Promoting choice and
value for all customers

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Dear colleague

On 23 April 2008 Ofgem hosted a fuel poverty summit aimed at identifying practical cost effective ways to make real improvements to the lives of vulnerable energy consumers and those in fuel poverty. One of the themes of the summit was ensuring that tariff differentials for different payment methods are fair and justified. Ofgem presented its latest analysis on tariff differentials and said that we would be issuing an open letter on the issue of customers switching to more expensive suppliers.

This letter meets that commitment. It sets out the evidence that Ofgem has that PPM customers in particular are switching to more expensive providers and seeks views on:

1) our interpretation of that evidence and whether customers are indeed moving to worse deals
2) whether regulatory action is required to tackle this issue
3) possible options for action including the possibility of a requirement on suppliers to alert customers if they are switching to a more expensive deal.

Responses are invited by 11 July and should be sent to Claire Tyler (claire.tyler@ofgem.gov.uk or 020 7901 7331).

In parallel Ofgem is continuing its wider work on the market probe looking at the extent to which the supply market is working effectively for all customers. A decision on whether further regulation is required in relation to customers switching to more expensive providers will be taken in the light of responses to this consultation together with broader evidence from the probe.

1. Summary of Ofgem Analysis

As part of its ongoing monitoring of the energy supply markets Ofgem has updated its analysis and recommendations on tariff differentials from June 2007. The headlines are set out in a short report which was circulated at the summit[1] and key findings are summarised below. We have also conducted qualitative market research into switching by vulnerable customers – the results of which are on our website[2]

This analysis shows that the premiums paid by both prepayment and standard credit customers over direct debit have, on average, significantly risen in recent years. There are

[1] http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/Tariff%20differentials%20summary%20FINAL.pdf
[2] http://www.ofgem.gov.uk/Sustainability/SocAction/Publications/Documents1/MORI%20report%20switching%20rates.pdf

very significant savings available for these customers if they have never switched. Historically PPM and standard credit customers have switched at markedly lower rates than direct debit customers. However the most recent data shows that in 2007 PPM customers switched at least as much as direct debit customers, while standard credit customers switched less often.

Figure 1: Percentage of customers that switched supplier in 2007

	Gas	Electricity
Direct debit	21%	21%
Prepayment	23%	20%
Standard credit	13%	12%

Source: Ipsos Mori 2008

While it is encouraging that PPM customers are switching more, we have found evidence that some of this switching is to more expensive suppliers. On the face of it, we would expect to see customers switching away from the relatively expensive suppliers and towards the less expensive suppliers, particularly as 78 per cent of customers say their main reason for switching supplier is to save money. However, information from suppliers about their PPM gains and losses does not show such a perfect relationship. In 2007 63 per cent of electricity and 56 per cent of gas PPM transfers went to the three most expensive suppliers.

This analysis confirms anecdotal evidence from one supplier who has said that over the past year or so a very high proportion of customers switching away from them appeared to be switching to more expensive suppliers.

There may be a number of reasons why this is happening. Customer survey results from our recently commissioned Mori survey indicate that doorstep and phone sales play an important part in customer switching (as illustrated in figure 2), particularly for PPM customers. This information taken with evidence that some PPM customers may be switching to more expensive deals may suggest improved information for customers through the doorstep and phone sales route may be useful.

Figure 2: Method of finding out about the supplier's offer

	Switching site, phoned the supplier & phoned a range of suppliers	Doorstep & phone sales
All	29%	47%
Direct debit	33%	44%
Prepayment	9%	70%
Standard credit	26%	43%

Source: Ipsos Mori 2008

Some suppliers have argued that one reason for these results may be that we have only looked at this on a single fuel basis whereas most customers who switch do so to dual fuel. Our understanding is that suppliers, with the exception of EDF Energy, do not generally offer any dual fuel discount to PPM customers and hence this should not be an issue. While what this might mean is that a customer is not actually worse off as a result of switching – if you look at both fuels together – in reality they may have switched one of their fuels to a more expensive deal.

The number of transfers which our data are based on may have some further limitations. In particular, some of this data includes customers transferring onto prepayment but staying with the same supplier. We will look further at these limitations as part of the Energy Supply Probe and consider methods of correcting for this issue.

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We recognise that there may be other reasons why customers switch supplier and hence the fact that some customers are switching to a more expensive provider is not automatically a cause for concern. However many vulnerable customers lack the confidence, knowledge or initiative to seek out, find, evaluate and switch to alternative energy providers and consequently are more likely than others to be reactive switchers (ie switching in response to a visit or call from a sales rep). We are therefore particularly concerned to ensure that these customers are not prevented from exercising effective choice in the market.

We would welcome comments on the analysis presented above and the extent to which it suggests there is a problem which needs to be addressed to ensure PPM customers in particular are getting the best deal?

Compliance with existing legislation

At around the same time as Ofgem was completing this analysis media reports emerged concerning mis-selling by npower. Ofgem has confirmed that it is carrying out a formal investigation of a potential breach by npower of standard licence condition 25 of its supply licence.
This condition requires:

- all suppliers to have appropriate procedures for selecting and training sales staff, including staff from agencies or sub-contractors working on behalf of the supplier;
- that if a customer is entering into a contract the sales representative must make them fully aware that they are doing so; and
- the supplier must contact the customer within 14 days following the signing of the contract to confirm that the customer is happy to proceed with it.

