

Sean Baker
Ofgem
9 Millbank
London
SW1P 3GE

8 May 2009

Dear Sean

DIRECT DEBIT ARRANGEMENTS

Thank you for the opportunity to reply to Ofgem's report and consultation dated 27 March 2009 on direct debit arrangements.

We welcome the conclusion that there were no deliberate attempts by suppliers to increase cashflow through unjustified increases in direct debits and agree that the issue related to communication problems. The report is very helpful to us in supplementing the information we had picked up from our own experience in the Autumn and will help us improve the steps we already had in hand to make sure that the problems we had will not be repeated.

Direct debit reassessments following price changes had not been a significant problem area in the past. We have therefore given some thought as to why there were difficulties this time. We believe it was due to a combination of factors: the timing and scale of the price increases (meaning that significant increases in direct debits were happening at a time when many accounts were in credit); the higher level of political and media interest; and specific factors for certain suppliers (such as British Gas's accelerated reassessment and, in our case, the ending of fixed price deals that were struck at much lower prices). The existing communications with customers did not work well in those circumstances, leading to a significant volume of complaints.

We believe that suppliers have learnt from the experience. We have radically revamped our communications with customers around direct debit reassessments and believe that these changes will be successful in avoiding the problems of last autumn. Like others, we are happy to share in the ERA work on best practice.

For these reasons, we think that Ofgem would be mistaken in seeking to pursue detailed regulatory remedies in this area. Suppliers are now focussed on this aspect of customer service and we would expect problems to be swiftly ironed out. Any supplier which failed to do this would rightly risk losing significant numbers of customers to those who can manage the process better. In these circumstances, we believe that Ofgem has not established that there is a market failure that would justify new licence conditions or that action here would be "targeted only at cases in which action is needed".

Perhaps more significantly, regulatory obligations around direct debit communications could risk being counter-productive. Now that suppliers are aware of this particular problem, there will be a commercial imperative to solve it. But embedding this in regulation without allowing the market to solve it would both risk Ofgem being drawn into micro-management of all aspects of customer service and could also encourage management to focus only on this issue, at the expense of looking out for the next unanticipated customer service problem.

I attach a note which explains our thinking in more detail and responds to the specific questions. We would be pleased to discuss this issue and our response further; please contact me using the details printed on the previous page or Pamela Kelly, our Energy Retail Regulation and Compliance Manager on 0141 568 3231.

Yours sincerely,

A handwritten signature in blue ink that reads "Rupert Steele". The signature is written in a cursive style and is positioned above a horizontal line that serves as a separator between the signature and the printed name below.

RUPERT STEELE
Director of Regulation

Annex 1 - Direct Debit Arrangements

Response From ScottishPower Energy Retail Ltd

CHAPTER: Two

Question 1: Do you agree with our analysis of the issues?

Ofgem have carried out a timely and thorough investigation after what has clearly been a heightened period of public, political and media concern over the use of the direct debit scheme as a payment method by energy suppliers. We believe that the detailed information gathered from suppliers on this issue, in conjunction with relevant correspondence and customer complaints, has enabled Ofgem to provide a helpful analysis of this matter. Suppliers will find this input valuable (together with their own experiences) in ensuring that the problems of last Autumn are not repeated..

While we fully agree with Ofgem's analysis of the issues presented, we feel that one point should be highlighted for further consideration. It is clear that prior to late 2008 there had been no history of major problems or complaints relating to the direct debit scheme. However, at this time a number of factors coincided to create significant public concern. These included the size and timing of the price increases (necessitating increases in direct debit payments at a time when many accounts were in credit), as well as the enhanced political and media attention on the energy sector as a whole - in particular on energy prices - and the work of the Business, Enterprise and Regulatory Reform Select Committee. In addition, Ofgem's analysis demonstrates that one major supplier was undertaking a "rapid reassessment" of all their direct debit customers over a particularly short and indeed challenging period of time. In our case, we had a large number of customers coming off low priced fixed term deals, which led to high percentage increases on reassessment.

We do not believe that there is anything arising from Ofgem's investigation that indicates any kind of market failure. It is clear that suppliers were caught unawares by the consumer reaction to direct debit reassessments and that lessons have been learnt which can be expected to prevent a recurrence. Now that the issue is understood, market forces should be able to ensure this.

Regulatory action should only be considered if there is a sustained and systemic failing in supplier practices.

Question 2: Do you agree with the elements of best practice we have identified?

We agree with the broad elements of best practice that Ofgem have identified and indeed believe that we are already working in line with these principles in the majority of areas or taking steps to enhance our current operations where improvements have been identified. The best practice is helpful, guiding suppliers on areas that should receive particular attention, yet not overly prescriptive and in that respect retains the ability for flexibility of approach and innovation on an individual supplier basis.

