THE
CHARTERED INSTITUTE OF
PURCHASING & SUPPLY®

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Dear Kersti

Response to Energy Supply Probe

Summary

The Chartered Institute of Purchasing and Supply welcomes Ofgem's Energy Supply Probe and the discussion it is likely to stimulate. We see a good opportunity to introduce benefits for customers. As an organisation set up to protect and support buyers we are not commenting on aspects solely related to domestic markets. With this limitation we agree with the topics and comments made in the consultation but there are certain sections where we give our specific opinions. The main area is non-transparent payments to consultants (or third party intermediaries) by suppliers. We also make comments on the definition of SMEs; termination of contracts; change of supplier and the lack of sufficient small (new) suppliers to challenge the majors. We hope that Ofgem will follow up our responses with improvements to benefit customers. CIPS is willing to assist in this.

Chartered Institute of Purchasing and Supply

CIPS is an organisation that supports and represents buyers in the UK. Currently it has 28,000 members in the UK in all sizes and types of organisations large, medium and small, within both the public and private sectors. As a professional organisation it sets high standards for buyers to achieve full membership status. It has been prominent in the UK gas and electricity industries since privatisation and contributed to the development of these industries.

Non-transparent Payments by Suppliers to Third Party Intermediaries

Over the past few years we have increasingly become concerned at commissions paid by suppliers to TPIs without the knowledge of the customer and we are now looking for Ofgem to become involved. Previous meetings have shown there is a high degree of concern. Customers should know and agree the levels of the commissions being paid. However, this is not the case for various reasons. Many TPIs want it kept hidden as it may be difficult to justify the charges to its customers. At the same time there are many good TPIs that would welcome full disclosure of these commissions by all TPIs. Whilst we are not trying to stop the payment of commissions from suppliers to TPIs the amount of the commissions paid should be made known to the customer.

Non-transparent commissions give rise to other problems:

- A TPI may go just to suppliers which are willing to pay its desired level of commission. This is not necessarily in the best interests of the customer.

- There are some instances we believe where TPIs have contracts with suppliers that stop a supplier disclosing the commissions to the Customer. We think these should be stopped.

- Some TPIs prevent their customers having any discussions with any supplier, including their own supplier. We think this is bad practise and it is being used to hide the levels of commission paid.

Some may take the view that customers should not allow the above but CIPS takes the view that we are here to protect customers, even large ones. (The latter have been victims of large, hidden commissions.) We hope that Ofgem take the same view. It is also questionable whether hiding of commissions could be interpreted as collusion and leaves the TPI and supplier open to future legal action by the customer.

CIPS has set up a small working party to look at this whole subject. It has had discussions with many of the twelve major suppliers and these discussions are to continue. Suppliers have declared their dislike of the levels taken by some TPIs and would like their customers to know the actual amounts being taken. Some suppliers try and control the levels of commission but others are unwilling to challenge the payments demanded by TPIs as they may take their business elsewhere, and this has happened. If suppliers tackled this as a group then they could be referred to the Competition Commission. Suppliers would like Ofgem to put forward guidelines or even a code as we would. Other suppliers have also said they would like CIPS, as a professional body, to be involved. A code could be made very simple but it would take the cooperation of suppliers. We now think that cooperation would be forthcoming. CIPS is willing to be involved but would only consider support for a code if it insists on complete disclosure of commissions by TPIs. We know of no code, actual or proposed, that includes this.

Interestingly we have been told that until about ten years ago suppliers disclosed commissions paid to TPIs to their customers. We think this should happen and further, should be written into the supply contract between the supplier and its customer. This receives support from several suppliers. If Ofgem do no more it should issue guidelines to this effect.

We also draw Ofgem's attention to the recent article published in the Mail on Sunday on September 14th. We think this covers the subject well except that it tends to put all the blame on suppliers.

Definition of SMEs

There has long been a need to define SMEs. We suggest definitions as follows:

Small: micro-enterprises as defined as a result of the Consumers, Estate Agents and Redress Act 2007.

Medium: organisations that use less then 30m kwh of gas or 1m kwh of electricity and which are not included under small. Or it could be defined as less than £1m spend on gas and electricity but with the volatile nature of energy prices this could cause some organisations moving in and out of this segment.

Large: other organisations

CIPS is disappointed that the Government chooses to only have representations for micro-enterprises in the future. Medium sized businesses gained from the protection that EnergyWatch offered in the past. We assume that multi-site organisations would be classified to reflect their collective energy. However, we would prefer that each site of a multi-site organisation was treated individually if this gives it more protection by being classed as a micro-enterprise.

Improvements in one segment as a result of this Energy Supply Probe need to be shared with other segments, if there were to be a benefit.

Termination of Contracts

We see this as a major area of concern and a barrier to competition. The series of meetings organised by Ofgem did not come to a satisfactory solution. Larger customers usually have a contract that expires on a specific date and the customer pays out of contract rates if it has not arranged a new contract. To some extent this would be best for all customers as a supplier cannot "trap" a customer into a further period. However, it obviously means a customer who does nothing ends up paying high default rates.