If customers are switching to a more expensive provider as a result of misleading information provided by the sales agent then this could be a breach of the supplier's licence obligation if they have not taken all reasonable steps to prevent this happening.

Ofgem has made clear that if there are any other instances of mis-selling, in particular involving vulnerable customers, then it will take these very seriously.

However it is important to be clear that under the terms of SLC 25 individual instances of mis-selling can still arise. Even with robust recruitment and training procedures in place the occasional rogue agent can still slip through – however suppliers should have processes in place to detect and deal with them as quickly as possible.

The industry self-regulatory code also has a role to play and the register that is maintained should help ensure, for example, that an agent that is dismissed from one supplier cannot simply go and work for a different supplier.

The introduction of the Consumer Protection from Unfair Trading Regulations from 26 May 2008 also have the potential to impact on this area and Ofgem has committed to producing guidance on their application in the energy sector.

Existing legislation and self-regulation has an important role to play in tackling cases where the customer is switching to a more expensive supplier as a result of deliberately misleading or wrong information.

What is not clear is whether this covers the totality of the problem or whether the problem is much more one of customers switching on the basis of incomplete or inadequate information but where they are not actually being mislead.

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As part of our market probe we are proposing to carry out further consumer research with customers who have actually switched to a more expensive provider to try to understand the basis for their decision.

Our investigation into npower will also provide evidence on the potential scale of any mis-selling and how far that goes towards explaining the high level of switching to npower as a more expensive provider. It will also provide some insights into the effectiveness of the current licence obligations and the self-regulatory arrangements through the AES code.

We would welcome any views on how far the problems identified by Ofgem's analysis might be caused by actual mis-selling and hence could be tackled by robust enforcement of existing regulations - or whether the problem is more one of inadequate or incomplete information.

Options for possible new licence obligations

Even if customers are switching to more expensive providers as a result of inadequate or incomplete information this does not necessarily mean that regulatory action is required to tackle the problem. There are many markets in which incomplete information leads to customers making suboptimal choices. If the customer themselves does not view it as worth their time to research the best option then arguably that is their choice.

However in this particular instance, if Ofgem's analysis is supported, there is a potential concern here. PPM customers are typically on lower incomes and it is particularly important that we do everything we can for vulnerable and fuel poor customers to enable them to access the most competitive tariffs. And as noted above this group are particularly likely to switch in response to doorstep sales and hence there is a case for ensuring that full information is provided at that point.

In the financial services sector for example there is a requirement on companies to provide fair, balanced, and contextualised information to all consumers that accounts for their level of expertise. Similarly where comparisons between products are offered, the basis on which they are made must be explicit. The FSA monitors this against measurable outcomes for the customer.

While Ofgem does not propose to pursue further regulation in this area unless and until it is satisfied that there is a real issue that needs to be addressed, it would be interested in any preliminary views on the practicalities of a number of different possible options and whether there are any other approaches that should be considered. If Ofgem were to conclude that further regulation was needed in this area then it would expect to carry out a further consultation, including a full impact assessment, of different options.

Possible options that Ofgem has identified and on which it would welcome comments are:

1) A requirement on suppliers to provide a written statement of the savings that will be available to the customer from switching provider;
2) A requirement on suppliers to provide the customer with pricing factsheets (for example those prepared by energywatch) at the point of sale which show each supplier's offerings based on average consumption;
3) A requirement on suppliers to alert customers to the importance of checking that the product is the best for them and to provide details of where to obtain price comparison advice;
4) A requirement on suppliers to alert customers at the point of sale where they are switching to a more expensive supplier;
5) A requirement on suppliers to alert customers as part of the follow-up contact (under SLC25) where they are switching to a more expensive supplier.

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We would welcome views on the merits of these different options and any practical issues that may arise. In considering the different options in this area we will have regard to the Better Regulation Executive / National Consumer Council guidelines on regulated consumer information which provides a set of criteria for policy makers to consider when prescribing information that businesses must provide to consumers, to maximise the benefits and minimise the burden.

We would be interested to understand what win-back activity suppliers currently undertake and whether there is anything that could be strengthened as a part of that process which could help with this issue.

We would also be interested in views on whether any remedy should be applied purely to PPM customers given this is where there is currently clearest evidence of a problem – or whether there is any reason to expect standard credit customers to face similar problems, if not now in the near future.

We would also be interested in views as to whether any options could be effectively taken forward on a self-regulatory basis, building on the AES code, or whether licence changes would be preferable given they provide a more transparent and stronger enforcement regime.

> As indicated above we would welcome views on the range of options identified, whether the focus of any remedy should be only for PPM and the potential role of self-regulation.

Next steps

Responses to this open letter should be sent to Claire Tyler by 11 July. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website at www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000. Respondents who wish to have their responses remain confidential should clearly mark the document(s) to that effect and include the reasons for confidentiality. Respondents are asked to put any confidential material in the appendices to their responses.

As indicated previously we will be publishing our initial findings from the market probe at the end of September. Our aim is to have a view by that point as to whether further regulation is needed in this area and, if we conclude that it is, then we would expect to produce a further more detailed consultation at that point.

Yours sincerely,

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