

Rachel Fletcher  
Consumer Markets  
Ofgem  
9 Millbank  
London SW1P 3GE

13 January 2006

[rachel.fletcher@ofgem.gov.uk](mailto:rachel.fletcher@ofgem.gov.uk)

Dear Rachel,

### **Non-domestic supply market review consultation: energywatch response**

energywatch welcomes the opportunity to respond to this consultation, and considers that an assessment of the health of the non-domestic markets is timely, given the changes in the energy markets seen since 2003. Business concerns are also increasingly important for energywatch, as we are seeking to build greater links with non-domestic consumers and research and respond to their needs. This has already resulted in the establishment of our centralised Business Services Team in Newcastle, and is being developed further through *Make the Connection*, our joint campaign with the Federation of Small Businesses (FSB) on the needs of small to medium enterprises (SMEs) in the energy market.

#### ***Ofgem consultation questions***

The consultation letter (11 November 2005) posed the key question of whether there is sufficient justification for a review of the non-domestic gas and electricity supply markets, and if so, which indicators of competitiveness and which sectors a review should focus on.

In response to this, energywatch considers that:

- A review of the non-domestic supply markets is necessary.
- The review should focus on current problems in the following indicators of competitiveness: poor information, low rates of innovation and product differentiation, poor quality of service and barriers to entry and further expansion for small business supply companies, which in turn creates a market situation which deters further new entrants.
- Any review needs to take particular account of the specific needs of the SME market, and to consider the smallest consumers at the lower end of this market segment.

The following response will explain the evidence and reasoning behind these opinions, and explain why energywatch has chosen to focus on these. It should be noted that while this response focuses on problems experienced by the SME sector, this does not suggest that there is no need to address issues experienced by large users as well. energywatch's remit to represent energy consumer interests extends to all consumers, and we observe that all sectors are exposed to some fundamental disadvantages, including the impact of wholesale prices, lack of information transparency and availability, and the difficulty of obtaining competitive offers.

energywatch does not prioritise consumer disadvantage, and in light of concern about the impact on the manufacturing industry of volatile energy prices, we have recently engaged in activities on behalf of both large industrial and commercial (I&C) and public sector consumers. But while consideration of the areas proposed for review will benefit all business sectors, energywatch believes that the degree of exposure to inequalities in the market increases as the size of consumer and its energy consumption decreases. 'Micro businesses' (which are those classified as those with 0-9 employees) account for over 90% of UK firms<sup>1</sup>, and while these consumers are classed as non-domestic, their consumption and knowledge of the markets will be little different from the average domestic consumer.

We recognise that there are no uniform segment definitions, but believe that consumers at the smaller end of the SME segment are the least able to understand and engage successfully with the complexities of the energy market. In recognition of this, and of the fact that large users are an experienced and vocal consumer group, our response has focused on the small business sector.

### ***Current problems in the non-domestic supply markets***

energywatch considers that there is strong evidence to show that consumers are being adversely affected by problems in the non-domestic supply markets, and that the behaviours and buying/selling strategies being adopted in response are unhealthy developments.

Details of these issues will be laid out in accordance with the list of competition indicators outlined in the consultation letter, although it should be noted that energywatch strongly supports the observation made by Nigel Cornwall<sup>2</sup> that 'no established means for the measurement of competition are readily available, meaning that judgements need to be made from assessments of activity and opinion'. Absence of any such measures leads to ambiguity over responsibility for the assessment of the market: the consultation letter suggests that consumers need to prove that competition is not working for them. In order for a robust assessment to be made of the market (either as part of the decision on whether to proceed with the review, or as part of the

---

<sup>1</sup> Figures are from the FSB website at <http://www.fsb.org.uk/general/about/>.

<sup>2</sup> *Business Energy Markets 2004* Section 8.2, p129 (Cornwall Consulting report commissioned by energywatch in November 2004).

review itself), energywatch believes that Ofgem must develop and implement competition measures and that these should be made available to consumers and industry stakeholders.

## **Poor information**

### **I. Lack of supplier comparison data**

Good quality information is vital for a market to function successfully. However, business consumers do not have open access to any reliable sources of data to compare the relative performance of competing suppliers on price, service performance, consumer satisfaction or market share. This is a particular problem for SMEs making switching and contracting decisions because of this group's limited resources and low level of knowledge of the energy markets. The problem is particularly felt at the smaller end of the market, where businesses are likely to be negotiating energy contracts without expert help, and are essentially expected to enter the market blind. This group is markedly similar to domestic consumers in its consumption patterns, expertise and contracting strategies, and would benefit in a similar way from the increased availability of comparison information. The npower Business Energy Index for summer 2005 suggests that around £2.3 billion is spent by this sector annually on gas and electricity<sup>3</sup>. Given the magnitude of this spend, if these consumers could access information and find better deals, even a small percentage saving across the sector would represent hundreds of millions in savings for businesses across the UK.

