

# Consumer Focus Submission

## Direct Debit Arrangements- Ofgem report and consultation

May 2009

## Summary

Consumer Focus welcomes Ofgem's report into Direct Debits (DDs) with its forensic detail of the DD processes of the Big 6 suppliers and the analysis of how best these can be improved. We particularly welcome the emphasis Ofgem now places on ensuring suppliers improve customer service. Consumers deserve a service that responds effectively to their enquiries and appropriately informs them about charges for energy consumption.

We believe a licence condition is necessary to realise these goals as historically neither competitive pressures, nor the voluntary Billing Code have been sufficient in tackling the problem. We favour Option B, subject to some caveats, as we consider that this strikes the right balance between breadth of coverage and ease of implementation. It should be up to suppliers to react innovatively to meet Ofgem's general principles, however Ofgem must closely monitor company performance to assess whether suppliers have indeed met the standards set out in the licence.

There are a few areas where we would like Ofgem to go further than simply improving transparency and clarity. We believe Ofgem should additionally stipulate minimum standards in DD processes. Specifically, we would like to see:

- A maximum of 90 calendar days from a price change to review and where appropriate amend DD payments;
- Mandatory dissemination of letters at the annual review that offer consumers the option to have credits refunded;
- An industry-wide standard to have large credit balances automatically returned at the annual review;
- To see an end to the practice of having debts repaid within a 12 month period. Suppliers must take ability to repay into consideration.

Consumer Focus feels such stipulations would largely prevent DD problems developing in the first place before consumers are compelled to complain.

### 1. Do you agree with our analysis?

Ofgem has identified some serious and chronic failings with some suppliers' internal management processes on DD accounts. We agree with Ofgem's analysis and share the determination to put this right. Consumer Focus, and its predecessor energywatch have long felt that the overall standard of customer service of many energy suppliers is inadequate.

We agree that the most troubling aspect is the failure to offer customers personalised account management, or to ensure that customer service agents provide correct advice. It is also of great concern that the process of calculating DDs is obscure and pays little regard to the impact on consumers. When

consumers have no understanding of how DD payments are calculated , or why they are subject to change, it is not surprising that there is little faith in the process and that so many are prompted to complain.

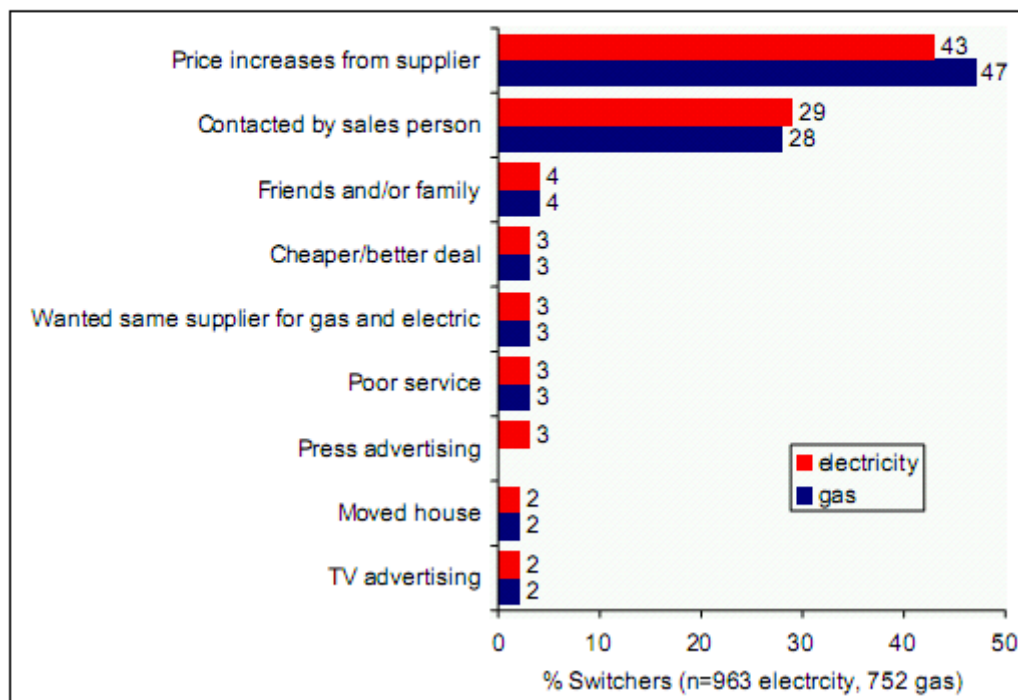
## 2. Do you agree with the elements of best practice we have identified

### Drivers for improved customer services

The question of how to maintain high standards in customer service is no easy task. Historically, the favoured means has been to empower consumers to react to performance and make choices by the publication of complaints data and customer satisfaction indicators. This is aimed at incentivising suppliers to improve performance in order to retain or gain customers. However, Ofgem research below<sup>1</sup> suggests that only 3% of consumers who switch do so on the basis of customer service, most do so instead after prices increases ,or approaches by sales agents.

