Campaigning for Warm Homes

Ofgem Analysis of Prepayment Meter Users Switching on Inferior Terms

Comments from National Energy Action

Introduction

National Energy Action (NEA) is a national charity working to minimise, and ultimately eradicate, fuel poverty. Much of NEA's work centres on the need to improve the heating and insulation standards of the housing stock in England and to ensure that energy costs are affordable. In terms of affordable energy costs, NEA adopts a parallel approach – household incomes should be maintained at a level sufficiently high to allow for adequate heating, and energy costs should be equitable and not impose a disproportionate burden on household budgets. The following comments are intended to address the latter of these two issues and, specifically, Ofgem's analysis of tariff differentials, the extent to which these can be justified in cost-reflective terms and the market failings whereby disadvantaged consumers of an essential service can find themselves exacerbating their disadvantage as a result of switching supplier.

Ofgem Analysis

NEA is somewhat bemused by the comment in the letter that: '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'. It is as if the Regulator had no role or involvement in developments in the market. It can be readily accepted that direct debit customers may be cheaper to serve for a number of reasons; what is less credible is that the relative cost of serving customers should have changed significantly over the last few years. Have direct debit procedures become even more efficient and economic during this period; have prepayment and standard credit customers accounts become more expensive to manage; or is there a third possible explanation?

The third explanation, of course, could be that pursuit of more lucrative direct debit accounts has led energy suppliers to offer preferential terms to direct debit customers at the expense of prepayment and standard credit customers. This would represent a perverse cross-subsidy and one that Ofgem should have been monitoring rigorously rather than remarking on in such an ingenuous manner.

If any cross-subsidy were to be tolerated by the regulator, NEA's hope and expectation would be that the losers were more affluent customers and the gainers the comparatively disadvantaged households who use prepayment or quarterly credit payment arrangements. It is also worth noting that unfair treatment of disadvantaged customers would not necessarily result in loss of custom since these two categories of consumer are considerably less likely to switch supplier than customers using other payment methods.

Ofgem is to be congratulated on raising the difficult issue of gas and electricity consumers switching supplier on inferior terms to those offered by their previous supplier. It is also noted that in 2007, contrary to historic trends, prepayment customers switched at a rate equal to or higher than direct debit customers. The explanation for this is unclear; as Ofgem notes there are potentially significant savings for prepayment meter customers who wish to switch supplier but Ofgem also suggests that there is evidence of prepayment meter customers switching to a higher-cost supplier and this is virtually incomprehensible. Ofgem has noted in the past that issues other than price can be factors in switching decisions but NEA would suggest that for prepayment meter users price, and consequent money savings, will almost always be the priority. This view is endorsed by the Ofgem research which suggests that 78% of customers see financial savings as the main reason for switching.

Ofgem data suggesting that in 2007 63% of electricity prepayment transfers and 56% of gas transfers were to the three most expensive suppliers would seem to be an astonishing illustration of market failure. This phenomenon illustrates two particular problems with the domestic energy market: effective operation is dependent on confident and informed consumers and also on ethical practice within the energy industry itself. Neither criterion appears to be met in these circumstances.

Customer survey findings from research commissioned by Ofgem are highly illuminating. Frequently, switching is driven by proactive energy suppliers and directed to (effectively) passive consumers. These consumers are not investigating the market for their best option; rather they are responding to information (and possibly misinformation) provided by an individual supplier with no other motive than to secure additional customer accounts. This is particularly evident in Ofgem data on prepayment meter switchers where only 9% took the initiative and undertook a comparative exercise, whilst 70% of switchers received their information through supplier agents via doorstep and phone sales.

Clearly there is a problem with prepayment meter switchers (there may in fact be wider problems given the dominance of telephone and doorstep sales across all payment methods). However, since prepayment meter users are most likely to be economically disadvantaged and uninformed, switching may well significantly exacerbate existing disadvantage, the priority must be to address and resolve problems in this segment of the market. To some extent prepayment issues should be at least partially resolved as a result of Ofgem’s investigation of disparities in charging structures and the legitimacy of any case for a surcharge on this payment method. The Ofgem investigation should also concentrate suppliers’ minds on greater efficiencies in the prepayment sector in anticipation of existing differentials being minimised or eliminated completely.