We think that suppliers use the complexities of their own individual contracts (for smaller customers) to retain their customers. So the first requirement is for all suppliers to have common termination terms to be put forward by Ofgem. We suggest the following:

- There should be no time limitations covering when the termination notice can be given unless a proposal has been sent out below and the 21 days has elapsed. So if any customer wants to revert to a larger customer type arrangement on entering the contract it can do (and takes the risk of going onto default rates). However, the supplier should still send a reminder of the contract termination date between 40 and 60 days before the end of the contract. This could include a proposal if the supplier wishes.

- Sending out proposals up to 120 days before the end of the contract is unacceptable unless the customer specifically asks for one. Proposals should be sent out between 60 and 40 days before contract termination. It should take one of two forms:

i. If the customer has previously given notice of termination then the proposal is only enacted if the customer signs and returns it.
ii. If the customer has not given notice of termination then the proposal becomes a contract if there is no response within a minimum of 21 days.

The latter will still give problems if the proposal is sent to an incorrect or unoccupied premise or is simply ignored. But the above we consider as the best solution.

Change of Supplier

We are still finding problems changing supplier and these form a barrier to competition. Customers that have experienced, or heard of this, are less likely to want to change supplier. First of all existing suppliers make it difficult to terminate existing contracts as detailed above. Then there still seems to be significant problems where existing supplies object to the transfer.

Suppliers are well aware of the rules of objection so further education would be pointless. We think that National Grid or Ofgem should publish six monthly figures detailing the number of change of supplier requests, how many objections were put in and the reason given. These should be broken down into the outgoing supplier. This should show up suppliers that are objecting to a higher proportion that average and enable Ofgem (and customers) to query.

New Suppliers

The power and gas markets are dominated by six companies and up until recently there have been a number of smaller companies that have survived in the smaller commercial sector. There have been little or no new entrants into the UK energy markets in the past 3 years.

However, the recent global finance crisis has had a marked effect on the UK energy markets. In the last month we have lost two suppliers, which have gone into administration because of record energy prices. There is now doubt about the continued operation of yet another supplier. All of these suppliers concentrated on the small commercial sector. In addition, the acquisition of British Energy by EdF now only leaves one supply company in British hands. CIPS has recently discovered that not all is well with the big six, with one supplier having to take out a multi million pound loan at 3% above Libor. To us this does not bode well for the future.

We are of the opinion that the "market will deliver" philosophy is wishful thinking; it cares little for the environment and only caters for today's generation, not tomorrow's. It is obvious to us that the markets are not sending the right messages to encourage new entrants. Both Government and Ofgem need to provide the right incentives if the private sector is to contemplate the entering this market.

Case Studies

We have attached some examples where customers have suffered because of lack of control in the above areas:

Case 1

A manufacturing company was advised by a fairly large TPI. The TPI was anxious that the customer signed a fixed price supply contract quickly. It put forward quotations from just two suppliers to cover both gas and electricity. The TPI made no effort to inform the customer there were other methods of buying its energy, the reason why only two suppliers were used or details of its commissions. When calculated the commissions could have been considered excessive.

However, the customer insisted that the TPI obtained a quote from another named supplier which was offering very good terms but would not pay commissions to TPIs. The TPI eventually agreed to obtain a quote but changed certain figures in the quote to make it look unattractive before passing it to the customer.

Case 2

A national "not for profit" organisation had been employing a TPI to assist them in the negotiation of their gas and electricity contracts. They had been using the same TPI for a number of years. The TPI had always advised them that his costs were covered by other organisations and that his services were free of charge because of the customer's charitable status. However, it has recently come to light that the TPI was taking commission from the suppliers and that the TPI had given instructions that the suppliers were not to divulge the value of the commission to the customer. Further, the TPI, on an annual spend of around £4 million, was making a commission of £750,000 per annum.

Case 3

Recently a large supplier altered its terms and conditions to make it more onerous to be able to leave that supplier, by sending letters of renewal up to 120 days in advance. As is normal, if these are not responded to in a short period then the customer is committed to at least another year's supply. This supplier objected to several customer transfers. When tackled the supplier admitted it had wrongly objected to transfer because the customers' contracts were based on previous terms and conditions.

Case 4

A customer decided to use an on-line company to find, and then move to a cheaper supplier. Eventually the change of supplier occurred a month late. The supplier blamed the on-line company and gave a list of dates when actions had happened. The on-line company disputed the dates given and this was put to the supplier. The supplier did not respond despite several prompts. Eventually, when told the case was going to be brought up in this Energy Supply Probe the supplier issued an apology and promised to investigate.

We have chosen not to name individual parties in the case studies. However, we are prepared, under confidentiality arrangements, to give the names and evidence to Ofgem.

We look forward to hearing from you.

Yours sincerely

Chris Lewis and Martin Rawlings
For and on behalf of the Chartered Institute of Purchasing & Supply