

By e-mail only

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Dear Claire,

Prepayment (ppm) meter switching

I refer to the Maxine Frerk's open letter of 30 May. For ease of reference I have used the same headings.

Summary of Ofgem Analysis

The statistics you cite in the letter show that customer switching remains healthy, the corollary being that consumers continue to have confidence in the domestic energy market. It would be unfortunate if the competitive market was undermined as there are significant benefits customers can realise (and are so doing) by switching supplier.

You recognise that while price is the main factor influencing switching, there is a wide variety of different offers available for customers. For example, our price freeze offer with no penalty if a customer leaves is very attractive to some customers, and while these may involve a premium in the short term compared to variable price contracts, over the longer term in the environment of rising energy prices, customers value the certainty. Such decisions are rational.

Customers also change supplier for non-price related reasons including actual or perceived poor service, reputation, brand, differentiated product features. Doorstep selling is particularly useful for engaging some types of customer eg those customers for who may not have access to the internet. If this form of marketing is curtailed, it could have the effect of excluding a tranche of customers who could benefit from competition

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We believe that the comparisons, and therefore the comments on "switching to a more expensive supplier", may be based on a fundamentally false premise and therefore incorrect. We believe that your comparisons are based on medium user consumption level or "notional consumption". This is a representation of national all GB domestic consumer average consumption across all payment types. In fact any price comparison should be based on the average PPM only customers consumption level ie actual PPM average consumption. To do the comparison on the basis that we fear you may have done, based on notional consumption, clearly makes the comparison incorrect and obviously risks encouraging customers to switch, whether to another supplier or to a different payment type, when in fact such a switch would not be beneficial for the customer.

We have written to Ofgem separately about the cost differentials for ppm and standard credit customers (our letter of 14th April 2008) compared to direct debit customers, where we have shown that these are at least as great as price differences. I hope you do not mind if we again set out the details which are as follows:

- The PPM total cost differentials for both fuels are:-

v QCC	£114
v MDD	£123

If all bad debt costs are assumed to be receipt of bill, the cost of bad debt per customer is £54.

This reduces the PPM cost difference to £60.00 v QCC. It remains £123 v MDD.

There is a time value of money benefit to suppliers in receiving cash from pre-payment customers sooner than from MDD or QCC customers. However for an average customer this benefit is less than £5.00 per annum on a dual fuel basis for PP v MDD and less than £11.00 per annum on a dual fuel bill for PP v QCC.

- The PPM total price differences (including discounts available for dual fuel DD) are:

v QCC	£34
v MDD	£118

Compliance with existing legislation

We take our responsibility to our customers very seriously and any instances of mis-selling are dealt with severely. In the most serious cases, including for example, fraud, staff are dismissed immediately. As Ofgem's note recognizes, individual

instances of mis-selling can arise even when companies are fully compliant with current licence conditions. Our determination to eliminate any possibility of mis-selling is evidenced by our introduction of 100% point of sale recorded verification, an assurance procedure which goes well beyond any existing formal or self regulatory requirements which we will continue to operate as well. We would welcome the opportunity to discuss this initiative with you in more detail.

Other features of our existing sales arrangements are also designed to address mis-selling (especially to PPM customers):

- Commission is not paid unless and until the contract has gone live and the customer has remained with us for a certain period of time;
- Should there be a subsequent problem arising resulting in a complaint by a ppm (or indeed any) customer regarding the sales process, these are investigated independently. The Agent Investigations Team, which deals with sales related complaints is completely separate from the sales function itself. Complaints are therefore investigated objectively and dispassionately;

And:

- We pay a lower commission rate to sales agents when we enter a contract with a ppm customer compared to other payment methods;
- We do our best to take vulnerable customers off walkbooks which is why we do not pay commission for a PPM sale at all if it is not on a walkbook.

You indicate that you propose to undertake research to try and understand why consumers who switched to a higher tariff did so. This is important, and if we can be of any help in developing the research proposition or providing information, we would be glad to do so. In any event, we look forward to seeing the results.

Options for possible new licence obligations

The raison d'être for introducing competition into the energy supply market was to bring an element of choice for customers in respect of pricing, service and other characteristics of the offering. Often, the most effective way that customers can be engaged to understand the different offerings available is by face-to-face or telephone contact. Without these modes of marketing, competition and hence the numbers switching supplier would be significantly reduced.

In our view, it is perhaps premature to speculate as to what, if any, further regulation is necessary in this area whether applied specifically to PPM customers or more generally. It is

perhaps better to wait until the results of Ofgem's research and analysis of information received under the market probe are available. However, we would make the following observations:

- i) We recognise that in order to make an informed choice, customers need access to impartial accurate and up-to-date information. However, a formal requirement to provide information on rivals' products would be highly unusual in a consumer retail market. Ofgem and other comparison providers already provide extensive information to assist customers. And Ofgem currently has initiatives to extend the coverage and accessibility of comparisons for lower income customers;
- ii) Price only comparisons could themselves distort the consumer's choice;
- iii) Depending on the outcome of Ofgem's further work, Ofgem may wish to consider the option of formalizing 100% point of sale recorded verification;
- iv) Consumers already have a right under the licence to a cooling off period during which time they can review their decision at no cost to themselves. It may be that an appropriate and proportionate response to Ofgem's findings is to specify the duration of this period and to require the sales agent to draw this right to the attention of the customer.

Conclusion

The need, if any, for further regulatory intervention in this area should await the further evidence which Ofgem is gathering. However, most of the initial proposals suffer from the drawback that they focus only on price. We believe that it is better for the sales agent's conduct to be 100% verified at point of sale and for the customer to be fully aware of his/her "cooling off" rights so that they know they can review their decisions should they wish to do so.

I hope you find the above helpful. If you require any further information, please do not hesitate to contact me.

Yours sincerely,

David Mannering
Corporate Economic Regulation Director