energywatch
your gas and electricity watchdog

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30 May 2007

Dear Steve

Modifying the arrangements for the use of objections in the non-domestic market: consultation open letter

energywatch welcomes the opportunity to respond to the issues raised by this consultation. This response is non-confidential and we are happy for it to be published on the Ofgem website.

The circumstances surrounding the MEC determination and the subsequent appeal have undoubtedly caused controversy but what they have also done is highlight the situation consumers (in this case non-domestic consumers) find themselves in when industry processes, of which they are often passive recipients, work against them.

energywatch is disappointed by the tone of the open letter which seems to portray the issues arising from the MRA appeal as only worth considering from the point of view of how to reduce suppliers' commercial risks and the consumers' role in that regard. It fails to give due weight to real concerns from consumers (which we elaborate on below) that suppliers may be abusing the MRA objections process to obtain information about customer switching and inducing breach of contract to the detriment of consumers and effective competition.

In any competitive market, players, whether or not they are dominant, will seek to reduce their exposure to commercial risk as often as is possible. Whilst energywatch recognises this fact, we are concerned that in reducing this exposure to risk it is inevitably the consumer who pays.

Whilst energywatch appreciates that the consumers referred to in your consultation are non-domestic and therefore business consumers (the vast majority of whom will be small businesses) it must not be assumed that there is an equivalent level of knowledge or understanding across all business consumers or even sectors of business. Indeed, some 95% of small businesses have less than ten employees and a significant percentage are sole traders, none of whom can be expected to have a team, or even an individual, who regularly deals with or keeps up with developments in energy matters. In many respects, these consumers have no better understanding of the markets than domestic consumers, as is reflected in the ways in which suppliers approach them. Energy, although important, is a minor part of the daily routine but, when things go wrong, there can be significant difficulties for some.

energywatch supports the view that consumers should be able to get the best offers available and that they should be able to make informed decisions. We believe, however, that some consumers are unable to make informed decisions as they lack sufficient information on the consequences of entering into more than one contract, even if they are aware that this is what is happening. Frequently this information forms part of the sales pitch where consumers are led to believe that they are free to leave contracts when in fact they are not. Indeed, it is not part of the normal sales routine for agents to run through the full legal implications of any verbal agreement which the customer may make either over the phone or through direct selling.

Further, the current arrangements actually create barriers to informed decision-making by consumers and potentially provide some suppliers with several bites at the cherry. If a supplier makes an offer which a consumer rejects, only to come back at a later date (having discovered the consumer is about to switch to a different supplier) with a better offer, how fair was the price in the first place? In a competitive market, should a supplier not come forward with a competitive quote to retain custom at the time the contract is up for renewal? Competing suppliers ought to have a more informed picture of the market than consumers since they are quoting for business every day. Does this process not run counter to Ofgem's view that consumers have the right to be offered "the best deal at all times"?

The process for transfers which exists within the MRA is just that - a process for allowing the smooth and speedy transfer of customers from one supplier to another **once those customers have made a firm decision to switch based on an informed decision**. The customer has no interest in how the industry manages the transfer, other than that it is effected in a reasonable time and with the minimum of fuss, nor would the customer anticipate the use of a data exchange process for the commercial purposes of win back. energywatch agrees that the non-domestic consumer is responsible for business decisions and for contracts entered into, but the fact that a small business could be placed in a situation where it is held liable under two contracts at the same time is both the cause and the effect of the confusion that surrounds the contractual impact of the transfer process and which, inevitably, results in consumer detriment both individually and collectively.

Much of the inconsistency and confusion arises from the difference between the effective date of the contract and the supply start date. Unless otherwise agreed, the effective date will be the date on which agreement is reached, which in the case of a verbal contract will be the date of the phone call. In every case this will pre-date the supply start date, which is generally the only date that is defined in the contract.

Whilst the significance of the difference between these two dates matters to suppliers engaging in sales and transfers, generally this will not be pointed out to the non-domestic consumer and the ambiguity will be exploited, albeit in different ways depending upon who the consumer is talking to.

The significance from the gaining supplier's point of view is that whilst it has yet to register, supply or bill the supply point, it will nevertheless be exposed to commercial risk in securing supplies at a quoted price for a future period and so

requires to be able to lay this risk off onto the consumer. It must be entitled to make plans to supply, and enter into forward commitments, based on the effective date of the agreement and will feel entitled to apply penalties if the verbal contract is broken following a win back approach. This situation is more acute in the case of small suppliers.

From the losing supplier's point of view, it will want to be free to sell up to the very last possible moment. It will want to persuade the consumer that the agreement just entered into with the gaining supplier is not effective until the supply start date, that no binding contract exists because the supply start date is in the future, and that the consumer is therefore free to ignore the verbal contract with the gaining supplier and stay with the losing supplier. This is, at worst, tantamount to inducement to break a contract and at best ignorance of the fact that a consumer has entered into a legally binding contract with the gaining supplier which may render them liable to liquidated damages for breach of contract or an order of specific performance, which then exposes the consumer to a claim for damages from the losing supplier.

Ofgem suggests that suppliers could use contractual terms and conditions in this way for consumers who breach their contracts which should prevent re-contracting following acceptance of the initial offer. As already stated, this would only be effective if consumers understood (having had them fully and properly explained) the consequences of a breach of contract. Ofgem suggests that failure to meet the penalty costs could be addressed by taking the consumer to court. Clearly this would not only be costly for the losing supplier, it would create unhappy consumers who may become disillusioned not just with that particular supplier but indeed with the transfer process itself. This would not be good for consumers nor would it be good for competition in general. Most consumers simply do not envisage that what they would consider a relatively straightforward purchase could create unintended (for them) legal consequences.

