Making a positive difference
for energy consumers

To: Holders of Gas and Electricity Supply Licences, DECC, Citizens Advice, consumers and their representatives and other interested parties

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30 July 2014

Dear Colleagues,

Statutory consultation on non-domestic automatic rollovers and contract renewals

This letter contains our final proposals to improve the information suppliers provide to micro-businesses when they renew an energy contract. It also covers our proposal to standardise the timeframe for contract renewals. We would like to hear your views on the effect of these proposals and the proposed modifications to the standard licence conditions (SLCs) 1 and 7A of the electricity and gas supply licences.

Our new rules would require suppliers to:

- include the consumer's annual consumption and current prices, as well as rollover prices, on the renewal letter
- require consumers to give no more than 30 days' notice if they want to leave at the end of a contract – rather than the current maximum of 90 days
- acknowledge receipt of a termination notice within five working days.

Representations to the proposed modifications should be made in writing on or before **28 August 2014**. We expect these amendments to be implemented by 31 March 2015.

We are not proposing to ban automatic renewals at this stage, as doing so carries some risks to consumers and we are considering whether it would be proportionate and in consumer's interests. However, we have serious concerns about the difference in prices charged by a very small number of suppliers when they renew contracts automatically. This practice may be unfairly penalising customers who do not actively engage with their supplier at contract renewal. Over the next six months we will monitor whether this situation changes: if not, then we will reconsider the case for a ban on automatic renewals.

To further help small businesses, we plan to publish an updated factsheet to help them know what to look for as their fixed-term contract comes to an end, so they are equipped to shop around and avoid an automatic renewal if they wish.

Background

During the Retail Market Review (RMR) we committed to review the practice of automatic renewal contracts (auto-renewals). Under our current rules, suppliers can agree contractual terms that allow them to extend a micro-business contract for up to 12 months if the customer does not contact them to agree a new contract or tell them they want to change supplier. Consumer groups and third party intermediary (TPI) representatives have expressed concerns about auto-renewals and some have called for them to be banned.

In summer 2013 the six largest suppliers announced that they would end their current use of auto-renewals during this year. Together they supply around 90% of micro-business customers for electricity and 86% for gas.

On 14 February 2014[1] we published a consultation on changes to the regulatory framework to protect micro-businesses and help them secure better deals on their energy contracts. This included examining the role of auto-renewals for micro-business consumers. The non-confidential responses to that consultation are now on our website. You can find a summary of responses in Appendix 1.

Our conclusions following consultation

In a competitive market we would expect to see consumer action, such as the threat of switching supplier, exert competitive pressure on suppliers. There is evidence to show that clear and simple information can help facilitate such engagement. The RMR reforms and our recent work on third party intermediaries (TPIs) is aimed at improving the quality of information available to consumers, establishing clear and transparent processes and standards to facilitate engagement.

Our final proposals for clearer information and simpler processes described below should improve the ability of micro-business consumers to assess their options when they come to renew their energy contract. Micro-business consumers need to be fully aware of how their prices will change if they do not contact their supplier before a contract ends, and have the information available to decide whether to contact their supplier, or compare other offers. A common timeframe for contract renewals should also make the process simpler for consumers. These proposals should assist effective consumer engagement, irrespective of whether the supplier still uses automatic renewals.

Our proposals to improve contract renewals for micro-businesses

Maximum 30 day termination notice period

- We propose to reduce the maximum termination notice period for micro-business consumers from 90 to 30 days.
- Suppliers will have to send a renewal letter around 60 days before a fixed-term contract ends. This would apply to all fixed-term contracts, irrespective of whether they retain auto-renewals.
- For contracts that allow auto-renewal, at least one offer must be kept available until 30 days before the fixed-term ends.

Most respondents supported the proposal for a maximum 30 day notice period. Two suppliers warned that it could reduce competition and choice for consumers.

We think that micro-businesses will benefit from a consistent timeframe for giving notice and receiving a renewal letter. It will make the market[2] simpler and clearer. Notice periods currently vary between 30 and 90 days. In our 2013 business consumer survey,[3] a

[1] Proposals for non-domestic automatic rollovers and contract renewals. https://www.ofgem.gov.uk/ofgem-publications/86071/automaticrolloversconsultationfinal.pdf
[2] In this document we use the term "market" as shorthand for referring to the energy sector. For the avoidance of doubt this term is not intended to describe or otherwise suggest the approach that may be taken by Ofgem for the purposes of market definition in competition law investigations.
[3] Quantitative Research into Non-domestic Consumer Engagement in the Energy Market, Element Energy and The Research Perspective, December 2013. https://www.ofgem.gov.uk/publications-and-updates/quantitative-research-non-domestic-consumer-engagement-energy-market

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significant minority (17%) of businesses with a fixed-term contract were unsure or did not know when they could renegotiate their contract or give notice. A further 36% knew these dates approximately.

