

Maxine Frerk  
Ofgem  
9 Millbank  
London  
SW1P 3GE

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Dear Maxine

### **A market investigation into the energy market**

The public has lost confidence in the energy market<sup>i</sup>. Polling suggests consumer trust in the UK energy sector is lower than in other UK sectors, and in the same sector overseas<sup>ii</sup>. Consumers overwhelmingly distrust energy suppliers to tell them the truth<sup>iii</sup> and don't understand what goes in their bills<sup>iv</sup>. Too often basic customer service processes go wrong and complaint volumes are rising<sup>v</sup>. Consumers in distress contact us in ever greater numbers<sup>vi</sup>.

Energy bills have risen much faster than inflation<sup>vii</sup> and are the number one concern of consumers<sup>viii</sup>. But despite there never being a greater need for engagement, switching rates are declining<sup>ix</sup> and nearly two-thirds of consumers have still never switched<sup>x</sup>. The loss in competitive pressure is resulting in steadily expanding margins<sup>xi</sup> and the ability for suppliers to pass through increases in costs more readily than they pass through decreases in costs<sup>xii</sup>.

It is little surprise that consumers want to see tougher regulation and greater scrutiny of the market. 80% of consumers want to see a referral of the market to the CMA while only 5% do not<sup>xiii</sup>. 73% of consumers want to see tougher regulation of the sector while only 2% do not<sup>xiv</sup>. While the popularity of intervention is not in itself an argument for intervention, it is symptomatic of the lack of public faith that the market is acting in their interests.

The causes of this loss of trust are multiple, with supplier behaviour and transparency among the major causal factors. Poor face-to-face sales standards resulted in many consumers experiencing mis-selling, an issue that eventually became so toxic that it resulted in a voluntary end to doorstep sales by most major suppliers, multiple enforcement penalties<sup>xv</sup> and one supplier facing court convictions<sup>xvi</sup>. Badly explained and configured tariffs have made switching decisions unnecessarily difficult. Complaint handling standards remain variable and, in some cases, unacceptably poor. The sector is starting to make progress in some of these areas, but it will take time to rebuild consumer confidence.

While efforts have been made to improve the transparency of the sector in recent years it remains opaque and consumers lack confidence that the price they pay for power and gas is

fair. Suppliers routinely attribute price movements to some combination of wholesale cost, network cost and/or social and environmental cost changes but the publicly available data often does not support their statements. There remain genuine question marks over whether it is appropriate for suppliers to deliver some environmental and social schemes. In some cases, such obligations result in clear conflicts of interest – for example, between their commercial incentives to sell more energy and their policy obligations to reduce energy consumption<sup>xvii</sup>. In other cases, it is questionable whether supplier-led delivery is more cost-effective than other models might be – for example, in rolling out smart metering. Policy delivery decisions may be distorting the market. While consumers are increasingly switching to smaller suppliers<sup>xviii</sup>, it is not clear whether this plurality is being artificially stimulated as an unintended consequence of policy cost exemptions – or whether it is genuinely sustainable.

## The scope of the referral

We think the investigation should concentrate on four key themes:

First, **ensuring the market works for all consumers, both domestic and non domestic.**

Analysis needs to drill down beyond the notional average consumer to look at the circumstances affecting different types of consumer. This must include those who differ from the norm for reasons of payment method (such as prepayment meter users), type of metering, type of tenancy, and main fuel source for heating, as well as protected characteristics, vulnerability, region, and customers in the devolved nations affected by devolved policy<sup>xix</sup>.

Energy is an essential service, and the CMA needs to be confident that the market works for all consumers, not simply those in favoured segments. If it is not, the CMA needs to identify if the problem is that the market is not currently serving some groups but could with structural reforms that it could make, or if the problem is deeper and that these groups are fundamentally unlikely to ever be well served by the market. If some vulnerable groups are so disengaged that no competitive remedy is likely to ever reach them, it should give consideration to whether ‘backstop tariffs’ or other mechanisms are needed for their protection.

Second, the **delivery of social and environmental programmes.** Though these schemes are mandated by Government, we have deep concerns that using suppliers for their delivery creates competitive distortions, diminishes trust and transparency, and is a fundamental conflict of interest. Because of the costs in setting up processes to comply with these schemes, exemptions exist for smaller suppliers. While an unintended consequence is that this may be helping market entry, it may also be distorting the market and it is unclear that this approach is sustainable in the longer term. The costs of delivering these schemes are opaque and have become a disputed matter, particularly around price rise announcements where they are increasingly blamed by suppliers for price inflation<sup>xx</sup>. The inquiry will need to give the public confidence that they are not being used as scapegoats. Suppliers’ fundamental business proposition is selling energy – and with efficiency schemes they are being tasked to destroy that market. Does this result in the right incentives to ensure cost-effective successful scheme delivery?

