the Confidence Code on many criteria performed better than non-accredited ones.<sup>75</sup>

### **Small business consumers**

The CMA has identified a number of areas where the market does not appear to be working effectively for small business consumers.

The current system of regular re-contracting represents something of a risk to small businesses as their disengagement with the market can mean they can be rolled over onto expensive, fixed term contracts or, even worse, end up using deemed or out-of-contract rates in an effort to gain some flexibility. We have had longstanding concerns about deemed and out-of-contract rates, particularly as the 'voluntary' ban on auto-rollovers was not accompanied by parallel reforms to ensure that deemed/out-of-contract pricing accurately reflected the risks to suppliers. We agree that this should be a priority area for further analysis by the CMA.

The lack of price transparency in this market makes it more difficult for these consumers to quickly compare and switch their energy supply, which was raised as a concern by Ofgem, FSB and us. Higher search costs are much more of a barrier to engagement. The end result of this situation appears to be a large percentage of micro-businesses remaining on poorer value tariffs. The CMA highlights that only 33% of electricity consumers (29% gas) are on acquisition tariffs.

As with the domestic market, we're keen that the CMA establish whether different categories of micro-businesses or those operating in certain sectors are more likely to face difficulties

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<sup>75</sup> <http://www.consumerfutures.org.uk/files/2013/05/Comparing-comparison-sites.pdf>

engaging and/or obtaining fair prices. The domestic market is highly segmented, with some consumers able to switch to attractive offers, while others struggle to engage. The micro-business market is likely to share many of these characteristics, with some consumers considered to be more attractive than others. Some key differences, however, are that there is no duty to supply a micro-business consumer nor are these consumers able to carry out a comprehensive or transparent price comparison to understand whether the prices they are currently paying are competitive.

The Citizens Advice Service recently commissioned qualitative research looking at how different groups of small businesses engage with regulated markets which found that sole traders, home based businesses, rural businesses, and businesses without access to the internet were more likely to have difficulties engaging.<sup>76</sup>

### *Higher margins*

It is notable that despite superficially greater levels of competition in the non-domestic market, as measured by the number of active suppliers and lower market shares held by the former incumbents, this does not appear to have translated into more competitive prices for consumers, with margins in the SME segment being much higher than the margins achieved in the domestic or industrial and commercial segments.

We would be interested in knowing why, despite already being higher, SME margins have further increased in the period analysed by the CMA. We would want to see how these relate to the costs to serve these consumers.

### *Lack of price transparency*

We think that the lack of price transparency is a key barrier to engagement by micro-businesses. The process of shopping around for a new contract is more time consuming and there are limited public benchmarks to compare prices against.

Even those customers who use TPIs are not able to obtain a comprehensive view of the market as the flow of information will be controlled by the broker. In contrast, domestic consumers using a PCW will be able to pull up results for all available domestic tariffs meeting their specific requirements.

We recognise that some suppliers do publish some tariff prices already but that there is no consistency or comparability and so the gains for consumers are very limited: all suppliers must publish for any potential benefits to be realised.

It is our view that the prices offered to micro-businesses by individual suppliers will be standardised given that there would be limited incentive on suppliers to provide bespoke tariff

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<sup>76</sup>[http://www.citizensadvice.org.uk/index/policy/policy\\_publications/the\\_experiences\\_of\\_small\\_businesses\\_as\\_consumers\\_in\\_regulated\\_markets.htm](http://www.citizensadvice.org.uk/index/policy/policy_publications/the_experiences_of_small_businesses_as_consumers_in_regulated_markets.htm)

prices for typical micro-business consumers in profile classes 3 & 4. However the fact that these prices are not in the public domain, may lead consumers to believe that the supplier or broker is offering them a bespoke tariff rate.

The CMA notes that suppliers have said that prices will vary depending on the consumer's credit worthiness. The next stage of the CMA's work should seek to shed some further light on this issue so that its materiality and consequences can be understood.