However, the main issue for consideration here is how suppliers comply with ethical rather than commercial considerations in their marketing practices. Compliance with existing licence requirements is clearly non-negotiable and NEA would expect the regulator to implement severe penalties where there have been deliberate and consistent breaches of standard licence conditions. It is crucial to confidence in the market and to social equity that the market is seen to meet required standards relating to trust and integrity.

NEA welcomes Ofgem's proposed analysis of cases where switchers have transferred to a more expensive supplier and believes that the findings may illuminate some murkier aspects of the competitive market. NEA notes Ofgem's intention to distinguish between deliberate mis-selling and inadequate or incomplete information. In the case of direct selling by suppliers NEA would make no distinction between false or misleading information and the deliberate withholding of relevant information.

NEA notes with some concern Ofgem's comment that*: '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.'* There are three key issues here: the first relates to the essential nature of energy services for health and welfare; the second relates to the information and knowledge deficit experienced by many low-income and vulnerable households; and the third relates to the fact that the main concern is not suboptimal switching but switching to disadvantage. In a regulated market where the wrong choice can result in severe adverse consequences both economic and in terms of well-being NEA considers this attitude to be insupportable. NEA also notes in passing the description of a specific category of non-switching household as 'lazy/indolent' in Ofgem's recent report on vulnerable consumers' engagement with the energy market. Such pejorative terminology is inappropriate in documentation commissioned and published by the energy regulator.

Ofgem Proposals to Redress the Problems

In relation to the range of proposals put forward by Ofgem NEA would adopt a pragmatic but principled approach:

1) A requirement on suppliers to provide a written statement of the savings that will be available to the customer from switching supplier. **NEA would endorse this proposal and would suggest that the written statement should entitle the customer to redress where claims are subsequently found to be inaccurate.**

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**. At face value this proposal appears both naïve and impracticable. A company's sales staff could hardly be expected to be the source of complete and objective information that, ultimately, identified a competitor's offering as superior. However, since the salesperson's emphasis would be on the specific savings offered by his/her company it seems likely that in many cases the general information would not be consulted and the transaction would be completed. Nevertheless where comprehensive price comparison information had been presented this would at least present an opportunity for fully informed optimal choice of options and, as such, would represent an improvement on existing practice.**

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**. This is a further refinement of 2) in that it emphasises**

that the offer under discussion may not be the best available. It would be further enhanced by provision of pricing factsheets at the point of sale. Clearly this model militates against the culture of a sales process and against the instincts and interests of sales staff. It is difficult to see how this suggestion could be policed since there would presumably be no record of the process where a sale was not completed.

4) A requirement on suppliers to alert customers at the point of sale where they are switching to a more expensive supplier**. Such a requirement imposed on sales staff would, in theory, pre-empt the need for stage 5. However, NEA would see this as a Utopian aspiration the operation of which would have to be vetted anyway by non-sales staff to ensure compliance.**

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. **It would seem more rational for vetting of transactions to occur at this point rather than relying on sales staff with a strong vested interest to counsel the customer about an economically disadvantageous action. To some extent this element of marketing could become self-policing if review of contractual terms where customers switched to their disadvantage led to disciplinary action against dubious sales practices.**

Ofgem also raise the issue of win-back activity currently undertaken by suppliers; we assume that this generally refers to 'incumbent' electricity suppliers. NEA has regularly commented on the anomalies of the competitive market where it generally appears that suppliers compete for all customers except their 'legacy' customers. Our belief is that this practice is sustained by three factors: inertia, anxiety or lack of knowledge on the part of customers (disproportionately vulnerable customers); a lack of interest on the part of the regulator in what can be seen as unfair practices in the market; and the considerable revenues accruing to suppliers from what is effectively a surcharge on loyal customers.

Given the nature of the relationship between many incumbent suppliers and their legacy customers the only effective 'win back' policy should be to offer competitive terms to former customers in keeping with the rest of their customer base. Not only would this serve to win back former customers it would also serve to retain customers, with considerable commensurate saving on marketing and recruitment costs. Only at the point where all energy suppliers compete on price to acquire new customers and retain existing customers will there be a fully competitive market.

Finally, Ofgem asks whether any remedy should apply exclusively to prepayment meter users or be extended to standard credit customers. NEA would point out that the potential problem extends beyond these two payment methods; currently some 25% of fuel-poor households pay by direct debit and, whilst prepayment issues currently dominate this debate, the regulator should demonstrate rigour in eradicating poor practice and malpractice from all marketing activities within the competitive energy industry.