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Dear Maxine,

## **Centrica Response to Ofgem's PPM Open Letter**

### **Executive Summary**

1. We welcome the opportunity to contribute to this important debate on prepayment customers and sales practices. Ofgem's open letter raises some questions about the drivers behind the switching behaviour of prepayment customers. It notes the evidence that these customers are increasingly active in the market. It then raises concerns about the basis on which these customers make switching decisions, and suggests that this may demonstrate that there is a need for changes in the regulation of selling practices.
2. We appreciate the industry is under scrutiny on selling practices as a result of the npower investigation. But the AES model has served customers well, and there is already extensive regulation in this area, including the marketing licence condition. There are also new rules on Consumer Protection from Unfair Trading which will bring energy into line with other sectors. If Ofgem is still minded to consider further regulation, we suggest that it needs to first gather some more robust evidence to better understand the drivers of customer behaviour and the decisions they make. We include some thoughts on the challenges of collecting reliable data in this paper.
3. It should be recognised that field sales is a channel through which significant numbers of consumer engage with the competitive market, who otherwise may not do so. Ofgem should therefore be cautious in relation to further regulation of field sales unless it is clearly warranted, as indeed all customers may suffer if there is simply less field sales activity as a result.

4. In terms of customer messaging on the doorstep, there is not necessarily a simple best deal that can be explained on one factsheet in a way that is appropriate for every prepayment customer because customers have different consumption characteristics and attach different values to price, service features and acquisition incentives. Some prefer fixed rather than variable tariffs, some value good service more than others and some will want to invest more time than others in reading the sales material with which they are presented. In a competitive market, this drives innovation in proposition development and selling.
5. Therefore any new licence-based measures to encourage more transparency would need to be clear on the problem they are trying to solve and the risk of the unintended consequences to which they might lead. Given that unit rates are already disclosed and there is a standardised view of industry average consumption, it is not immediately clear what additional measures will achieve. This is particularly so since customers will inevitably never know their future consumption or the precise shape or seasonality. Compared to for example mobile phone tariffs with a set number of minutes or text messages, energy suppliers are providing customers with an unlimited option on consumption levels, with no fixed volume commitment.
6. In addition, making greater price transparency operational for all field sales agents would probably require a new rulebook of definitions and processes and therefore add significant complexity to sales. Yet there are already procedures in place to which all suppliers are obliged to adhere to prevent misselling. It might be difficult to deliver against a new, tighter set of rules without at the same time actually raising barriers both to suppliers effectively marketing their offerings and to customers making their decisions in the ways that they want.
7. Of all payment types, the innovations of British Gas in its prepayment offering demonstrate that this is not a pure commodity market and that British Gas is trying to differentiate its product. So a focus on price driven by regulation on selling risks crowding out other messages that may be as important to customers. This is important as the trend in retail energy offerings in general is towards more non-price differentiation, driven by high prices and the climate change agenda.
8. Ofgem should also consider that if more complex energy service offerings are to reach the mass market, field sales and advisory services are likely to have a significant and positive part to play. Field sales activity in the life and pensions industry in the 1990s was significantly cut back in response to new rules on selling. New measures which might actually lead to less field sales activity in the retail energy sector should therefore be subject to proper scrutiny and consideration before any decisions are taken.

## **The Prepayment Differential to Other Payment Types**

9. Ofgem's letter starts by noting the widening prepayment differential relative to other payment types. However, at least as far as British Gas is implicated in this widening, Ofgem omits the context in which our own differential movements took place. It was part of our initiative to better target our assistance to the fuel poor and vulnerable through the introduction of our *Essentials* tariff in February 2007. In not acknowledging *Essentials*, Ofgem leaves the impression that the market is tending to make the fuel

poor relatively worse off when in fact British Gas has taken action to ensure that the opposite is true, through effective targeted assistance.

10. Only 25% of prepayment customers are fuel poor and the majority of the fuel poor do not use prepayment meters. So it is unhelpful to use the prepayment differential as a surrogate for how well the fuel poor are being served relative to others. Our commercial strategy now recognises that there are much better means of targeting assistance to those who need it than equalising the prepayment price to the standard credit price (as was our practice for gas before February 2007). So we have stopped doing it and replaced it with something better.
11. For those fuel poor who do use prepayment meters, our creation of a special Pay As You Go Energy team within British Gas gives us a strong focus on reducing our costs to serve for prepayment meter customers. All of our prepayment customers will benefit from this.

