

Verastar Ltd (“Verastar” or “we”) supplies multiple services including gas, electricity, water, insurance and telecoms to over 160,000 microbusinesses. We are regulated by Ofgem, Ofwat, WICS, the FCA and Ofcom. Our experience in five regulated sectors provides valuable insight into the supply of such services to microbusinesses and we welcome the invitation to respond to this consultation.

There are 5.4 million microbusinesses in the UK which account for 96% of all businesses¹. The majority of these microbusinesses have a single owner operator which means they have limited time and resources to engage with the energy market. If they are to be encouraged to do so, then the process for engagement needs to be simple. We do not believe that the current process is simple for the reasons set out below.

We would like to propose a solution that:

- reduces energy prices to microbusinesses;
- increases competition in the energy market; and
- reduces broker costs.

We believe there are two main reasons why some microbusinesses pay more than they need to for their energy:

1. general apathy on the part of microbusinesses as to their choice of utility supplier; and
2. providers acting in their own self-interest.

The actions of brokers are a consequence of these two reasons and the current market construction.

Behaviour of microbusinesses

We believe the apathy shown by microbusinesses is perfectly rational. The utility cost for a typical microbusiness is a low, single digit percentage of the overall cost of running their business. They generally also believe that the cost and service doesn't vary much by supplier. They therefore focus their time and effort on generating revenue and reducing their material costs, such as those of key suppliers. In short, their perception is that any energy savings they could make would not be material to their business.

Microbusinesses on out of contract rates could, however, save a substantial amount by negotiating a fixed term rate.

Behaviour of energy providers

Energy providers are aware of the customer apathy and price their services as high as they can, knowing relatively few will negotiate a lower price and many of those that do can be reactively retained. This creates a significant price differential between contracted rates and non-contracted rates, which the theories of harm focusses on.

Behaviour of brokers

The combined behaviour of microbusinesses and providers as set out above allows brokers to fill a gap in the market. Brokers tell microbusinesses they can save them money (which they can and do) and they tell providers they can gain them customers (which they also can and do). In view of the

¹ <https://researchbriefings.files.parliament.uk/documents/SN06152/SN06152.pdf>

number of active brokers in the energy market, it is fair to assume that the broker market works reasonably well for brokers. However, brokers require a profit margin. We believe their costs are far higher than is reasonable due to the current market construction and that incumbent brokers are able to exploit customer relationships to a greater extent than they could in a truly competitive market. Brokers will often decide to switch microbusinesses to the provider offering the highest commission to the broker rather than the provider offering the best rates to the microbusiness. Brokers also commonly apply their own mark up to the rates offered by the provider.

Current outcomes

The combined behaviours described above of microbusinesses, providers and brokers create a situation in which providers price high where they can, brokers cover their cost and profit requirements for new customers by exploiting existing customers and inert customers are charged considerably more (either via a broker or out of contract rates) than those who actively engage with the market.

Broker charges are high in part because their costs are high. Their costs are high because of the way in which the market currently operates. One of the causes of this is the proliferation of fixed term contracts.

Fixed term contracts offer a number of benefits including, for the customer, the ability to fix prices and remove risk and, for the provider, the ability to offset its risk by firstly hedging or forward purchasing and secondly by objecting to transfers.

However, fixed term contracts also make it more difficult for brokers to gain new customers unless customers actively wish to change provider. Brokers have to initiate contact with potential customers and identify both their contract end date and an estimate of usage to establish whether or not they can offer them a contract in the near future and, if so, at what price. Even once the customer has agreed to transfer, the customer/broker needs to provide written termination of their contract to their current provider. Brokers typically obtain a Letter of Authority (LOA) to fulfil all three requirements. Although LOA's are commonly accepted by providers, each provider requires different LOAs as there is no universally acceptable LOA.

Without fixed term contracts, we believe that the market would be more fluid, broker sales volumes would be higher, cost of sales lower and as a result, customer prices would fall.