One respondent said a shorter notice period could lead to suppliers making more objections when gas consumers want to switch. Under the Uniform Network Code,[4] a customer's new supplier can ask the old supplier to switch a supply 42 days before the contract starts. If the customer has until 30 days before the contract ends to give notice then they may not have submitted a termination notice to their existing supplier by the time the new supplier requests to take over the supply. The current supplier could then object on the grounds that it had not received termination notice. Although we are aware of this risk, this situation may occur for suppliers that already have a 30 day notice period. The objection window[5] should allow this situation to be resolved and we do not see it as a justification for not going ahead with our proposal.

Current prices and annual consumption details on renewal letters

- Renewal letters must include the prices which apply to the current contract, as well as the prices that would apply if the customer is rolled over or does not renew the contract.
- If prices may change during the contract, suppliers must inform customers and explain how prices will vary or fluctuate or direct customers to where they can find the prices.
- Renewal letters must also include the consumer's annual consumption or a best estimate where this is not available.

Most responses agreed with the intent of this proposal, although there were different views on how much information should be included on the renewal letter. Some suppliers said it could be misleading to have current prices on the letter, particularly if they were agreed two or three years before and wholesale prices had changed significantly. Two suppliers thought our proposals should go further and require a forecast of the annual bill and the difference from current prices to be shown in percentage terms.

We believe a comparison with current prices will provide a more effective prompt to consumers than the new prices alone. This is likely to be the first comparison consumers make before deciding whether to compare other supplier offers. Our quantitative research showed that switching tended to be price-driven, rather than relating to dissatisfaction with the previous service. Although we also see the benefits of a full personal projection of the annual bill, we are aware of the potential complexity and cost for smaller suppliers in particular.

Most respondents agreed that annual consumption on renewal letters could be useful for consumers, although there were queries about whether suppliers should use industry sources such as the Annual Quantity (AQ)[6] or Estimated Annual Consumption (EAC).[7] Suppliers should use the most accurate consumption information available to them. We do not want to restrict suppliers by mandating industry sources if better data is available. However, if the supplier has less than one year of meter readings or had the customer for less than a year then a best estimate can be used. This could include using industry sources such as the AQ or EAC.

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[4]The Uniform Network Code is a common set of rules which ensure that competition in gas supply can be happen on level terms. It governs processes, such as the balancing of the gas system, network planning, and the allocation of network capacity

[5] A period of two to seven working days in which the current gas supplier can object to a consumer's transfer request to a new supplier if permitted by the contract terms.

[6] Annual Quantity is the estimated yearly gas consumption for a meter point. It is calculated using historical consumption. It is used by Xoserve, gas shippers and networks.

[7] The Estimated Annual Consumption is an estimate of electricity consumption expressed in kWh per year

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Acknowledging termination notice

- Suppliers must acknowledge receipt of a termination notice in writing, which may include by electronic communication.[8]
- They must do this within five working days of receiving this notice (or as soon as reasonably practical thereafter).

Most respondents were supportive of this proposal, and most suppliers said it was already in line with their current practices. One supplier agreed with the rationale, but believed it should apply only when the customer could automatically renew. They also said that there could be more effective ways to update the customer on their contractual status, such as on the bill.

Whilst we agree that acknowledging termination notices is particularly important for auto-renewal scenarios, suppliers may still require 30 days' notice if a customer wants to leave. With or without auto-renewals, it is important that the customer is aware that their supplier has received a valid termination notice and they can enter into new contract without facing an objection.[9]

When will these rules take effect?

We recognise that our proposals for consumption information and current prices on renewal letters may require significant IT changes. We are now proposing that:

- The requirements to acknowledge termination notices and implement a maximum 30 day notice period will apply from **31 December 2014**. For contracts entered into before 31 December 2014, the maximum 30 day notice period would apply when a micro-business consumer enters a new contract, or if a contract is extended.
- The additional price and annual consumption information on renewal letters will apply from **31 March 2015**.

The draft modifications to the SLCs of the electricity and gas supply licences are included alongside this letter.

Why we aren't banning automatic renewals now

Some larger suppliers and consumer groups believed strongly we should ban auto-renewals, and three suppliers said we should consider banning exit fees for auto-renewed contracts. This would allow suppliers to extend the contract for another fixed term, but allow customers to leave the contract early without paying an exit fee. Smaller suppliers were strongly in favour of retaining auto-renewals.