### **The Prepayment Customer Profile**

12. Ofgem's concerns are given extra weight by the suggestion that vulnerable or fuel poor customers may be unduly affected by poor sales practices. It is therefore pertinent to consider the characteristics of prepayment customers, to the extent any common features can be identified.
13. The level of prepayment customer switching has been growing since 2005 and it is now the most active segment. We believe that prepayment meters customers are 47% and 51% more likely to switch than the average customer for gas and electricity respectively. This may be in part driven by the changing profile of our prepayment customers. Our analysis has found that whilst there is a bias towards low income groups, the overall customer base is quite diverse. The profile of the groups is skewed towards young people in the early stages of establishing their careers and setting up home; families who have spent beyond their means that are dependent on credit to fund their lifestyles; young lone parents and single people living in council or housing association accommodation and people in their later working years living in low value terraces and semi detached houses. Financially these groups have an average annual income between £14,000-£26,000.
14. 70% of the prepayment meter base is relatively young, more mobile than average and more likely to switch supplier. Of the factors and characteristics which tend to be associated with reduced switching, older customers are less likely to switch. The same lower switching inclinations tend to be associated with customers who have stayed longer at their residency.
15. Therefore, whilst the prepayment customer base is skewed towards customers on lower income, this does not correlate with those customers necessarily being fuel poor. Nor are they necessarily more vulnerable than other groups, or likely to be less able than others to make their own informed decision. There is some evidence from our research that many prepayment customers take "spur of the moment" decisions. This means that while they may be convinced to switch more easily than other customers, they are also less loyal and may make multiple switches.

## Switching to Higher Priced Suppliers

16. The central point on which Ofgem's letter rests is the statement that while most customers say they switch to save money, more than half of the prepayment transfers in 2007 appeared to involve the customer switching to one of the three most expensive suppliers. This concern is then compounded by the recognition that doorstep and phone sales account for 70% of prepayment switching, raising in Ofgem's mind the spectre of misselling.
17. However there is only a limited amount that can be reliably inferred from Ofgem's switching data and customer research as presented in the letter. Ofgem only look at aggregate switching volumes on a national basis between gas and electricity suppliers over 2007. However different suppliers will be the three most expensive depending on the region, the fuel and the reference point in time. Furthermore, the relevant price comparison for any individual customer will depend on its own household consumption and it must factor in what deal that customer was actually offered. For instance supplier incentives (cashback or one-off discounts) are a common feature in the first year of many supplier offerings so the comparison would need to allow for the fact that the customer's first year price is different to the rate the customer is otherwise paying.
18. Furthermore there is no single pattern of customer behaviour that Ofgem should necessarily expect to see from customers who tell a pollster that they switch to save money. Firstly, there is often a gap between what customers say in surveys and what they do in practice. And secondly, a motivation to save money is consistent for instance with customers switching on the basis of who they think will be the cheapest or best value supplier in the future (not necessarily the cheapest at any point in time) based on the brand values they associate with each supplier. Similarly a recent price reduction by a supplier might influence a customer's switch decision, although a short time after, or even before the switch is complete, moves by other suppliers may have changed the chosen supplier's relative positioning.
19. Furthermore of all gas and electricity product payment types, prepayment is where the market is the least commoditised (i.e., there are product attributes customers value other than price). British Gas is investing extensively to differentiate its prepayment offering (e.g., access to the largest payment point network in the UK, the unique provision of 24x7 service, and the only supplier offering in home vending capability) to improve customer experience. If we did not think customers were prepared to pay us a higher price for that offering (and that instead they would opt for an inferior but cheaper competitor alternative), then clearly we would not make those investments.
20. Ofgem also needs to think more broadly about the link between doorstep selling and customer engagement in the market. Customers are effectively comparing their current provider with their possible new provider when propositioned on the doorstep. Neither of these two suppliers is necessarily one of the cheaper suppliers. The customer may however still save money if the new supplier is cheaper than the old. Furthermore, many customers will not consider switching unless they are pro-actively offered another option, nor will they take any interest in their energy supply at all unless prompted to do so. If more complex energy services to the household market are to develop in the future, it is hard to conceive of the mass market developing without field sales and advisory services playing a significant part. Against this background, Ofgem needs to think as much about the value field sales may have to add as about some of the risks with which it is sometimes associated.

