

30 May 2012

**Ofgem's response to DECC's consultation on the smart meter Consumer Engagement Strategy and draft licence conditions**

We welcome the opportunity to respond to DECC's consultation on the smart meter Consumer Engagement Strategy and draft licence conditions.

As the gas and electricity market regulator we have an important role in ensuring the interests of consumers remain protected during the transition to smart metering and in the enduring framework. We will also play a key role in monitoring and, where appropriate, enforcing compliance with any licence conditions underpinning the Consumer Engagement Strategy.

It is important that the interests of consumers continue to play a central role in the Smart Metering Implementation Programme as a whole. The roll-out of smart meters has the clear potential to change the way consumers use energy. Consumers will only realise the full benefits of smart meters if they are able to understand how to use smart meters to improve the efficiency with which they use energy.

We support DECC's high level aims for the consumer engagement strategy:

- Building consumer support for the rollout by building confidence in benefits and providing reassurance on areas of consumer concern;
- Delivering cost-effective energy savings, by helping all consumers to use smart metering to better manage their energy consumption and expenditure; and
- Ensuring that vulnerable and low income consumers can benefit from the roll-out.

We recognise that there is a clear role for some coordinated and centralised consumer engagement activity. The consultation document proposes that this be undertaken by a Central Delivery Body (CDB), established and funded by suppliers in accordance with detailed licence conditions, or that suppliers voluntarily establish a CDB without regulatory requirements.

We set out below some observations on the regulated model with licence conditions, and the voluntary option that DECC is specifically consulting on. Then we briefly set out two alternative approaches that we think would better achieve DECC's policy aims.



## Detailed Licence Conditions Establishing the CDB

DECC has included draft licence conditions in the consultation document setting out the detail of how the CDB should be established, and the detail of how the CDB should function. In these licence conditions, DECC has established a high level of independence for the CDB. This independence from suppliers has some advantages, particularly ensuring that the CDB is impartial, and ensuring that it is able to focus on consumer interests.

Our key concern with this model is that the independence comes at the expense of accountability. The licence conditions do not ultimately ensure that anyone is accountable for achieving the consumer engagement outcomes. Suppliers have a responsibility to establish the CDB as set out in the licence conditions, but have very limited responsibility for ensuring that the outcomes are achieved. Should the CDB fail to deliver outcomes in an efficient and effective manner, there is no ability for government, suppliers or Ofgem to step in. We consider that this could potentially be to the detriment of consumers, who would ultimately pay for this activity through their energy bills.

## Voluntary Arrangements

The consultation document asks about the potential for a voluntary model, if suppliers decided to establish a consumer engagement body without it being mandated.

The key challenge with a voluntary model is ensuring that the appropriate incentives are in place for suppliers to achieve benefits around energy efficiency and behaviour change for all consumers, including vulnerable and low income consumers. While we see some merit in a voluntary approach, in this instance we do not think that a voluntary model without regulatory backing will be likely to provide these incentives.

We recognise, however, that suppliers are currently working towards a draft of a voluntary model for centralised consumer engagement. If suppliers do choose to establish a CDB, there are a number of principles we think it would need to meet to operate effectively, mitigate the risks, and protect the consumer interest.

- *A clear focus on the consumer interest* – It is especially important that a voluntary consumer engagement body meets the consumer empowerment and behaviour change objectives for all consumers, including vulnerable and low-income consumers. Objectives around ensuring access to consumers premises to install meters are clearly important, but must not become the sole focus for an industry-led consumer engagement body;
- *Suitable representation of consumers and other stakeholders* – Including appropriate consumer representation in the governance of a voluntary body would help ensure consumer interests are protected. Small suppliers should also be appropriately represented;
- *Impartiality* – A voluntary consumer engagement body would require suitable governance arrangements to ensure that it could operate in an impartial way and deliver impartial messages;
- *Competition law* – Suppliers would need to ensure that, in the establishment and operation of a consumer engagement body, they were complying with competition law.

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## Small Suppliers

Whichever model is chosen, an appropriate level of participation by small suppliers in any CDB is important. The CDB has the potential to alter the competitive landscape, and we would not want to see the six large suppliers gain a competitive advantage if smaller suppliers were not appropriately included in central consumer engagement.



## **Non-domestic Consumers**

It is important that smaller non-domestic consumers are able to benefit from smart meters, and that consumer engagement also targets this group. We welcome the recent DECC workshop on consumer engagement for non-domestic consumers, and look forward to working further with DECC in this area.

## **Alternative Approaches**

We can see two options that we think will better achieve the aims of the consumer engagement strategy. The first option is outcomes-based licence conditions, on a model similar to the digital rollout. The second is a voluntary arrangement with licence conditions as a backstop if the voluntary arrangement is not achieving the objectives. We describe each of those models, and their potential advantages, below.

### *Outcomes-Based Licence Conditions*

One approach that we think will effectively achieve the aims of the consumer engagement strategy is licence conditions focused on desired outcomes. We understand that this approach was used successfully to establish Digital UK for the digital switchover. Given the success of that campaign to deliver communications to consumers in a large scale national infrastructure rollout, we think that the model provides a useful basis for obligations on suppliers to deliver consumer engagement on smart meters.

Under an outcomes-based approach, DECC could design a set of objectives, based on the aims set out in the consultation document. Suppliers would be required, as a condition of the licence, to take all reasonable steps to meet those objectives, but would have flexibility to decide the best way of meeting the objectives. Suppliers could cooperate to achieve those outcomes as appropriate, and we would expect that they would establish a central body to do so.

Suppliers themselves would need to carefully work through steps they chose to undertake to work together to establish a central body to achieve the outcomes. Suppliers would have a strong interest in the governance of the body, to ensure that the objectives were met. For the consumer engagement to be effective, suppliers would need to ensure that the body acted and presented information impartially. Clearly, suppliers would also need to ensure that they complied with competition law.

We think that this model would establish the incentives on suppliers to deliver the required consumer engagement aims in an efficient and cost effective way.

Outcomes-based licence conditions would require Ofgem to play a greater role in monitoring the consumer engagement activities, and where necessary undertaking enforcement action if the objectives were not being achieved. We would welcome the opportunity to work with DECC in preparing an appropriate set of outcomes-based licence conditions, and to work further on the role Ofgem would play in monitoring and enforcing such licence conditions.

### *Voluntary Arrangements with Licence Condition 'Backstop'*

A wholly voluntary approach has some merits, but as noted above, we consider that this on its own would not incentivise suppliers to deliver all the objectives for the consumer engagement strategy, for example in delivering cost-effective energy savings. An alternative approach would be to draft outcomes-based licence conditions, which would only come into force if a voluntary model failed to deliver the desired outcomes. This would resolve a number of the wider problems with a voluntary model. It would strengthen the incentives on suppliers to ensure that any voluntary model works effectively, and, in

particular, ensure consumers can benefit from using smart meters to improve energy efficiency, and ensure vulnerable and low income consumers also benefit from the rollout.

We recognise that this approach brings a risk of delay if failure of the voluntary model occurs, while licence conditions intended to remedy a failure of the voluntary option are brought into force. Any delay could prove to be a missed opportunity for consumer engagement, given the relatively short timeframes for the rollout.

We welcome your constructive engagement with us and other stakeholders so far, and look forward to further discussions in the coming months. If you have any questions about this response in the meantime, please

Yours sincerely