Our initial discussions with suppliers have suggested there is limited appetite to extend the publication of price data from the domestic to the small business market, despite the prevalence of standard terms at the smaller end of this sector. This leads energywatch to conclude that competition for small business consumers is not sufficiently strong to lead to the voluntary publication of this data, and that more formal requirements would need to be put in place for it to be produced. Energywatch has observed a 3 fold increase in requests for business price comparisons over the past 12 months, to which we are unable to respond.

We believe that the review should address the questions of whether lack of free and readily available information is hampering small business consumers' attempts to compare suppliers, and whether the requirement on suppliers to publish this data would lead to improvements in their performance and behaviour.

---

<sup>3</sup> Calculated from the npower figures, available at <http://www.npowermediacentre.co.uk/imagelibrary/detail.asp?MediaDetailsID=299>. The Business Energy Index is an independent survey sponsored by npower and conducted by Moffatt Associates twice a year. The FSB, the Major Energy Users Council and Energy Intensive Users Group have all assisted with the research.

## 2. Increased use of energy agents and brokers

energywatch believes that SMEs' struggle to engage with the markets in contract negotiations is evidenced by one of the very things that the consultation letter highlights as an encouraging development. The rise in use of third party intermediaries (TPIs) such as brokers or agents (over 60% of energy is now purchased through these parties in the non-domestic sector) is described by Ofgem as positive evidence of 'a supply market response to changes in wholesale market conditions'. energywatch disagrees with the assertion that this is an entirely welcome development, and believes that the complexity of the market and the negotiation process is forcing consumers to seek expert help from this unregulated sector. The increased reliance on TPIs also further alienates small players from the energy market, some of whom (for example through small business trade associations, who related their experiences to us at the recent energywatch/DTI purchasing seminar – see below) are now resorting to joining buyer consortiums to attain the purchasing power they lack as individuals.

energywatch is proposing to work with TPIs and consumer groups during 2006-07 with a view to developing a code of practice for the activity of TPIs. The recognition by both consumers and the TPI industry itself that this code is needed is indicative of a problem in the market, and energywatch does not consider that this substitutes for an Ofgem review to examine the underlying reasons for why consumers are choosing to turn to these companies in the first place.

## 3. Lack of accurate site data

energywatch considers that the review will also need to consider whether confusion over the provision of accurate site data is hampering the transfer process to such a degree that competition is affected. Problems arising from inaccurate site and meter data can interfere with the smooth transfer of sites to a new supplier, and also create subsequent billing problems. The impact of this is most keenly (although not exclusively) felt by multi site consumers, and energywatch believes that this can reduce consumer disposition to change supplier. While consumers must accept some responsibility for ensuring the accuracy of data they collect and are asked to provide, the supply side currently handles data with varying degrees of efficiency and accuracy, little accountability for errors, and with no exposure to the financial impacts. By comparison, the individual consumer's exposure to the impact of such errors is absolute and actual.

energywatch recognises the work on data accuracy and validation undertaken by the Customer Transfer Programme (CTP), but concludes that, even within the scope of the project as configured, actions to measure the CTP impact on business consumers will not be implemented much before the middle of 2006. In light of this, energywatch recommends that the provision of, and responsibility for, accurate data by all parties should be reviewed to examine the effects this has on the market and whether this is being exploited to consumer detriment during the transfer process.

## **Low rate of innovation/differentiation**

energywatch recently issued a questionnaire to all business gas and electricity supply companies on their practices in dealing with SME consumers. In a number of cases, suppliers seemed unwilling to offer detailed responses, but the information provided showed that some companies are making efforts to personalise and improve the products offered to businesses, but the responses also suggested that many small business consumers are offered standardised fixed term products, with differentiation only occurring on rates, contract notice periods and supplier practices as contracts draw to a close.

This suggests a lack of product differentiation between suppliers, but also perhaps a failure of suppliers to determine and respond to the specific needs of small businesses. This group is viewed by suppliers as coherent enough to be offered standard terms (like domestic consumers), but it is not offered the same protections as domestic consumers (the AES code of practice or cooling off periods, for example). However, without more transparency of prices and terms (one company has refused even to disclose the average price increase for SME consumers since 2003 in confidence) it is difficult for consumers to put pressure on suppliers to offer more tailored or competitive terms.

## **Poor quality of service**

The Ofgem consultation letter offers research<sup>4</sup> showing improving SME consumer satisfaction ratings as evidence of suppliers competing to improve customer service. energywatch notes these figures, but the interpretation of them ignores the diverse nature of the SME market: the Datamonitor survey sample covers both consumers paying between £1000 and £5000 annually, but also consumers paying between £5000 and £30,000 (accounting for 33% of the sample). These two groups will adopt very different buying strategies and may have very different experiences of the market. This survey group may also exclude 'micro' businesses, despite the fact that this group accounts for such a large proportion of UK businesses.

Quality of service was a major theme at the recent energywatch/DTI seminar on energy purchasing in the public and small business sectors<sup>5</sup>. Ofgem will be well aware of this issue as it was well represented at this event, and Alistair Buchanan spoke on the current volatility of the market and Ofgem's commitment to assist small businesses where possible. The key conclusions from the seminar, common to both the public and the SME sector, were a desire for greater transparency, accountability and confidence in the buying process, specifically in the areas already mentioned: the availability of comparison data, the practices of TPIs and the accuracy of site data.