Our conclusion is that auto-renewals are not a negative feature in their own right, but may be problematic where prices are significantly higher than an equivalent negotiated contract. This may indicate a lack of consumer awareness or engagement with the renewal or switching process.

Proportionality

A ban would be significant intervention in the market, restricting the products that suppliers can offer to micro-businesses. Our 2013 business consumer survey, undertaken before the large supplier announcements, indicated that only 2% of business consumers said their

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[8] Electronic communication is defined in SLC 1 as "... a message comprising text or an image of text that:
  a) is sent over a Public Electronic Communications Network;
  b) can be stored in that network or in the recipient's terminal equipment until it is collected by the recipient; and
  c) is in a particular form and is used for a particular purpose and the recipient of it has expressed a willingness, to the sender, to receive it in that form and for that purpose"

[9] As long as there is no other valid reason for an objection, such as outstanding debt.

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current contract had been rolled over without their knowledge. There was no significant difference in the level of satisfaction among those who negotiated a new contract with an existing supplier (83% satisfied) and among those who had their contract rolled over (86% satisfied). We have also estimated that 1% of micro-businesses would remain on rolled over contracts[10] following the announcements of larger suppliers to stop auto-renewals.

In addition, our RMR policy requiring suppliers to publish contract end and termination notice dates on bills only came into effect from 31 March 2014. This policy should help to improve consumers' knowledge of these dates and we will be monitoring how suppliers comply with these rules.

Direct risks to consumers

There is a risk that banning auto-renewals will mean that some consumers move to more expensive prices than if they were rolled onto another fixed-term contract.

Our information request showed that electricity prices for micro-businesses without a fixed–term contract (deemed[11] or out-of contract[12]) were on average 80% higher than negotiated contracts. The data also showed that around 10% of electricity consumers and 11% of gas consumers were on deemed or out-of-contract prices; and on average, half of deemed consumers stay on these prices for more than 12 months.

Hedging risk for smaller suppliers

Having a large proportion of customers on fixed-term contracts allows a supplier to hedge[13] the risk of short-term changes in wholesale electricity and gas prices. If a small supplier is uncertain how many customers it is likely to have for the next 12 months, it will be more difficult to effectively hedge its demand and this risk is likely to translate into higher prices.

Suppliers that do not have auto-renewals are likely to have more customers on variable-term contracts. Due to greater uncertainty about customer numbers, they would have to purchase more electricity or gas on the near-term market, one to two months ahead of delivery. One independent supplier has said the hedging cost of a variable term contract is around 5% more than a fixed-term contract. These additional costs could be passed through to consumers, leading to higher prices. This would make it harder for smaller companies to offer competitive prices.

Leaving a 'ban' option open

Despite our current view not to ban auto-renewals, we are concerned about the price differences charged by a very small number of suppliers between auto-renewed contracts and contracts agreed with the customer. The average annual bill for a micro-business on auto-renewal prices in April 2013 was a third higher than negotiated prices, but some suppliers charged significantly more.

While pricing decisions are a matter for individual suppliers, we are concerned that a minority of customers auto-renewed with these suppliers would be locked into significantly higher prices because they did not contact their supplier during the renewal process. Through our consultation, we have not seen any explanations for such significant differences. We will be writing to the suppliers in question about our concerns.

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[10] Estimated using supplier data from April 2013.
[11] A Deemed Contract typically arises where a person moves into a new property and consumes electricity or gas without agreeing contractual terms with a supplier. The circumstance where a deemed contract occurs is set by Schedule 2B paragraph 8(1) of the Gas Act and Schedule 6 paragraph 3(1) of the Electricity Act.
[12] Suppliers may apply out-of-contract terms when a fixed-term contract ends but the customer does not switch supplier or agree a new contract.
[13] A 'hedge' is a transaction that fixes the future price of a good or service, and so removes exposure to its daily (or spot) price. This enables a supplier to reduce the risk of short term-price movements.

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For this reason we are keeping the option of banning auto-renewal contracts on the table. If in six months' time there is evidence that auto-renewals remain problematic for micro-businesses, despite the RMR information remedies and our current proposals, we expect to propose a ban on auto-renewals. We will closely monitor the market during this period.

Deemed Contracts

In our February consultation we asked whether the current licence conditions on deemed contracts were sufficient and whether suppliers should be allowed to object to deemed customers with outstanding debt.

Most responses thought the supply licence already provided sufficient protection for business consumers. Two consumer groups disagreed and said we should prescribe a specific methodology for deemed prices. Most suppliers believed they should be allowed to object for deemed customers with outstanding debt.