The current transfer process is as follows:

1. find a customer interested in changing provider or customer calls in;
2. supplier is required to obtain contract end date and consumption data;
3. this is provided by the customer, via bill or third party or the supplier must obtain a LOA;
4. If LOA is required, supplier is required to submit a LOA and wait to receive contract end date and consumption data, which can take weeks;
5. contact the customer again to quote the customer;
6. enter into a contract with the customer;
7. customer provides notice to current supplier;
8. customer transfers to us.

The above process is arduous and has multiple points of failure, a high rate of wasted effort and a low success rate. The end result is a high cost to transfer a customer due to an inefficient process, but a process that is required for the energy market to balance current provider pricing. Consequently, a

broker that already holds the required information, having previously established a relationship with a customer, has a disproportionate advantage over a broker attempting to establish a relationship with the same customer for the first time. The originating broker is in a much stronger position and can continue to make a high margin whilst at the same time preventing a new broker from being able to price effectively and cover their costs.

Proposed solution

The Verastar solution is very simple but would transform the cost of using a broker and stimulate competition.

There are three proposed changes:

1. Firstly, remove the contractual requirement to terminate a contract in writing. The receipt of a transfer order (together with the licence obligations on placing a transfer order) should be deemed acceptable notice from the customer, via their chosen new provider, to terminate an existing contract with effect from the chosen transfer date. The existing provider should be able to object to a transfer if the customer is within a fixed term period at the effective date of the transfer.
2. Secondly, the information obtained via an LOA should be provided as a regulated dataflow via the Central Switching Service (CSS). A provider cannot currently place a transfer order without customer consent but evidence of that consent is not provided to the existing provider. Why then should the existing provider require an LOA to provide a contract end date and usage information to a gaining provider? The potential harm to a customer of transferring their supply without consent is far greater than that for providing contract end date and usage information. In practical terms, the creation of a new data flow where a provider requests and receives contract end date information and consumption data would significantly reduce the costs of brokers. The end result would be more efficient broker activity, reduced broker margins resulting in lower customer prices and increased competition as customers approach the end of their fixed term contract.
3. The final change should be the introduction of a cooling off period similar to that in the fixed line and broadband market, where the customer has the right to cancel a contract up to the point of transfer. For the energy market, we would suggest a slight change so the contract could be cancelled up to the point of no return of the transfer order. Without a cooling off period, broker activity focusses on winning the race to be the first to enter a customer into a contract, which sees brokers acting earlier and earlier in the contract life cycle (increasing cost as more and more risk is factored in). The cooling off period should include the existing provider for new contracts or contract extensions, where the “point of no return” is the final day of the original fixed term contract.