---

<sup>4</sup> Datamonitor: UK I&C Buyer market Perspective (August 2005)

<sup>5</sup> Details of the seminar are available from the energywatch website at [http://www.energywatch.org.uk/media/events/index.asp?view=month&cal\\_date=01/11/2005&campaign\\_id=#event\\_anchor\\_8](http://www.energywatch.org.uk/media/events/index.asp?view=month&cal_date=01/11/2005&campaign_id=#event_anchor_8)

Views gathered at the seminar (in particular the afternoon SME breakout session) provided an insight into many of the problems faced by this community (although these cannot be taken as wholly representative of experiences of this sector). SME group representatives admitted that many of their members were unfamiliar with the complexities of the energy markets, but were not confident that suppliers appreciated their specific needs. Consumers were keen to see (for example) extension of payment terms to bring energy bills into line with other products, and more personalised customer service.

energywatch considers that if suppliers are failing to offer services that satisfactorily fulfil these criteria, this suggests that competition between suppliers for these consumers is limited. Ofgem has asked for comparison to other sectors to be demonstrated in this answer: as outlined above, the lack of measures of performance for the business supply market makes this difficult, and shows the need to establish these indicators soon. Ofgem must be willing to accept substantial anecdotal evidence in the absence of consistent and measurable indicators of performance as part of the review. Ofgem cannot argue that this is not representative given that it is the only evidence of consumer experience available.

### **Barriers to entry and expansion**

Ofgem's consultation letter notes that market concentration has reduced since 2003, with shifts in position between the big six companies' market shares, and the entry of new players. However, energywatch is concerned that this does not reflect more recent developments in the market. December 2005 alone saw the failure of Eledor Limited (an I&C electricity supplier<sup>6</sup>), Reepham Limited (an I&C and domestic gas shipper<sup>7</sup>) and the Team group of companies (an I&C and domestic gas and electricity supplier<sup>8</sup>). Sadly, there is a real possibility that several other companies will soon follow suit. This may well have knock-on effects, and a high rate of failure for small players in the business market is bound to act as a deterrent to further new entrants joining this market in the future. Clearly, this is an issue that Ofgem will need to consider carefully.

The 2004 Cornwall Consulting report echoes this concern about the number of players active in the market. It cautions that the overall number of trading suppliers does not equate either to the number of suppliers active in the business market, or to the number of active suppliers willing to offer competitive quotes. The Cornwall research suggested that both large and small consumers were finding it increasingly difficult to secure an adequate number of competitive quotes, with suppliers being more selective about the contracts they pursue. The report attributed this problem to faster moving wholesale markets (whereby suppliers wish to time-limit offers, but some consumers, particularly in the public sector, have decision making processes that can take days or even weeks) and concerns about data accuracy (particularly with multi-site customers).

---

<sup>6</sup> Licence revoked by Ofgem 18 December 2005.

<sup>7</sup> Licence revoked by Ofgem on 19 December 2005.

<sup>8</sup> Licences revoked by Ofgem on 1 and 2 December 2005.

Stephen Littlechild's research into the experience of small domestic supply businesses<sup>9</sup> also references the Cornwall report in its assessment of the experiences of small domestic suppliers, suggesting that problems of data quality and lack of liquidity in the wholesale markets are common to suppliers operating in both the domestic and business markets, and favour larger vertically integrated players, who can absorb the costs of data inaccuracy within the overall 'smoothing' of settlement data specifically in wholesale electricity.

energywatch asks Ofgem to take these reports of small suppliers and consumers' concerns into account, and question its optimism about the state of the market.

### **Conclusion**

In conclusion, energywatch urges Ofgem to carry out the proposed review, and highlights the following key points:

- There is a pressing need to implement formal competition measures to provide a clear and reliable assessment of the state of the non-domestic market.
- Key problems, as viewed by energywatch, are the lack of supplier comparison data and the complexity of the buying process leading to the increased use of specialist energy brokers, the inaccuracy of site data, poor quality of service and lack of innovation, and the increasing difficulties being faced by small suppliers.
- A review should take the particular needs of small business consumers into account, and recognise that the non-domestic market is made up of many different customer types, with very different approaches to their energy supplies.

Business consumers regularly tell energywatch that they lack, but desperately want, confidence that their energy offers and contracts represent best practice and best value for money, especially as prices continue to rise and energy costs become a primary financial concern for many companies. energywatch believes that an Ofgem review of the non-domestic market is essential, in order to provide consumers with a close examination of the current problems (as outlined above) and offer potential solutions, and energywatch is committed to working with Ofgem and the industry to identify these solutions.

Yours sincerely,

Carole Pitkeathley  
Head of Regulatory Affairs

---

<sup>9</sup> Smaller Suppliers in the UK Domestic Electricity Market: Experience, Concerns and Policy Recommendations (June 2005)

energywatch