The area of social and environmental programmes is the one specific area where we suggest that you should clarify your proposed Terms of Reference (‘ToR’). The draft ToR define the

market in terms of the ‘the supply and acquisition of energy in Great Britain’. We think that the delivery of these schemes falls within that definition but it would be helpful if you could more unambiguously make this point in your final referral notice. It will also be important to consider any impact of energy efficiency schemes funded by the Welsh and Scottish Governments on the supply market.

Thirdly, **competitive intensity**. Ofgem has identified evidence of tacit co-ordination in pricing movements, and of asymmetric pass-through of changes to supplier costs – with hikes passed on more readily than drops<sup>xxi</sup>. Its supply market indicators suggest a sustained medium term increase in the profitability of supply activities<sup>xxii</sup>. Such evidence implies a market characterised by soft competition, with insufficient pressure on suppliers to compete margins away. The CMA must identify and tackle the causes of this. It should consider whether vertical integration is acting in the public interest or is contributing to a foreclosed market. It should identify and tackle barriers to entry that may protect incumbents from rivalry or foreclose the entry of new challengers or disruptive forces to the current models. This should include credit rules and the complexity of market arrangements. It should also consider whether the large volumes of ‘sticky’ consumers inherited by the former regional monopolies give an unfair advantage to incumbent suppliers in specific regions or devolved nations – and if so, how this should be removed.

Finally, the CMA needs to improve **trust and transparency** in the sector. The public lacks confidence that the prices they pay are fair. A major contributory factor is the lack of transparency on the underlying cost drivers that move retail prices, which has resulted in a toxic cycle of claim and counter-claim. The inquiry needs to equip the public with the tools to break this cycle<sup>xxiii</sup>. The current lack of trust in the sector means fewer consumers willing to engage in the market, consumers accepting poor or inadequate service as standard and low satisfaction levels<sup>xxiv</sup>, all of which ultimately reduces the competitive intensity of the market. Whilst the RMR reforms may improve consumers’ general energy literacy, they are unlikely to tackle low levels of trust in the sector.

Citizens Advice has been calling for an independent investigation into the energy market since 2007. Increasingly, suppliers themselves have come to welcome the opportunity it would provide to clear the air<sup>xxv</sup>. It is hard to credibly argue that an investigation would cause investment uncertainty when the sector is so politically and publicly disliked that chronic uncertainty already exists. It is more credible that an investigation will actually reduce investment uncertainty, by providing a mechanism to find answers to the deep-seated problems that have plagued consumer experience of the sector. Consumers deserve better.

This submission is entirely non-confidential and may be published on your website. It represents the joint position of Citizens Advice and Citizens Advice Scotland. We would be happy to discuss any issues raised by it in more depth if you would find this helpful.

Yours sincerely

**Audrey Gallacher**  
Director of Energy

Direct dial: 03000 231329

Email: [audrey.gallacher@citizensadvice.org.uk](mailto:audrey.gallacher@citizensadvice.org.uk)

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<sup>i</sup> YouGov polling in September 2013 found that 56% of people agreed that “energy companies treat people with contempt” while only 7% disagreed. 83% felt energy suppliers maximise profits at the expense of customers <http://tinyurl.com/qbjq3jq>. Subsequent YouGov polling published in April 2014 suggested only 7% of consumers trust the utilities industry to focus on the best interests of its customers and wider society <http://tinyurl.com/ol9amsq>. In November 2013 the Which? Consumer Insight Tracker suggested that only one-in-seven consumers’ trust energy companies to act in their best interests. <http://tinyurl.com/nkh7dww>. In a February 2013 uswitch poll, 45% suggested their levels of trust in energy suppliers had decreased in the preceding two years, while just 10% suggested it had improved. <http://tinyurl.com/op59g23>

<sup>ii</sup> The 2014 Edelman Trust Barometer found that the UK has the highest incidence of public distrust in the energy industry of any country surveyed, with a net trust percentage of -23% compared to a global average of +32%. It was the joint least trusted sector in the UK, alongside banks. <http://tinyurl.com/lzx2fuc>

<sup>iii</sup> In December 2013 YouGov reported that only 3% of the public fully believed suppliers’ explanation for price rises, while 30% only partially believed it, and 57% did not believe their justification. <http://tinyurl.com/nucmfom>

<sup>iv</sup> Polling conducted by MVA for Consumer Focus in 2012 suggested that 67% of the public were unaware that social and environmental obligations were paid for through their energy bills (sample size: 798). In separate deliberative workshops conducted as part of the same project, we found consumers had little awareness of the proportion of bills that was attributable to social and environmental policies. “Who Pays?”, Consumer Focus 2012. <http://tinyurl.com/k372rc>