#### *Prompts for Switching*

Price increases are the main prompt to start thinking about switching (43% electricity, 47% gas). The other main prompt is an approach from a supplier's salesperson (29% electricity, 28% gas).



<sup>1</sup> <http://www.ofgem.gov.uk/Markets/RetMkts/Compet/Documents1/12882-2406b.pdf>, p22.

The research for the DD report , and the above table, both support the proposition that consumer purchasing power has not improved the quality of customer service. There is not sufficient evidence of a strong enough link between purchasing decisions and experiences of customer service. If, as we have seen, competition alone cannot drive performance improvements the question is how best to regulate the sector in a way that does not prevent innovation, yet provides robust standards.

We agree that the best option is to look at standards across the industry and find the approach that delivers an acceptable service, using that as the future benchmark. In this case that means benchmarking the highly regarded customer service of Scottish and Southern Energy (SSE). The Ofgem proposals will require all suppliers to follow SSE's approach to individualised account management. Whilst competitive pressures alone cannot guarantee good service, having a number market participants does allow Ofgem to assess company performance and establish who is best meeting customer need. We believe benchmarking SSE's customer service approach offers an intelligent response to ensure an acceptable standard on DDs.

In terms of the practicalities, we also agree that Ofgem should undertake a review of advice sheets, checking suppliers' contracts and supply material to ensure they are compliant with consumer protection legislation. However, the review should do more than just assess legality. Ofgem should ensure bills and statements are sufficiently clear, with charges and payment information to allow consumers to clearly understand the level of DDs, and the state of the account. Consumer Focus would be happy to provide support to Ofgem in the assessment of these documents to ensure that they are clear, unambiguous and easy for consumers to understand.

### **Consumer Information on Company Performance and Best Practice**

While we support the effort to inform consumers about DDs, we have some slight concerns about the factsheet Ofgem proposes to disseminate to consumers. The factsheet (p.40-41 in the consultation) shows the performance and policies of each provider using an array of indices. It is thorough, but perhaps too complex to be truly useful as a consumer worksheet. More work is needed to make it customer friendly, specifically, reducing the number of indices shown and greater clarity on what the stars are indicating (the maximum stars achievable is not clear). Once again Consumer Focus would be happy to assist.

However, the potential value of even a clear factsheet is limited. Simply providing additional information on customer service performance and refunding credits will not in itself dramatically alter switching patterns or drive performance, as the table on page 2 demonstrates. It is therefore essential that regulatory incentives are placed on industry to drive performance in DD processes.

### 3. Other elements of best practice

#### Refunding credits

The Ofgem document states that DDs must be “*accurate and updated regularly*” and “*credits must not be unreasonably withheld*”. However, Consumer Focus feels that more specific guidance is needed on the process that should take place to ensure consumers can claim credits at the annual review.

Ofgem should stipulate in the best practice guidance that a statement be issued at the annual review providing information about the condition of the account in relation to credits or debts along with the options for dealing with these, for example to carry the amount into the next year and adjust the DDs accordingly, or have any excess refunded.

The large volume of consumer complaints and national media coverage around DDS was due to the impression that credits were deliberately being built up as ‘free loans’ by the energy companies who then failed to pay back any excess collected. Offering consumers an easy means to have credits returned could largely eliminate such concerns.

Addition protection is also needed on the question of automatic refund triggers. We believe large credit balances should be refunded automatically to ensure consumers are not faced with significant fluctuations in payment rates, ie a big credit could mean monthly payment reduce significantly only to increase at the end of the year to ‘normal’ levels.

The principle of benchmarking good performance could be used to provide a minimum threshold to establish automatic triggers for returning large credits. As the Ofgem table (p41) shows, *E-on* automatically return any credit over £5 whereas *British Gas* will only do so with credits exceeding £200 at the annual review. Consumer Focus would not propose a specific figure but Ofgem should determine what is a ‘reasonable’ point at which automatic refunds kick in at annual reconciliation. This could help the industry further allay fears that customers DDs are being used as free loans. At a time when retail prices have fallen, and household disposable income may well be shrinking due to the economic crisis, the return of credits is likely to become a pressing issue for many consumers, and suppliers should ensure that consumers’ money is returned as easily and quickly as possible.