As Ofgem have recognised, there are links with the ongoing market probe that should be considered here, for example the provision of an annual statement of information to customers, including annual consumption. Such information, if retained by customers, could prove useful in the switching process in terms of setting direct debit levels for new customers. In the longer-term smart metering, and the potential for greater data sharing amongst suppliers, should also enable direct debit payments to be set at an appropriate level for new customers.

Question 3: Are there any other elements of best practice you think we should consider?

It is clear from the situation that arose in relation to British Gas that, when carrying out reassessments, suppliers should consider the optimum period over which these should occur to effectively manage customer contacts, debt build up and payment levels. It may be helpful to enhance Ofgem's best practice to suggest that:

- Suppliers should ensure that reassessments are carried out on a timely basis, *taking account of the need to manage customer contact levels.*

CHAPTER: Three

Question 1: Is a licence condition needed in this area? Please give reasons.

We believe that additional regulation in the form of a new licence condition should only be considered where there is clear evidence of a market failure. This would be the case if it were proven that the industry as a whole has demonstrated a sustained and systemic failure in servicing customers. A new licence condition is not the appropriate response to an unexpected problem which the industry is now addressing and which (with the measures now in place) is unlikely to recur.

In general, questions of customer service can be left to the market to deliver. Companies which give bad service are likely to be punished by loss of customers and there is no evidence that this is an area which falls outside the "wherever appropriate" requirement for Ofgem to protect the interests of consumers by means of competition. Neither would this seem to be a case where regulation would be "targeted only at cases in which action is needed" as required by changes made by the Energy Act 2004.

As indicated above, we believe that Ofgem have carried out a valuable exercise that has identified a number of useful improvements to the current direct debit arrangements that suppliers operate. Introducing a standard licence condition appears to be a disproportionate regulatory response in such circumstances. On this occasion, in particular, we anticipate that all suppliers are likely to readily recognise the value in the elements of best practice that Ofgem have proposed and the improvement in customer service that can be achieved from adopting Ofgem's proposals or other initiatives with a similar effect.

We believe that the problems of Autumn 2008 are unlikely to recur, following suppliers' experience, and that a combination of individual initiatives and shared industry work on best practice should be effective in managing the issue for the future.

We are concerned that introducing licence conditions for this kind of issue without allowing the market to solve it would risk Ofgem being drawn into micro-management of all aspects of customer service and could also encourage management to focus only on this issue, at the expense of looking out for the next unanticipated customer service problem.

Question 2: Do you consider that suppliers could deliver the improvements we have identified through self-regulation? Please give reasons.

As indicated above we believe that all suppliers will be willing to commit to implementing a strong package of improvements in this area of customer service and self-regulation is

an option for delivering this. If this is the case, and in light of Ofgem's commitment to the principles of "better regulation" we would suggest that Ofgem ask energy suppliers to deliver the best practice requirements through self regulation within a specified timescales. Ofgem can take the appropriate steps to monitor suppliers' compliance but will then have the option to propose licence conditions if suppliers do not deliver on their commitment in these key areas as required.

We believe that this approach provides for a more proportionate and co-operative approach and places the onus very much on suppliers to proactively rectify the failures in service that Ofgem's investigation has discussed.

We believe that the industry as a whole would benefit from a wider understanding of Ofgem's position on self-regulation and, in particular, the strengths and weaknesses of existing practices and their expectations with respect to the delivery of future initiatives. This would undoubtedly involve some consideration of the current OFT review of self-regulation and industry led compliance. It may be that direct debit is perhaps an ideal issue around which to look at how Ofgem and the industry can work together to solve a problem without needing licence conditions.

CHAPTER: Four

Question 1: Which of the options A, B or C do you consider would be the better approach? Are there any other models we should consider?

While we support the use of self-regulation on this occasion, if a licence condition is subsequently shown to be necessary we believe that something between Option A and Option B could provide a possible approach. However, the drafting is at present not fully defined and so it is difficult to be definitive at this stage. We do not believe that the current rather qualitative wording is suitable for the licence route for enforcement.

Question 2: Should any obligation apply to small business consumers as well as domestic consumers?

We are not aware that the issues identified in Ofgem's report are relevant to small business customers or that any of the complaints that arose were in relation to small business customers. As such we do not currently see a need to extend any such obligation to small business customers. In particular, small business customers are more likely to enter longer term fixed contracts, keeping their prices stable over a longer period of time. Therefore, direct debit fluctuations and indeed concerns of the type seen in the domestic sector seem unlikely to arise in the small business market.

Question 3: What would be a realistic timescale for implementation?

It is our understanding that suppliers have already looked at the way they handle direct debit reassessments and we believe that a significant improvement is already in place. This is certainly the case for ScottishPower. We would expect to make further changes by the end of this year, building on the helpful material set out in Ofgem's consultation document.

The timescale for compliance with any regulatory requirement would obviously be dependent on when the final decision is made by Ofgem, the results of the statutory consultation on the proposed modification, and the precise details of that modification.

8 May 2009