As we said in our February 2014 consultation, we do not intend to make any further changes to the deemed contract licence conditions. The Standards of Conduct now apply to all matters relating to deemed contracts and suppliers should be treating micro-businesses fairly.

In our consultation on 'moving to reliable next-day switching' [14] we said we would examine the potential costs of retaining objections for the domestic and non-domestic retail markets by the start of 2016. Future work on objections will be included in this project, although we do not expect to consider options which allow for objections on deemed contracts.

All respondents agreed that more consistent use of terminology across suppliers would also be beneficial, although two suppliers suggested this work should be led by Ofgem. Energy UK is currently developing standard terminology which would be adopted on a voluntary basis. We support this initiative and will remain closely involved.

Next steps

Please respond with your views on this consultation and the effect of the draft licence modifications by **28 August 2014** to nondomestic.rollovers@ofgem.gov.uk. We prefer to receive responses by email, but they can also be posted to:

Meghna Tewari
Ofgem
9 Millbank
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After considering responses we intend to publish a decision letter in autumn 2014.

Responses will be published on our website. If you don't want your response to be published, clearly mark it as not for publication. We will respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

Yours faithfully,

Rob Church
Associate Partner, Smarter Markets and Smart Metering

[14] Moving to reliable next-day switching, 16 June 2014. https://www.ofgem.gov.uk/ofgem-publications/88156/fastandreliableswitchingcondocfinal

Appendix 1 - Summary of consultation responses

We received 23 responses to our February 2014 consultation.

- 15 from suppliers
- five from consumer groups and trade associations
- two from third party intermediaries
- one from a business consumer.

Non-confidential responses are published on our website.

Banning auto-renewals

Responses were mixed on whether we should ban auto-renewal contracts. Two large suppliers and consumer groups believed that we should ban, arguing that most consumers would prefer not to be rolled over automatically. They also said it could be confusing for consumers to have the option of contracts with and without auto-renewals, giving a competitive advantage to suppliers that retained them.

Most independent suppliers supported auto-renewals. They said it was an important option for some consumers, and a ban would be disproportionate and result in more customers on deemed contracts.

Three suppliers suggested that we ban termination fees for contracts that have been auto-renewed. This would allow suppliers to extend contracts for a further 12 months and offer price stability, but still let consumers leave the contract at short notice.

Maximum 30 day termination notice period

Most respondents supported this proposal and many suppliers said it was already in line with their current practice. One supplier argued that it would increase uncertainty for them, as they would have less time to hedge their position with the wholesale market. They also said it would reduce their ability to differentiate themselves from suppliers with shorter notice periods.

Another supplier supported the proposal, but said it was not consistent with the current switching window for gas, which can be up to 42 days before a contract starts. A shorter notice period could lead to more objections if the new supplier has applied for a transfer, but the customer has yet to give their current supplier valid notice of termination.

Current prices and annual consumption details on renewal letters

While most respondents agreed with the intent of this proposal, there were differing views about the amount of information that should be included on renewal letters.

A few suppliers and a consumer group thought our proposals should go further, by requiring the letter to show an annual bill forecast and the percentage difference from current prices. For our annual consumption proposal, most respondents agreed this information could be useful for consumers, although there were queries about whether suppliers should use standard industry sources.

Acknowledging termination notice

The vast majority of respondents supported this proposal and many suppliers said it was already their current practice. One third party intermediary argued that acknowledging termination notices gave the suppliers an opportunity to win back the customer, and suggested that terminations should be led by the new supplier. One supplier believed there were more engaging ways to update the customer on their contractual status, such as on the bill.

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Deemed Contracts

Most respondents thought the supply licence already provided sufficient protection for business consumers on deemed contracts. Two consumer groups disagreed. One said we should prescribe a specific methodology for deemed prices, with a maximum percentage difference between deemed prices and equivalent contracted prices.

Most suppliers said they should be allowed to object for deemed customers with outstanding debt, as it would help to reduce their bad debt risk and ultimately lead to lower deemed prices. Three suppliers and two consumer groups disagreed. They said deemed objections would be anti-competitive and cited other ways to recover debt.

All respondents agreed that more consistent use of terminology across suppliers would also be beneficial, although two suppliers suggested Ofgem should lead this work.

Implementation timetable and costs

Consumer groups agreed with our implementation timings, but most suppliers said our proposed implementation date of 31 August 2014 was too soon. Suppliers told us the proposal for consumption and price information on renewal letters would require IT system changes that could take six to nine months to implement.

Specific information on implementation costs was limited, although six suppliers provided estimates of one-off implementation costs. These ranged from £15,000 to £655,000. The average was £220,000.

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