Rachel Clark
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

30 July 2018

Dear Rachel,

Supplier Guaranteed Standards of Performance: Consultation on Switching Compensation

ESB Energy welcomes the opportunity to respond to your consultation[1] on introducing switching compensation. Our understanding of your concern is that the number of switches that go wrong is too high and this is damaging confidence in the switching process and consumer engagement in the market. This is despite a number of obligations and a voluntary code being put in place in recent years. Your main intention is to create incentives to ensure suppliers improve their switching performance and make switching more reliable through new guaranteed standards. This will also have the effect of compensating individual consumers for switches that go wrong.

Our response suggests some changes to your proposals which we believe will deliver better outcomes for consumers. We have not provided any suggestions around identifying which party is at fault for a switch gone wrong in each circumstance and ensuing only they pay compensation. However, we would be supportive of this, if practicable. We've set out our suggestions in order of greatest importance.

In Questions 16 and 17, you ask how compensation payments should be split between gaining and losing suppliers in Guaranteed Standards A and C. You suggest that the gaining supplier should pay £30 and the losing supplier pay £15. We haven't seen any evidence of why this split in payments has been chosen beyond this statement: "We understand that the majority of the responsibility for getting a switch right sits with the gaining supplier." At a recent Cornwall Insight Energy Supplier Forum you presented a slide[2] that shows that 75% of erroneous transfers (ETs) were caused by incorrect industry address data. It is the incumbent supplier's responsibility to ensure that the data they have on their customers is correct and that changes to industry databases are requested as necessary. This would indicate that the losing supplier is actually responsible for ETs 75% in of time.

In any case, we would suggest that if your main goal is to create incentives to ensure suppliers improve their switching performance, then the overall level and split of payments between suppliers needs to be assessed in a different way. A good financial incentive should be set at the minimum level that drives appropriate behaviour to deliver the desired outcome:

- If the incentive is set too low, a rational actor (such as a supplier) will decide that the cost of changing their behaviour outweighs the cost of the incentive and they will continue to act as before. The desired outcome won't be achieved.
- If the incentive is set too high, the supplier will change their behaviour. However, the additional cost beyond what was necessary to change supplier behaviour will ultimately be borne by consumers, including vulnerable consumers, through higher bills. An excessive incentive could lead to unintended consequences. For example, it could also lead to a chilling effect on switching as suppliers' efforts to make sure switches go right reduces the number of available sales channels or causes hassle for consumers.

You state that delayed switches are caused by "poor validation of switch requests by gaining suppliers or poor meter point data quality as a result of inadequate data maintenance by losing suppliers". We agree and also consider these the key drivers behind erroneous switches. Here is a summary of the behaviour change needed on the part of gaining and losing suppliers in order to minimise delayed and erroneous switches:

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[1] https://www.ofgem.gov.uk/publications-and-updates/supplier-guaranteed-standards-performance-consultation-switching-compensation
[2] See Annex 1

- Gaining supplier: Validate the data received as part of the switching process and address any issues in a timely manner. There is a clear trigger for carrying out this validation exercise, the switch. The number of data points the gaining supplier receives from the customer and the losing supplier, directly or through industry databases, is limited. Gaining suppliers have an existing financial incentive to carry out these validation checks. The quicker the switch is successfully processed, the quicker the customer becomes a source of revenue. The behaviour change required is relatively modest.
- Losing supplier: Check all customer data in your portfolio. Make changes as necessary, including requesting changes to relevant industry databases. For large suppliers, this will involve checking tens of millions of data points across millions of premises. Losing suppliers won't know when each of their customers is going to leave, so data quality must be maintained continually. Losing suppliers have no clear financial incentive to carry out these checks. The quicker the switch is successfully processed, the quicker the customer's revenue is lost. The behaviour change required is much more substantial.

Furthermore, while the gaining supplier will automatically pay compensation, the customer must claim it from the losing supplier. The smaller the level of compensation on offer, the less likely the customer is to claim it. A rational actor would price in the likelihood of paying the incentive when weighing its impact against the necessary behaviour change.