21. All these factors demonstrate that this is a difficult area for analysis. Detailed modelling could shed light on to what extent switching really does help customers get better deals. But it is difficult to take account of intangible factors (such as brand preferences and the influence of the service experience) without performing some rather complicated work. And Ofgem should not approach it expecting to see at the end of it a clear mapping between switching decisions and relative price or value.
22. Evidence from other consumer markets suggests that confronted with a range of prices and offerings, customers do not all converge on the lowest price or best value offering. Clearly an important factor is that different customers have very different levels of interest in exploring their options. Ofgem may still think that more work in this area, despite the complexities, is worthwhile. But it should take some comfort from the fact that recent experience tends to suggest that those suppliers who offer better value overall gain market share in the long run, while those who offer poor service and high prices get punished.
23. In summary Ofgem's letter provides limited evidence on the relationship between the decisions customers make and the prices and services offered to them by suppliers. It is insufficient to conclude that – taking into account the existing rules that already govern suppliers – new regulations are necessary to shape the interaction that takes place between field sales representatives and customers, and the decisions this leads customers to make.

## **The Existing Regulatory Framework**

24. Ofgem's letter does not explain the existing regulatory (and self-regulatory) framework that applies to energy suppliers and how this acts to protect customers. British Gas sales practices are governed by a number of sets of rules including the marketing licence condition in the supply licence, our voluntary participation in the Energysure Code through the AES and distance selling rules. Also the new rules on Consumer Protection from Unfair Trading entered into force in May 2008 and Ofgem has said it will provide guidance for energy suppliers based on these rules.
25. Whilst not an obligation, it is British Gas' practice to apply the principles of CAP (Committee of Advertising Practices) to all of our customer facing sales literature to ensure we follow a best practice approach where we can. In addition, the Energysure Code has played a major part in improving the customers experience on the doorstep. It has driven best practice across its members whilst underpinning agent standards by having in place a central database of agents who have met, and continue to meet the Energysure standards. For British Gas, we have seen energywatch complaints about our sales practices fall by 99.99% since April 2002.
26. We acknowledge the investigation into npower is outstanding. However, the Energysure Code can only address systematic failures, not individuals acting independently of the supplier, regardless of the quality of training. Nonetheless, the supplier cannot of course absolve itself from its liability for the actions of its agents. We await the findings of both the Ofgem and Deloitte investigation (on behalf of the Energysure Code Manager), with a view to establishing what action needs to be taken

by npower. Clearly we cannot prejudge the outcome of this investigation so it would not be appropriate to comment further on it at this stage.

27. Ofgem's letter of 3 December 2007 on "regulation of marketing to domestic customers" states that "*doorstep selling continues to be an effective marketing channel for suppliers..... between July and September 2007, complaints to energywatch on direct sales totalled 103. In that same period 2.1m gas and electricity domestic customers switched supplier*". You also recognise that "*this performance reflects the strides the industry has made in developing self governance regulations for face to face selling activities*".
28. Therefore there is little evidence overall, notwithstanding the npower investigation, that customers are unhappy with the sales experience provided by sales representatives. The most recent energywatch data for example indicates that in May 2008, they received a total of just 15 complaints and 141 empowerment cases about sales practice across the entire industry. Customers who want to complain about a sales practice they have been subject to can now take their complaints to the Energy Ombudsman. The Ombudsman received just 16 level 1 complaints of this type for the industry as a whole for May 2008.
29. To the extent that there are any gaps in the rules on sales practices, these are in our view addressed by the new Consumer Protection from Unfair Trading Regulations. The introduction of these new customer protection regulations will oblige businesses not to mislead consumers through acts or omissions, or subject them to aggressive commercial practices such as high pressure selling techniques. We believe that compliance with this legislation will help to deliver the sorts of assurances that Ofgem wants for all customer types and products and not just those on a prepayment meter. These new rules will also have the effect of bringing energy sales into line with practice in other sectors.
30. Against this background, considering changes to supply licences does not at this stage look like an appropriate or necessary response to the customer detriment identified. Self-regulation through the AES is an obvious alternative to licence changes should Ofgem believe rule changes or a change in sales practices is necessary.

