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Dear Colleague,

Modifying the arrangements for the use of objections in the non-domestic market

Introduction

1. On 17 April 2007 we published the Authority's decision in respect of an appeal made by BGT in respect of a decision taken at the MRA Forum on 28 September 2006, upholding the MEC determination dated 25 July 2006, that BGT is in breach of clause 38.1 of the MRA.

2. The appeal concerned a practice in respect of non-domestic customers which had agreed to take supply from a new supplier. The issue arises in circumstances where the existing supplier receives a loss notification (in electricity, this is a dataflow from the distributor referred to as a D0058), and it does not have a contract with the customer that would permit it to object to the transfer. In practice there is an opportunity within the period allowed by the process for raising an objection[1] for the existing supplier to contact the customer and offer to enter into a new contract. If the customer accepts that contract, the new contract typically gives the existing supplier permission to object to the proposed transfer; consequently, the supplier then will raise an objection based on the new contract and the customer will stay with them.

3. In brief, the question the Authority was required to consider in the recent appeal by BGT was whether an existing supplier was permitted under the terms of the MRA to use "confidential information" (a defined term in the MRA) which it received in the loss notification for the purpose of contacting their customer (with the aim of re-contracting as outlined in paragraph 2 above).

4. The Authority's conclusions are set out in our decision letter. In summary, it was concluded that there was sufficient evidence to support the view that BGT, given the drafting of the MRA (and statements made by Ofgem), could reasonably believe that the use of the confidential information provided to them in the loss notification data flow could be used by them for the purposes of re-contracting.

5. In the course of hearing BGT's appeal as to whether they were in breach of the MRA as drafted, it became clear that there was in the view of various parties a wider policy

[1] In electricity, under the MRA, this period is set at 'five working days'. For gas, under the uniform Network Code, it is 'seven business days'. Objections may be raised, for example, where the contract between the supplier and the customer provides for an objection to be made if insufficient notice has been given, or there is outstanding debt.

issue, namely whether the practice of re-contracting during the objection period with the aim of preventing the proposed transfer was an *appropriate* market arrangement. It is a question that may apply equally in gas, where similar arrangements operate.

6. While it is a matter for the industry to suggest any modifications to the Network Codes and MRA, Ofgem has the ability to put forward licence amendments. This letter asks whether interested parties believe that the existing arrangements should be amended.

Recontracting during the Objection Period

7. A majority of the representations made in the course of the appeal argued that BGT's behaviour was an unfair, uncompetitive or otherwise illegal (e.g. anti-competitive contrary to the competition law rules[2] or tortious) form of conduct. Many respondents argued therefore that measures should be implemented to prevent this conduct continuing.

8. As regards the arguments relating to the detrimental or unfair impact on competition, Ofgem does not think that in principle there is anything wrong with customers receiving the offer of a better deal from their current supplier at any point in time including up until the point at which they are finally about to switch. Any offers benefit the customer and are for the customer to evaluate as he or she sees fit. The practice of approaching a customer with an alternative offer does not bind customers to the existing supplier; they are free to reject the offer that is made to them and continue with the transfer to the new supplier.

9. Furthermore, we understand that it is widely accepted regarding the terms of the MRA, that a supplier may re-contract during the objection period in circumstances where it has been alerted to the customer's intention to switch by the customer himself (this not being defined as "confidential information"), rather than the loss notification process. This suggests that the customer should have all the information at its disposal about competing offers, without undue restrictions, and that making distinctions between the information or offers that customers should be able to receive in different situations may be problematic.

10. However, Ofgem recognises that some specific issues arise in this industry because of the nature of the switching process. Industry processes have been designed to ensure a seamless transfer of supply for the customer from one supplier to another, with (in electricity) a five-day objection window built into that process to enable certain checks to be made to ensure that there are no legitimate objections to the switch from the outgoing supplier. Given this design, there is an argument that to preserve the integrity of the switching process, there must be a time beyond which suppliers and customers accept that a customer's switch is "in process" such that, save for any legitimate grounds for objections being raised by the outgoing supplier, the transfer must proceed as notified.

