

Non-domestic Gas or Electricity Supply Licence Holders, non-domestic consumers and their representatives, and interested parties

Our Ref: 68/09

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Dear Colleagues

Amendment to proposals outlined in the *Energy Supply Probe – proposed retail market remedies* relating to automatic contract rollovers for micro business consumers.

1.1. In April 2009 Ofgem published *Energy Supply Probe – proposed retail market remedies*¹ report. This report outlined a number of proposals aimed at improving competition in the domestic retail sector, as well as in the micro business² segment of the non domestic retail sector. A significant number of Respondents to this Consultation argued strongly that Ofgem should consider modifying the remedy relating to automatic contract rollover³ in the micro business segment for a number of reasons, which are detailed below. We have drafted this Open Letter to highlight our amended proposal and invite comment from Industry, consumers and other interested parties.

1.2. The Energy Supply Probe highlighted that many non-domestic consumers, particularly smaller businesses, are not able to engage effectively with energy markets and can resemble domestic consumers in both their attitudes toward energy procurement and ability to influence supplier offerings. Indeed, our research identified that a significant proportion of small business consumers are unaware of where to go for independent information about energy offers, confused about how to compare prices, and unsure how to select energy products that best meet their needs. However, they are not afforded the same levels of protection as domestic consumers due to variances in licence conditions. This results in the small business market being subject to different dynamics than the domestic market.

1.3. The Probe identified various areas of concern impacting small business consumers, including:

- The amount of information small business customers receive about contract terms and conditions can vary significantly, and full terms and conditions are not always provided; and

¹ *Energy Supply Probe – proposed retail market remedies* report, published 15 April 2009 <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Energy%20Supply%20Probe%20-%20proposed%20retail%20market%20remedies.pdf&refer=Markets/RetMkts/ensuppro>

² A micro business is defined in Article 2(1) of The Gas and Electricity Regulated Providers (Redress Scheme) Order 2008 as including businesses that employ fewer than ten people and which have an annual turnover of less than 2 million euros; or which use less than 200,000 kWh of gas per year or 55,000 kWh of electricity per year.

³ *Energy Supply Probe – proposed retail market remedies* report, pg 37-38

- small business consumers may not have the ability to negotiate contract terms and conditions with their supplier, this includes text governing how suppliers use the terms of contract to object to consumers' attempts to switch supplier.

1.4. To help address these issues, Ofgem proposed a range of remedies, which were published for consultation in the *Energy Supply Probe – proposed retail market remedies* report. Two of the proposed options included potential changes to the Gas and Electricity supply licences. These were; a proposal to provide consumers with clear and understandable information regarding the terms and conditions of their contracts and their rights and responsibilities at the end of any fixed term period; and a proposal to remove suppliers' ability to automatically roll over fixed term contracts through changing the circumstances under which a supplier is permitted to object to a customer transfer after the end of a fixed term period.

1.5. The intention of our proposal to increase the provision of information to consumers is to enable them to be in control of their energy procurement decisions, and make contracting decisions based on clear and timely information provided by their supplier. With regard to proposals concerning automatic contract rollover, our objective is to address concerns over consumers being automatically locked into unfavourable long-term contracts without their full awareness, and to provide higher levels of consumer confidence in, and engagement with, the retail energy market.

1.6. The majority of respondents to the consultation welcomed measures to improve the functioning of the market for smaller businesses, and were broadly in support of our proposed remedies around clear contract terms and conditions.

1.7. There was considerable support for our proposals relating to automatic contract rollover from small business consumers and trade associations, who argued that it would facilitate increased consumer engagement. However, one notable consumer representative did express a concern that some customers may face higher energy prices if, as a result of the licence condition, suppliers shifted customers who failed to engage towards the end of their energy contract onto unfavourable "out of contract"⁴ prices.