We think the incentive on the gaining supplier is too high. This will lead to increases in customer bills that could otherwise be avoided. On the other hand, we think the incentive for the losing supplier is set too low. This will cause an increase in bills without the associated increase in switching performance. For these reasons we suggest that a payment of £10 from the gaining supplier and £30 from the losing supplier would deliver improved outcomes for consumers compared to what you had proposed - more switches would be successful and bills would be lower.

Question 30 asks if a two month implementation period is sufficient for making the necessary changes for complying with your proposals. Your stated rationale for such a brief period is that your proposals are "consistent with existing requirements". However:

- In your engagement with us you've stated that this isn't a 'minded-to' position. You're consulting with an open mind and welcome any suggestions. Many of the proposals in this consultation do not appear to be underpinned by evidence. We understand you plan to address this through your Request For Information and further engagement with the industry. For these reasons, we believe your policy proposals will evolve significantly over the coming months in response to feedback and new evidence. That makes it difficult to plan for implementation at this point in time.
- Some of the existing requirements you've referred to are in the Energy Switch Guarantee. Just 24 of the 69 domestic suppliers in the market are signed up to the Energy Switch Guarantee. For most suppliers in the market, these proposed requirements will be new.
- Even when the proposals are referencing existing licence conditions, there are key differences. For example, the requirements around a timely switch and sending out a final bill are subject to an 'all reasonable steps' test in the licence. This test does not feature in the proposed guaranteed standards.

For these reasons, we would suggest that the proposals will have more impact on the industry than you've assumed. More time will be needed for the implementation of these changes.

Question 25 asks whether Ofgem should take the power to make individual suppliers carry out an independent audit of their work. As far as we're aware, this power is unprecedented. It carries an increased risk of legal challenge and many issues would need to be thought through to ensure it's workable and proportionate. For example, how will Ofgem ensure that it does not unduly discriminate against an individual supplier in carrying out an audit? What can a supplier can do if it considers itself subject to undue discrimination by Ofgem? A legal challenge on this proposal could substantially delay the implementation of the overall package of measures. The existing guaranteed standards work well without an auditing function. Therefore, we would suggest you don't pursue auditing in order to de-risk the delivery of the overall package of measures.

Question 9 asks about your proposed requirement for the losing supplier to pay compensation where they fail to issue a final bill within 6 weeks. This is based on an existing licence obligation, however, a key difference is that it doesn't provide for an 'all reasonable steps' test. The key enabler of a final bill is agreeing an opening read with the gaining supplier. Once that's agreed, issuing the final bill is straightforward. We're concerned that the current proposals could be open to gaming by gaining suppliers if only the losing supplier faces a financial incentive to agree a timely opening read. For this reason, we would suggest that the gaining supplier should also be incentivised. For example, the gaining supplier could be required to pay £15 compensation where an opening read isn't agreed within 4 weeks and the losing supplier could be required to pay £15 compensation where they fail to issue a final bill within 6 weeks.

Question 29 suggests the idea of higher compensation where a supplier chooses to switch a customer within 5 working days during the transitional period of the Switching Programme. This measure would dis-incentivise suppliers from opting into the 5 working day process during the transition period. A lack of robust testing of the process during the transition period which would increase the risk of things going seriously wrong once faster switching becomes mandatory. We would suggest that this idea isn't pursued in order to re-risk the delivery of the Switching Programme.

Finally, a key factor in getting switches right is obtaining the correct information from the customer. We can take steps to minimise the chances of getting incorrect information through their own sales channels and, to a lesser extent, through 3rd party agents we are contracted with. A recent news report stated that Ofgem had ordered energy suppliers to accept switches through 3rd party agents with which they have no commercial agreement[3]. Unlike suppliers, these agents are not regulated. We would appreciate clarity as to whether Ofgem believes suppliers should be obliged to enter into commercial agreements with all 3rd party brokers in order to manage the quality of switches. More generally we would appreciate clarity from Ofgem on how they expect suppliers to manage the quality of switches through 3rd party agents with which they have no commercial agreement.

We would be more than happy to engage with you further as you develop this policy. Please don't hesitate to get in touch.

Yours Sincerely,

Paul Fuller
Regulation Manager

[3] https://www.thetimes.co.uk/article/energy-firms-block-automatic-switching-to-rivals-tdr9p8s98

Annex 1

Figure A1.1 Known outcomes in the switching process