11. However none of this necessarily has implications for the effective functioning of the competitive process. The design of the transfer rules has to reconcile the requirement to keep customers in charge of their own future supply arrangements with the practical need to have an orderly, predictable transfer process. In this industry this may involve some compromises or trade-offs at certain points in the transfer process. While different sets of switching procedures may strike this balance in different ways, we do not think that either approach would damage or impede the competitive process.

12. Any existing supplier can write into its procedures or contracts arrangements that enable it to be notified of its customer's intentions at any time. This may enable it to raise an objection to a transfer where the customer has not acted in line with its

[2] Specifically it was alleged that BGT may be abusing a position of dominance. As this was insufficiently substantiated (including any existence of dominance) it is not discussed further in this letter.

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contract, or to take other action against the customer to enforce its contract, where the customer is in breach. Similarly, incoming suppliers can write into their contracts penalties or protection if the customer changes his/her mind, including during the time before its supply from the new supplier has started. Indeed, there is evidence some suppliers do protect themselves in this way.

13. There are no obstacles to suppliers doing what they think is necessary to help them manage their relationships with their customers in this way. In our view, the real issue raised by the appeal is less to do with the use of the loss notification data, but rather what set of arrangements in respect of re-contracting in the objections window best serves customers' interests.

14. Under one set of arrangements – that which appears to be the preferred approach of many respondents – market rules would be amended so that customers are unable to re-contract in the objection window, except in very specific circumstances. This approach emphasises the role of the MRA in facilitating and executing customer transfers and the need for customers to accept some limitation in the offers they may receive and act upon once their proposed transfer has entered the objections window.

15. The alternative arrangement emphasises that any restrictions on re-contracting are not an essential part of the transfer process, and that suppliers and customers should be free to make and accept alternative offers at any time.

16. It is arguable that maintaining the existing arrangements (as interpreted in the decision under the MRA appeal) will lead to an increase in re-contracting in the objection period, and increase the commercial risk of those seeking to target customers who are not obliged to give notice under existing contracts. More suppliers may well adopt BGT's approach in the absence of an explicit contractual right to object. It would follow that new suppliers will either win and keep new business by offering more competitive prices and service, or may need to rely on such contractual or other remedies as they may have to recover their costs incurred through the customer failing to switch (in breach of contract).

17. Whether or not this is a desirable outcome for customers may depend on the transaction costs of the different approaches. We do not see why this would affect either the intensity or effectiveness of competition in the market. One view is that providing for some restriction on re-contracting in the objections window will save suppliers and customers from a potentially significant amount of legal and contractual dispute and debate. Suppliers may take the view that if the market rules do not change they will need to increase the protection they get from their contracts. To make this credible to customers they may need to take enforcement action through the courts in some cases if for, example, a customer who had signed a contract with a new supplier then went back to their previous supplier before the switching process had completed.

18. This sort of commercial dynamic is what one sees in many other industries, most obviously those where there is no need for any centralised customer transfer arrangements. This suggests to us that there is nothing inherently anti-competitive or unfair about this outcome; indeed this is how the general legal framework underpins the operation of markets.

19. However, the alternative view is that given that the industry has the transfer process that it has, customers will benefit if the industry rules prescribe the scope for re-contracting in the objections window. This will help to reduce the scope and requirement for suppliers to seek redress through the courts, which can be expensive and time-consuming for both customers and suppliers.

20. On the issue of the legality of the behaviour of various parties (such as commission of a tort or breach of contract, rather than licence breach or breach of the Competition Act 1998), these are typically matters for the parties concerned. The costs associated with

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private enforcement may be relevant to the regulatory framework where an increased need to take private action leads to increased but avoidable transaction (and related) costs, particularly if a regulatory solution which helps avoid those costs does not restrict competition.

21. We therefore invite views on the issues raised in this letter. We would welcome views on whether respondents agree that both sets of arrangements are consistent with competition. We would also welcome views on whether transaction costs and customer inconvenience would be greater under either set of arrangements. Finally we would welcome views about whether the existing market arrangements should be changed and if so, whether any changes should be left to the industry to make through raising changes to the MRA or whether Ofgem should seek to make changes to the supply licence to implement them.

22. Comments should be received by 31 May 2007. If, on the basis of the views received, Ofgem believes that the existing arrangements should be amended, Ofgem will then set out our conclusions and our views on how any changes (if necessary) should be made.

Yours sincerely,

Steve Smith
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