### *TPIs*

TPIs are prevalent in the non-domestic market due to the lack of price transparency. The CMA paper identifies the lack of trust many SMEs apparently have in TPIs or other brokers. This is something borne out in our consumer data and research over the years and why we have strongly supported the development of Ofgem's TPI Code of Practice as it will help drive out the minority of poorly performing TPIs who can cause significant detriment for businesses.<sup>77</sup> We note that Ofgem has recently announced that it will delay its work on the Code due to the CMA investigation.<sup>78</sup>

The paper also identifies that TPIs are more likely to target larger businesses, which makes sense as the margins associated with negotiating a new contract are likely to be more attractive. This is more evidence that micro-businesses find it difficult to shop around for new tariffs, and may help explain why so many micro-businesses are currently on unattractive tariff rates. Again we believe this highlights issues with the lack of price transparency for this market segment.

### *Complaint handling*

Another area where we think there are similarities with the domestic market, is general dissatisfaction with the complaint handling process provided by suppliers.

The non-domestic market actually fares slightly worse than the domestic market in Ofgem's 2014 complaint handling research. It found that micro-businesses contacted their supplier an average of nine times about their complaint (compared to six times for the average domestic consumer). Only 52% of micro-business consumers were satisfied with the handling of their complaint, compared to 57% of domestic consumers. Only 53% of micro-business consumers felt their supplier had resolved their complaint.<sup>79</sup>

In our report on the state of billing 10 years after the energywatch super-complaint, we've raised concerns about the high levels of direct complaints in the sector and low levels of satisfaction with suppliers' complaint handling performance. We do not think that suppliers are subject to

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<sup>77</sup> <http://webarchive.nationalarchives.gov.uk/20130402174410/http://www.consumerfocus.org.uk/files/2011/03/Watching-the-middlemen.pdf> and <http://www.consumerfocus.org.uk/publications/under-the-microscope-reviewing-the-micro-business-energy-market> and <https://www.ofgem.gov.uk/ofgem-publications/94051/nondomquantfinalv4-pdf>

<sup>78</sup> <https://www.ofgem.gov.uk/ofgem-publications/93764/openletterpipprinciplesmarch2015forweb-pdf>

<sup>79</sup> <https://www.ofgem.gov.uk/ofgem-publications/90427/ofgemcomplaintsreportfinal8august2014.pdf>

sufficient incentives to improve the level of customer service provided due to the weak competitive pressure.

### *Rollover contracts*

As with the domestic market, where the regulator had to impose a new requirement forcing suppliers to provide customers with the name of their tariff on their energy bills, Ofgem has had to impose rules on micro-business suppliers requiring them to put contract end-dates on bills. It is notable that all suppliers had not voluntarily provided this key information on customer bills.

We would like to understand the impact of the new rollover process and contract termination process on the market given that different suppliers are now following different practices. We favour a ban on rollover contracts and consider it would be preferable to the mish-mash of (voluntary) agreements that currently exists. We are concerned that Ofgem's compromise on rollovers has resulted in more confusion and thus potentially less engagement.<sup>80</sup>

There are clear benefits to consumers associated with having a common and easily understood process. It would be helpful if the CMA could analyse whether putting in place a 30 day notification period before a consumer can terminate their contract, is having an impact on consumer behaviour and engagement levels. For a consumer who is already struggling to compare prices, this further barrier may be the reason why they decide just to stay put.

We hope that the CMA will be able to draw conclusions about the interplay between limited price transparency, engagement levels, overall customer satisfaction, contract types and supplier margins. The interlocking relationship between these key variables will be crucial towards understanding whether there is adequate competition in the micro-business market.

### **Risks associated with poorly prepared market entrants**

Whilst we welcome the increasing competitive pressure on the Big 6, as a result of the increasing market share of independents, an ongoing concern for the Citizens Advice Service has been the lack of preparation demonstrated by various suppliers after their launch. We acknowledge that there is a balance to be struck between ensuring new market entrants are able to acquire a licence in a timely fashion and ensuring there is an appropriate level of consumer protection, we are not convinced that the current balance is working. We have had ongoing exchanges with Ofgem about the need to introduce a more formal compliance regime, including a risk based framework, to help support licensees in understanding their regulatory obligations. The current licensing process appears to give no active consideration to the applicant's proposed business model or its knowledge of the energy supply market.