When a supplier, irrespective of size, takes on a new customer, it does so expecting to serve that customer and will purchase energy accordingly – it cannot return this energy if the consumer decides or is persuaded to stay with the existing supplier. That is why the timing of a legally binding contract matters. Assuming it had entered into a legally binding contract with the consumer, the supplier is now left with energy but no customer to sell it to. The effect of this will be, as previously stated, greater on smaller suppliers than it will be on bigger suppliers, given their respective abilities to manage risk. The consequence is that smaller suppliers will seek to reduce exposure to risk by offering higher prices or more restrictive contractual terms, in turn reducing their ability to compete and limiting the overall effectiveness of competition.

What is most concerning, however, is the details of the offers that are made to win back consumers that have emerged since this issue first arose. Suppliers, particularly larger ones, seem able to use their purchasing power to offer consumers a contract renewal at one price, which is then reduced at a later date once it is known that a new supplier has made or even had an offer accepted. This means that the old supplier is 'loss leading' to retain that customer, and makes it more likely that the loss will be recovered from other customers. Whilst this may demonstrate market

forces at work, it will also undoubtedly prevent smaller suppliers from competing on a level playing field, further reducing the number of players in the market and increasing the possibility of an increasingly oligopolistic market structure where a few larger suppliers are free to price at whatever level they choose. It will certainly offer no incentive to new entrants.

What is required is a market where consumers are made fully aware, at all times, of the consequences of entering into a contract and where, at the point that the contract is binding and the consumer is clearly made aware of this fact, the consumer is prevented, by the further actions of all suppliers, from renegotiating during the transfer process. Suppliers, irrespective of size, must take responsibility for this process and not only agree a practical solution but also deliver it to excellent effect. Failure to do this, at any stage in the process must result in regulatory intervention to avoid consumer detriment.

Our responses to the specific questions raised in the consultation are as follows:

1. Are both sets of arrangements (para 14 suggesting new rules severely restricting the customer's right to re-contract in the objections window and para 15 suggesting no change to existing rules) consistent with competition?

Our understanding of the way that BGB's current actions are impacting the market leads us to believe that the status quo is detrimental to competition because it is more likely to lead to the customer being retained by the incumbent supplier rather than switching, thereby preventing him from exercising an effective choice. It seems to energywatch that some major suppliers are adopting aggressive retention strategies through the use of evergreen contracts with termination windows that are hard for the consumer to exercise. As BGB's win back strategy has now been confirmed, this consolidation will only get stronger as other large players follow suit. It follows that if large suppliers are successfully retaining high percentages of their customer base then the possibilities for independent suppliers making inroads into the market are much reduced. This will effectively neutralise new selling activity by independent suppliers as each new sale is turned into an instant, targeted win back opportunity for the incumbent with a very high conversion rate and will lock in higher prices. There is evidence that the renewal prices offered are not generally competitive.

It also creates confusion for consumers, something which is contrary to the effective operation of an orderly competitive market. Even if the option in para 14 is implemented, the way that suppliers are required to implement the MRA rules must recognise the legal and contractual realities facing consumers, and must outlaw the practice of inducing consumers to break contracts.

2. Would transaction costs and customer inconvenience be greater under either set of arrangements?

In our experience, the consumer who is subject to such a win back call does not take a risk-based decision on the opportunity cost of accepting a better deal as against the likelihood of getting sued by the new supplier. On the contrary, he is

typically being at best pressured and, at worst, misled into thinking he is free to accept the better deal and induced to break the terms of the (probably verbal) contract he has freely entered into. The idea that either consumers or suppliers need to factor in the possibility of legal action to undo a contractual dispute made possible by inadequate rules does not reflect the reality for either party and should not even be contemplated. Ofgem may believe that "this is how the general legal framework underpins the operation of markets" (para 18) but this should only be "in extremis". All commercial transactions do indeed involve much legal small print but Ofgem should recognise that few consumers would fully appreciate the full consequences and would tend to place a fair degree of trust that the seller will 'do the right thing' should something go wrong. Any acceptance that this should become a normal and necessary part of the sales and transfer process – as would be the case if the para 15 option were chosen - would be an admission of market failure.

3. Should the existing market arrangements be changed and if so should any changes be left to the industry to make through raising changes to the MRA or should Ofgem seek to make changes to the supply licence to implement them?

energywatch believes that the rules should be changed to prevent aggressive win back activity through use of the D0058 flow which only offers competitive prices to consumers who have rejected the unattractive renewal rates, and induces them to break a competitive contract with a new supplier. The rule change should also recognise the need to tie the transfer process to some transparent contractual frameworks that are consistent across the industry. This would provide consumers with confidence:

(a) that they were being offered competitive renewal prices as a matter of course;

(b) that they could successfully select a new supplier on the merits of that offer without being harassed by their outgoing supplier; and

(c) that they could engage with the renewal/switching process within the context of a set of rules which protected them from legal exposure as a result of being induced to break a contract and made it impossible for them to be under contract to two suppliers at the same time.

energywatch would prefer implementation of these arrangements through changes to the supply licence as these are accessible to consumers and are subject to direct enforcement by Ofgem rather than on appeal. The fact that BGB has been able to reach a unique interpretation of the MRA rules which contradicts the majority of other signatories' and consumer views, and this unique interpretation has been upheld by Ofgem on appeal, gives energywatch some concern that the compliance and enforcement infrastructure of the MRA may not be sufficient to protect consumers' interests in this regard.

If you do wish to discuss this response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs

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