1.8. While most respondents recognised that there were problems associated with some small business customers being inadvertently rolled over onto unfavourable contracts, the Big 6 suppliers and many smaller non-domestic suppliers opposed our proposed remedy. They did not agree that banning rollovers was the best way to address the issues outlined and were concerned that the measure would change the dynamics of competition in the small business market. Specific concerns included:

- increasing uncertainty around customer demand, which, they argued, would expose suppliers to increased costs associated with wholesale market risk;
- some suppliers use their contracted customer base as collateral, if a larger proportion of their customers are "out of contract" this increases their costs associated with securing credit and purchase energy;
- added costs would be passed on to customers, a proportion would be spread across all consumers, but it is also likely that customers who were "out of contract" would see significant increases in their energy prices until they formally agreed another energy contract;
- a proportion of customers will not engage with the market: they argued that these customers would be disproportionately disadvantaged by this proposal because they

⁴ In this case, "out of contract" represents the period after a fixed term agreement has expired where a customer has a pre-existing relationship with an energy supplier based on their most recent fixed term contract; however, both the customer and supplier are no longer bound by the full terms of that contract, and the customer is free to agree a new contract with that, or another supplier at any time.

would be more likely to be moved onto “out of contract” rates than other consumers; and

- a proportion of consumers may view automatic contract rollover as a valuable service option, and our existing proposal would be taking this market offering away from these consumers.

1.9. In the light of responses to consultation, and the concerns about the possible impact on the functioning of the market for energy consumers, we have developed an alternative to our April proposal of banning automatic contract roll-overs. Importantly, we feel that the alternative proposal, outlined below, would help address the key concerns raised through our research into the small business market, while minimising the negative impact of change on the market.

Alternative proposal

1.10. This proposal would not eliminate suppliers’ ability to automatically roll over customer contracts, but it would limit the conditions under which suppliers could do this. We believe it would also help to further increase transparency in this segment of the market. To achieve this, we propose a licence condition that would limit automatic rollover to circumstances where the supplier can demonstrate:

- the length of time a contract can be automatically rolled-over is no more than 12 months;
- there is a minimum period of 30 days between the time a customer is sent a reminder notice that the fixed term period of their contract is due to come to an end and the last point they are able to notify their supplier they would like to switch supplier or agree a new contract. We are also seeking views on introducing a common timeframe for when the reminder notice outlined above is sent, and if it is, which timeframe would be most appropriate;
- customers can give notice that they wish to transfer to another contract any time from the inception of contract up to the ‘close’ of the regular notice period; and
- when contacting customers to alert them that their contract is coming to an end, and offering new contract options, suppliers should promote customer engagement by highlighting the importance of the material, making the consumer aware of their options and what action they may wish to take - for example, suppliers should avoid using language that could discourage engagement such as “no action is required”.

1.11. We consider that our new proposal will go a long way to addressing the issues we have identified by making switching easier, improving customer awareness and limiting rolled over contracts to 12 months. However, we recognise that it does not entirely eliminate the risk of potential consumer detriment as a result of automatic contract rollover. We note that if we were to pursue this alternative proposal, and it was to prove insufficient in addressing the problems identified, the option to ban rollovers entirely remains open.

1.12. It is our intention that this licence condition would be in addition to our proposed new licence condition on improved information on terms and conditions for micro business consumers. As outlined in the *Energy Supply Probe - proposed retail market remedies* report, key elements of this proposal are:

- a customer should be provided a clear summary of the key terms and conditions before agreeing to an energy contract; and
- a full copy of contract terms and conditions will be provided to a customer after a sale has been agreed.

1.13. In addition, we intend to undertake further research regarding the impact that suppliers' use of objections has on consumers and the market, although we note this would take place on a separate timetable to the work outlined above.

Period for responses

We expect our Authority will reach a decision in July regarding the package we will put forward for Statutory Consultation. As such, we welcome your views on the alternative proposal relating to automatic contract rollovers at this time. All responses to this consultation should be submitted in writing or electronically to arrive at the following address by **Friday 3 July 2009**.

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If you have any questions about the contents of this letter please do not hesitate to get in touch with me or my colleagues, Gosia Rees or Katie Brennan.

Yours sincerely

Andrew Wright
Managing Director, Markets