Our predecessors have had to refer several small suppliers to Ofgem over their failure to achieve basic compliance with key licence requirements and other regulations. This followed

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<sup>80</sup><https://www.ofgem.gov.uk/publications-and-updates/decision-automatic-rollovers-and-contract-renewals-micro-business-consumers>

extensive attempts to work collaboratively with the companies to help them address these deficits.

[✂]

We believe a best practice regime would include the following processes for new applicants:

#### Assessing financial suitability of applicants

- The ability to launch
- The ability to have a sustainable business
- The suitability of the financial backing/partners

#### Analysing the applicant's business case

- Looking at potential consumer/vulnerability issues
- The capability and experience of senior employees and any possible lack of industry expertise
- Highlighting their key licence obligations
- Greater handholding to confirm their understanding of the licence requirements
- Embed the ethos and expectations of the regulator into the applicant's business

#### Regular contact to ensure the new licensee is managing its responsibilities appropriately

- Early warning provided to the licensee when any questionable practises are identified through routine monitoring

This would also help ensure that consumers do not suffer detriment as a result of poorly prepared suppliers. Suppliers seeking to enter the market undergo extensive testing to ensure they cannot harm the industry systems for trading gas and electricity. They do not undergo comparable formal testing or proactive audits to ensure their customer service processes are fit for purpose and the company is aware of its regulatory obligations, including the treatment of more vulnerable consumers. The knock-on effects on consumers of a poorly prepared new entrant can be severe, with some households and businesses having their energy supply disconnected, being left with unaffordable shock bills or suffering the stress of being unable to get their complaints resolved for extended periods of time.

In each of these cases, much of the consumer detriment could have been avoided if there was an additional step taken by Ofgem prior to the companies' formal launch. This process would assess their readiness, the scalability of their systems, and their understanding of their regulatory obligations.

In addition, we believe the introduction of a fit and proper person test<sup>81</sup>, which exists in other sectors, would also be a useful tool. We have concerns that some other new entrants may be inadequately prepared to comply with licence requirements.

### **Changes to tariff structures and the impact on low gas users**

There have been regulatory interventions which can cause perverse outcomes for some groups of consumers and the wider market. An example was the shift by suppliers to transfer consumers from two tier tariffs to tariffs composed of a unit price and standing charge, as required by the Retail Market Review changes. The change resulted in affordability problems for some consumers, which was something we had predicted.<sup>82</sup>

Since that time, Ofgem has provided further clarification on deemed contracts where there has been no consumption and indicated that it would accept targeted derogation applications from suppliers to provide support to consumers in this situation.<sup>83</sup> We would still like to see suppliers be more proactive at identifying these consumers.

### **[New] Theory of harm 5: the broader regulatory framework, including the current system of code governance, acts as a barrier to pro-competitive innovation and change**

We agree with your decision to include the current system of code governance as a theory of harm. The proliferation of codes, their complexity and the resource intensiveness of the change process create barriers to entry and to engagement. The codes' change processes can cater for limited, incremental change (though even this can sometimes become protracted) but act as a barrier to more material reforms. While Ofgem's Significant Code Review process was intended to remove that barrier, it is not clear that it has worked; the pace of major reviews has been extremely slow.

To help diagnose structural deficiencies it might be useful for the CMA to identify reforms that, in a competitive market, might have been expected to have emerged organically from the codes process but have not: what does not get raised, and why? Why, for example, modifications to substantially reduce the time it takes for consumers to switch only came forward as a result of pressure from Government and Ofgem. It appears to us that a plausible explanation is that the complexity and resource intensiveness of the process hinders the ability of challenger firms to progress modifications that would presumably be to their benefit.