### **Options for New Licence Obligations**

31. A case could be made for an approach to regulation with requirements closer to those in the financial services industry and it is these sorts of options that Ofgem set out in its letter. However, some of these options are fraught with practical difficulties. For example, it is unclear how a requirement to provide a customer with a written statement of the savings its household will make in the case of fixed price deals. How should the supplier describe the value of "peace of mind" and certainty of price that the customer receives from these deals? Similarly if a supplier is required to present a comparative pricing factsheet to the customer at the point of sale, this will be expensive and cumbersome to maintain, given the variety of tariffs on offer and the regularity with which new tariffs are offered or withdrawn from the market.
32. Assuming some sort of additional information requirement could be made to work operationally, some customers might benefit from the improved transparency this might

bring to the sales process. But equally other customers may be put off by it, or do not need it and are happy to make their own decisions based on the information presented to them now.

33. Forcing suppliers to focus more on their price (or their price relative to competitors) in their sales messages may also crowd out other messages in a market in which suppliers are increasingly differentiating their products and focusing on more sophisticated messages such as fixed price deals, green tariffs and energy service offerings. Many customers meanwhile will continue to view their energy supply as a purchase where they are not prepared to invest in high search costs, so more complexity and checks in buying energy on the doorstep may discourage overall customer engagement.
34. The net result of a tightening of selling rules could in fact be that there will be less doorstep selling overall and so many customers would not have the opportunity to engage in the market in the way that they do now. This is precisely what happened in the life and pensions industry when similar changes were applied in the 1990s. We offer below some specific feedback on the options Ofgem identifies:
35. *A requirement on suppliers to provide a written statement of the savings that will be available to the customer from switching provider.*
36. The practicalities of doing this will depend very much on the circumstance and product offering. Fixed or capped products, often sold at a price premium offer customers “peace of mind” and price certainty in the face of potential but uncertain increases in energy prices. It would not be possible to confirm savings in this scenario. Indeed customers may lose money if tariffs generally are reduced whilst the customer is on a fixed price.
37. A written statement based upon the customer’s consumption is also dependent on the information being provided by the customer either at the point of sale or within a given period and as such may not be possible in all instances. The accuracy of the information presented will be dependent upon the accuracy of the information provided by the customer.
38. *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.*
39. Ofgem needs to clarify if it is proposing that suppliers distribute energywatch pricing information at the point of sale or that the supplier produces their own pricing factsheets based upon competing suppliers’ tariffs. Our view is that this would be impractical. We are not aware of any other industry where suppliers operating in a competitive market are required to present to their potential customer all other competing suppliers’ prices at the point of sale. It also reinforces the notion of the market operating purely on the basis of price rather than service or product.
40. In addition, providing information of this nature requires the information to remain accurate and timely. It is not feasible for suppliers to co-ordinate this without incurring extra costs to support this process. These costs will either be passed on to the customer in some way or will need to be met by energywatch or the new NCC.
41. *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;*

This seems a more feasible option. It supports the principle of empowering the customer to make an informed judgment.

*42. A requirement on suppliers to alert customers at the point of sale where they are switching to a more expensive supplier.*

Again this seems bureaucratic and unnecessary. It is also not clear how the new supplier establishes if the customer will be paying more without detailed knowledge from the customer about his consumption, his current supplier and the tariff he is paying. So long as customers are presented with clear and accurate information at the point of sale, the customer should be able to seek out further information via service providers such as Consumer Direct. Customers are already "protected" by a cooling off period, should they wish to change their mind.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Philip Davies', with a long horizontal line extending to the right from the end of the signature.

Philip Davies  
Director of Regulatory Affairs