#### Avoiding sharp increases in DD payments

The consultation paper suggests suppliers should review and update DD levels promptly following price changes in order to avoid sharp changes in payments as the result of any large debts or credits being accrued. Consumer Focus agrees and Ofgem should consider identifying a specific timescale in which this should take place.

Ideally, it would make sense for suppliers to notify DD reassessments when consumers are informed of price changes. Suppliers currently have 65 days to inform of price changes; in the notification it would be sensible to tell consumers the impact of the change on the payment arrangement they have. In no circumstance should the review go beyond a normal quarterly billing period i.e. 90 days.

### **New customers paying by DD**

Consumer Focus agrees with Ofgem that sensitive individual account management is key. As such, it is critical to prevent as well as react to potential problems. One example of this is when consumers change from pre-payment meter (PPM) to DD payment method. The Probe found that PPM users consume less energy than those on other payment methods. Evidence from Consumer Focus's Extra-Help Unit indicates that when a PPM consumer moves to DD they are less conscious of energy usage and cost. Consequently, it would be beneficial for reassessment to take place earlier i.e. within the first 3 months, to check consumption forecasts. We believe this stipulation should be added to any best practice guidance for suppliers.

Consumers' expectations need to be managed when they commence a DD scheme so they understand that consumption is estimated and there is potential to use more energy than forecasted, especially if there are lifestyle changes. Suppliers must therefore ensure that communications on DDs goes beyond the explanation of the level of payment and how that was established.

Ofgem has also identified in its proposed marketing licence condition cases where DDs have been suppressed by certain sales agents to persuade customers to switch, only for debt to be accrued and payments to increase later. Ofgem should ensure its proposals in these two licence conditions are co-ordinated to prevent such unscrupulous practices.

### **Wider issues with pricing or payment clarity**

Consumer Focus has wider concerns about pricing strategies and customer services. Although Ofgem addresses these points separately in the Probe, there is a great deal of crossover with the issues Ofgem has correctly identified in the research for this consultation. A functioning market requires informed consumer, unfortunately suppliers have a great deal to do to improve the clarity of information they provide. We will respond to the issues of clarity, consumer information and ensuring real choice separately in our Probe response but the DD problem is symptomatic of an industry that needs to radically improve consumer information. We look forward to discussing how to address this in our response to the proposed retail market remedies consultation.

### **Debts and ability to pay**

British Gas's policy of insisting on collecting all payment within a 12 month window, even when it was perhaps culpable in the accumulation of debt due to for example incorrect payment levels, is

unreasonable. Suppliers must take a consumers' ability to repay debt into account when reassessing DD levels which incorporate an element of debt recovery.

### **The Direct Debt Guarantee**

Ofgem should also consider how the DD proposals will interact with other established protocols on collecting DDs. The 'Direct Debit guarantee' applies to *all* banks and building societies taking part in the direct debit scheme. It says that<sup>[1]</sup>:

- If there is a change in the amount to be paid or the payment date, the person receiving the payment (the originator) must notify the customer in advance.
- If the originator or the bank/building society makes an error, the customer is guaranteed a full and immediate refund of the amount paid.
- Customers can cancel a direct debit *at any time* by writing to their bank or building society.

It is therefore the billing company's responsibility to ask the customer for the money and prove their billing is correct and that information on any changes in the terms of payment must be given to customers prior to any new DD. Energy suppliers should operate under the same principles so that clear information is provided to their customer prior to any change in the DD level with ample opportunity for the consumer to contest the revised amount if he/she is unclear as to how it has been set or whether any change is necessary at all. This should not be considered a perfunctory step but enable the consumer to challenge it if they disagree with the supplier's action. Monies taken in error by a supplier under DD arrangements should also be returned promptly.

#### **4. Is a licence condition needed in this area?**

Consumer Focus believes that a licence condition is needed. Whilst we approve of efforts to inform consumers of the situation regarding payment, we must be realistic; few consumers are likely to base their decisions to purchase energy on questions of customer service or DD procedure, even if the information provided is clearer<sup>2</sup>. Consequently, market pressures, even with highly active consumers, will be of limited value in ensuring supplier responsiveness to consumer needs. Consumer Focus welcomes Ofgem's recognition in the report that market pressures have not helped. Whilst we welcome the standards of conduct proposed in the retail market remedies consultation we are not convinced these will be sufficient to rectify specific issues such as DD payments. Therefore, we share Ofgem's view that a licence condition is needed to oversee changes to the DD processes.