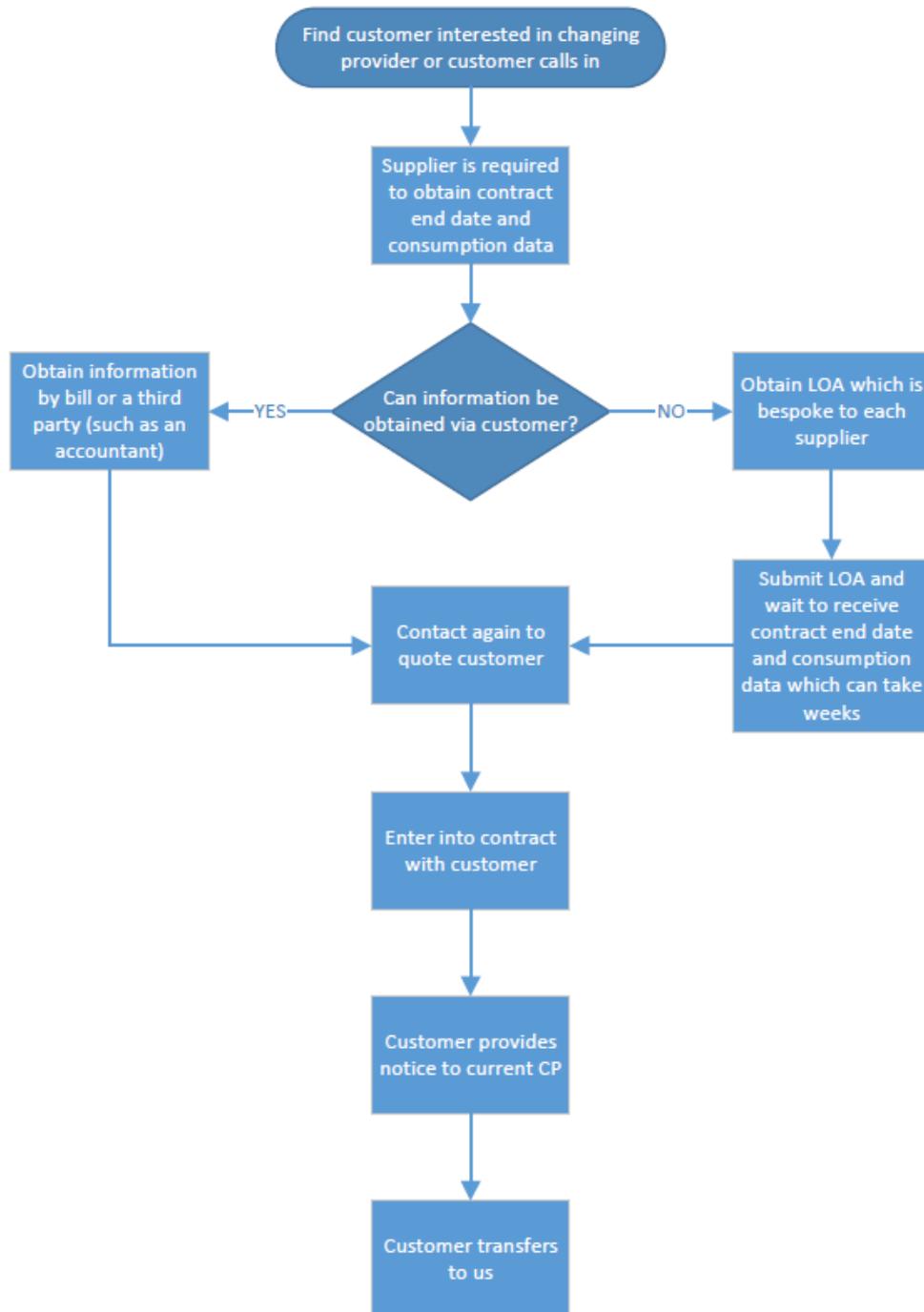
Why transfer objections should still be allowed

Providers generally forward purchase or hedge energy for contracts into which they enter. Without the certainty of a contract, the provider has a greater risk of a contract being unfulfilled and being exposed to the fluctuations of wholesale energy prices. As such, they would need to factor in that risk, which would increase costs to customers. In addition, customers would be able to change supplier at any time, encouraging brokers to contact them more regularly to switch supplier, but an unscrupulous

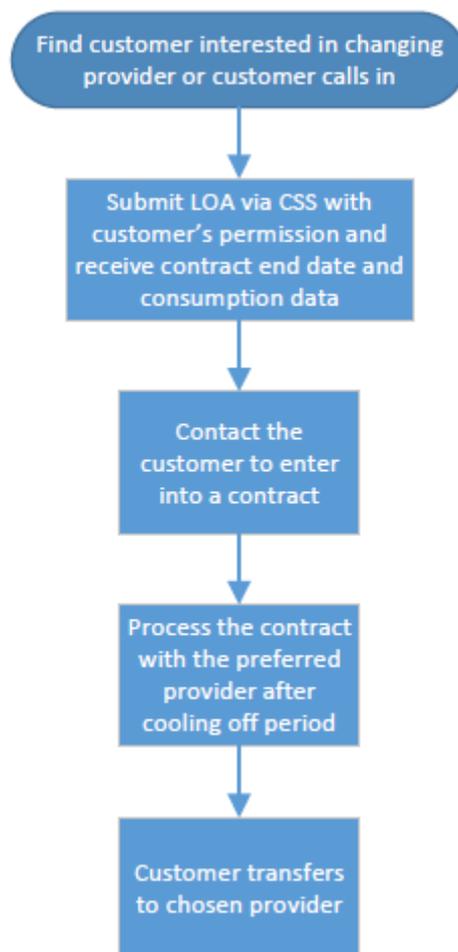
broker may not inform the customer of their contractual obligations, leaving the customer in two contracts, causing significant harm.