<sup>v</sup> The Energy Ombudsman received 17,960 complaints in 2013 – a 59% increase on the preceding year (11,283). It reports that complaints in the first three months of 2014 are 224% up on the equivalent months in 2013. <http://tinyurl.com/lco7any>. Citizens Advice analysis of supplier complaints at the Big 6 suggest these increased by more than half in 2013 from 54.4 (January) to 88.7 (December) per 100,000 customers. <http://tinyurl.com/mqnk2x5>

<sup>vi</sup> Citizens Advice Bureaux received 49,142 contacts in relation to fuel issues in 2013/14 – a 21% increase on the preceding year (40,560). There were increases in price and tariff issues (+14%), switching supplier (+35%), billing/meter issues (+25%) and selling methods (+16%).

<sup>vii</sup> Our analysis shows that the average dual fuel household bill increased by 112% between January 2005 (£594) and January 2014 (£1,257) even after allowing for reductions in the average level of consumption in that time. <http://tinyurl.com/khdh22r>

<sup>viii</sup> The Which? Consumer Insight Tracker shows that 75% of consumers are worried about energy prices (April 2014) – more than any other category of consumer concern. <http://tinyurl.com/k2vz8lu>. YouGov polling in September 2013 found that consumers felt that energy prices were the biggest threat to the UK economy. <http://tinyurl.com/qbjq3jq>

<sup>ix</sup> There was a sharp jump in switching in the last quarter, but a steady and pronounced decline in switching can be seen since 2008 in DECC’s quarterly tracking statistics. <http://tinyurl.com/o2ux9mb>

<sup>x</sup> You highlight in your assessment that “In surveys, 62 per cent of customers could not recall ever having switched supplier.”

<sup>xi</sup> The trend line – both historic, and projected – in Ofgem’s Supply Market Indicators suggests steadily widening supplier margins over time. <http://tinyurl.com/on67bk7>

<sup>xii</sup> You highlight in your assessment that “the large suppliers appear to raise prices more quickly and fully when costs increase than they reduce them when costs fall.” Statistical evidence for this is provided by your “Rocket / feather” analysis.

<sup>xiii</sup> In January 2014 as part of its quarterly tracker, GfK Energy Monitor asked 8,097 consumers “The Competition Commission (CC) is an independent public body which helps to ensure healthy competition between companies in the UK for the ultimate benefit of consumers and the economy. It conducts in-depth investigations into markets and also has certain functions with regard to the major regulated industries. Would you be in favour of a Competition Commission review of the energy market?” 80% said yes, only 5% said no. There was majority support for a referral in every demographic segment.

<sup>xiv</sup> 2014 Edelman Trust Barometer, *Ibid*.

<sup>xv</sup> Since 2010, Ofgem has imposed £39m in fines and redress penalties in relation to misselling. <http://tinyurl.com/ktwggqxh>

<sup>xvi</sup> SSE was found guilty of misselling both initially, and on appeal, at Guildford Crown Court. Its £1.25m fine is believed to be the largest ever resulting from a court case brought by Trading Standards. <http://tinyurl.com/kxtlou6>

<sup>xvii</sup> Until the end of 2012, through the Carbon Emissions Reduction Target (CERT) and Community Energy Saving Programme (CESP). Since 2013 through the Energy Company Obligation (ECO).

<sup>xviii</sup> Energy UK has reported that 40% of electricity supply switches in January 2014 were to independent (i.e. non-Big 6) suppliers. <http://tinyurl.com/lkeeglo>

<sup>xix</sup> Households in Wales are particularly loyal to SSE/SWALEC and Wales has much lower levels of switching than rest of GB. <http://tinyurl.com/q64snnk>

<sup>xx</sup> This was a particular feature of the Autumn 2013 pricing round. Please see our response to your consultation on “Rebuilding consumer confidence: improving the transparency of energy company profits” for further views on this. <http://tinyurl.com/kukn86n>

<sup>xxi</sup> *Ibid*.

<sup>xxii</sup> *Ibid*.

<sup>xxiii</sup> This should include establishing a clear metric for judging the competitiveness of our market with overseas markets – noting that most international comparisons tend to ignore the structural differences between UK and overseas tax and levy rates on bills.

<sup>xxiv</sup> Your own polling (referenced in paragraph 1.16 of the State of the Market Assessment) suggest that only 51-52% of consumers said they were satisfied with their supplier.

<sup>xxv</sup> Both EdF <http://tinyurl.com/p66n5v2> and E.on <http://tinyurl.com/lxnw7> have called for this.