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<sup>1</sup> <http://www.financial-ombudsman.org.uk/publications/ombudsman-news/27/27-directdebit-guarantee.htm>

<sup>2</sup> As shown by the table shown on page 2 of our response.

## 5. Is self-regulation sufficient?

The industry has failed to respond to the question of DDs voluntarily in the past and we see no reason to believe that self regulation will now be sufficient. Self-regulation codes elsewhere in the industry have proved to be weak on monitoring, enforcement and sanctions<sup>3</sup> and there is no indication that the ERA proposed remedies would work in this case.

## 6. Which licence condition is the best approach? Are there other models we should look at?

Consumer Focus believes the licence condition must cover the problems Ofgem identifies. The key issues to think about are:

- a) improved customer services and communication;
- b) accurate estimates of usage based on factual readings;
- c) fair, regular and sensitive implementation of direct debit changes; and
- d) the clear right for customers to have any excessive credits returned promptly.

Any licence condition must give clear guidance to enforce all these points and must not be too narrow so that suppliers are able to circumvent the policy behind the licence condition. Consumer Focus however does not believe that any of the proposed licence conditions, as currently formed, expresses these three points adequately.

**Option A** is clearly a necessary component of any licence condition, but only constitutes one aspect of the problems – communication – as Ofgem’s report identifies.

**Option B** is our preferred option but with some amendments. It covers the communication to consumers of direct debit levels and also it tries to ensure that shocks to direct debit payments, by irregular calculation updates, are avoided by basing payments on “*the best available information*”.

This still leaves some room for unfair and dramatic increases based on suppliers’ policies e.g. the BG collection of arrears during the 12 month period. Indeed, under the wording proposed in Option B by Ofgem, it is far from certain that many of the complaints identified in this report would be addressed. Consequently, we would like to see the addition of a phrase such as “*and that any reassessments are carried out within a reasonable timeframe and applied sensitively to avoid where possible substantial increases*”. With these changes Ofgem could prevent the enormous increases in DD payments when calculations were adjusted that your report identified as being particularly troublesome for consumers.

**Option C** is not the best option at this time for the reasons Ofgem has indicated in the report.

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<sup>3</sup> Such as the ERA code on Face-to-Face marketing that failed to identify, prosecute or fine Npower for flagrant examples of mis-selling, instead it was a media investigation and energywatch that exposed their practices and which lead to the £1.8 million fine from Ofgem.



Therefore, Option B, subject to some necessary additions and detailed guidance offers the best solution. Guidance from Ofgem would create a minimum level of service to provide regulatory certainty while still allowing suppliers the ability to differentiate.

### **7. Should any obligation apply to small business consumers as well?**

Consumer Focus believes the obligation should extend to cover small business customers because their need is just as great. In research recently commissioned by Ofgem and undertaken by FDS,<sup>4</sup> the conclusions were stark. It reported that small businesses are even less able to interact with the market than domestic consumers to find the best provider. Business suppliers can be inflexible in offering payment plans which can place a huge strain on small businesses. Small businesses are also more vulnerable to exploitation by energy suppliers since they are less well protected by legislation. Recent research by the Forum of Private Business reinforces these conclusions and suggests the service given to small businesses is getting worse.<sup>5</sup> This legislative disparity should not be further widened by not covering them in the DD licence condition. It is of vital importance in this economic crisis that their cash flows are not damaged by substantial credits being withheld by energy companies or by sudden and unanticipated increases in DD payments.

As an initial step we believe there needs to be an impact assessment (undertaken by Ofgem) of the relative benefits to consumers and the detriment to small suppliers of compliance costs and the possible barriers to entry. There is a possibility that the condition could only extend to those who operate in the domestic as well as the non domestic sector. It would seem perverse for the Big 6 suppliers to offer less protection to some customers (non-domestic), which as the research shows are just as vulnerable as many in the domestic sector. While we are inclined towards extending the condition to all suppliers a sensible approach would be to first undertake the impact assessment.

### **8. What should be the timescale for implementation?**

We agree with Ofgem that this licence condition should be implemented before next winter so consumers are clear about payment levels in advance of the next period of high energy use. This is another reason for excluding a code of conduct which would take too long to implement.

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<sup>4</sup> <http://www.ofgem.gov.uk/Consumers/CF/Documents1/small%20business.pdf>

<sup>5</sup> <http://www.fpb.org/images/PDFs/research/FPB%20utilities%20report.pdf>