We consider that the lack of alignment between the code objectives and Ofgem's statutory duties is contributing to the issues the CMA identifies in the codes paper. While Ofgem's principal duty is to protect the interests of current and future consumers, the code objectives themselves make no reference to consumers and the debate on proposals to change the codes

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<sup>81</sup> <http://fshandbook.info/FS/html/FCA/FIT>

<sup>82</sup> <http://tinyurl.com/pf35y5q> and <http://tinyurl.com/oalv47f>

<sup>83</sup> <https://www.ofgem.gov.uk/ofgem-publications/88276/openletter-treatmentoflowandzeroconsumersofgas.pdf>

often revolves around process rather than outcomes. This gap disenfranchises consumer representatives, discourages industry from thinking through the consequences of what change may mean for their customers, and defers consideration of the consumer impacts of proposals until later in the process, normally after the codes process has finished and a proposal has been sent to Ofgem for decision. Consideration should be given to giving each code a consumer objective against which the benefits (or disbenefits) of proposals should be assessed.

For further details on these points, please see the attached paper on codes.

### **Other issues: network price controls**

To date, the CMA's investigation has ignored the gas and electricity network price controls. We consider this a mistake, and argued in an earlier submission that 'we consider there to be prima facie evidence that energy price control settlements have tended to over reward the providers of monopoly network infrastructure and that this should be tested as a theory of harm.'

We were surprised to be asked no questions in relation to the price controls when we were called to give evidence before the inquiry team on 30 October, given that it was the concern we gave most prominence in our response to the initial issues statement. When asked if there were any matters we wanted to raise at the end of that session, we asked if you were considering including networks in the scope of the investigation following this feedback and were simply told that you were 'alive to the issue' and that it would be captured in the transcript and, by implication, considered.

We can see no evidence from the updated issues statement that the CMA has given any consideration to this matter. We recognise that the CMA is not bound by the feedback it receives and may legitimately disagree with stakeholders on whether any given matter should be given consideration. But we consider that there is a basic requirement on the CMA, as with any other statutory body, to explain its thinking, and to show evidence that it has considered the views of stakeholders even if it disagrees with them. This has not happened. You are unlikely to assuage public concerns if you do not address them.

Since our earlier submissions, we have seen two major further events in relation to the network price controls. First, the Energy and Climate Change Committee has released its report on the network price controls<sup>84</sup>. It suggests that over-remuneration is a problem, and that there should be an interim independent review of whether they offer consumers value for money. Secondly, two parties, one a supplier, the other a network, have appealed the proposed 'slow track' electricity distribution price control settlements for 2015-23<sup>85</sup>. One appellant argues that the slow track distribution companies are being over-rewarded to the tune of £1.369bn. In its own report, ECCC argued that a possible miscalculation of what would be the efficient costs of the 'fast track' electricity distribution network, WPD, may cost consumers £860m too much.

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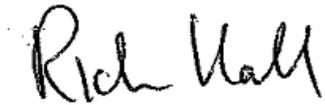
<sup>84</sup> ECCC, 'Energy network costs: transparent and fair,' 23 February 2015. <http://tinyurl.com/mdt3x6d>

<sup>85</sup> CMA, 'CMA receives two appeal applications over electricity distribution network price controls,' 4 March 2015. <http://tinyurl.com/jwhavoh>

We agree with the ECCC that an independent review would be merited. The obvious candidates to conduct such a review are either the CMA, or the National Audit Office. As a consequence of the appeal, the CMA will be considering some of the energy price controls in the coming months in any event. We think it should broaden its inquiry to consider whether the overall price control arrangements are offering consumers' value for money.

We trust this submission has been helpful and clear. We would be happy to discuss any matter raised within it in further detail if that would be helpful. If so, please contact Richard Hall on [X].

Yours faithfully



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Citizens Advice



**Sarah Beattie-Smith**  
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Citizens Advice Scotland

Attached papers:

- 1) Review of the retail market issues raised by the CMA (Draft report. Final report will be submitted to CMA in due course).
- 2) Summary of energy trust polling.
- 3) Improving the energy industry codes.
- 4) Report from the Centre for Sustainable Energy: 'Energy tariff options for consumers in vulnerable situations.' (Draft report. Final report will be submitted to CMA in due course).
- 5) Energywatch supercomplaint +10 (Draft report. Final report will be submitted to CMA in due course).