Current process V future process

Current process



Future process



RESPONSES TO CONSULTATION QUESTIONS

Theories of Harm

1. Do you agree that Ofgem's theories of harm represent the most significant and impactful areas of consumer detriment?

We believe the most significant detriment to microbusinesses is the complex process for transferring providers. Apathy on the part of customers enables energy providers to (1) price high knowing that few customers will negotiate a lower price and (2) pay high commissions to brokers who often transfer customers to providers offering them the highest commission rates.

We agree that the cost of disengagement is higher for microbusinesses than domestic consumers. However, it's unfair to assume that microbusinesses are unable to understand the energy market simply because they are smaller than other businesses. Microbusinesses have to comply with complex legislation and processes such as payroll, VAT, health and safety and GDPR. The energy market is no more complex or onerous than any other markets with which they engage. For these reasons, we continue to support the separation of domestic and non-domestic regulation. We do not believe that microbusinesses require specific additional protections to those offered to larger businesses.

2. Are there any other key areas of consumer harm that should form the focus of the review?

Yes. The review should include:

- A review of the current transfer process
- The removal of the contractual requirement to terminate a contract in writing
- The provision of the information currently provided in response to an LOA via ECOES
- The introduction of a cooling off period similar to that in the telecoms market

Please see proposed solution above for further detail on each of the above proposals.

Customer Journey

Awareness

3. Do you think awareness raising materials/initiatives would be of significant benefit to microbusinesses? What key information should any new materials focus on and how would they best be delivered to microbusinesses?

No. Awareness raising materials may benefit a small proportion of microbusinesses but we do not believe that this would be of significant benefit as microbusinesses already know that they can switch provider. As stated in our introduction, they do not do so because of apathy, belief that all suppliers are the same, the fact they do not believe the benefits of transferring justify the “hassle” involved and because they are time poor.

Browsing

4. What do you see as the most impactful issues hindering microbusinesses attempting to effectively browse the market in search of an improved deal/service offering? Please provide evidence demonstrating why you believe these issues to be most impactful.

Time

The utility cost for a typical microbusiness is a low, single digit percentage of the overall cost of running their business. They generally also believe that the cost and service doesn't vary much by supplier. They therefore focus their time and effort on generating revenue and reducing their material costs such as those of key suppliers. In short, their perception is that any energy savings they could make would not be material to their business.

Whilst there is much emphasis in the energy industry on the absence of a price comparison website for microbusinesses, we do not believe, for the reasons set out in our introduction, that a price comparison website would save time. Microbusinesses can already contact suppliers directly to obtain a quote.

Apathy

A key issue combined with the hassle factor preventing microbusinesses from browsing the market in search of an improved deal/service offering is apathy on the part of microbusinesses. Over 30.5% of the prospective energy consumers we've spoken to in the last 12 months were unwilling to discuss any offers or requested that no further sales calls be made. This was despite our offer to save them money by either moving them off deemed contract rates or fixing the cost of energy until the end of their fixed term.

Contract

5. What do you see as the key issues microbusinesses face when they come to enter into a new contract for their energy supply? Please provide evidence demonstrating the extent and impact of the consumer harm caused by these issues in the form of both financial and non-financial detriment.

Currently there is no mandatory cooling off period.

There are 2 clear benefits of introducing a mandatory requirement on suppliers to place orders a number of days after the contract agreed date:

1. Where a customer has entered into a contract without considering alternative options, it allows them a period of time to consider whether they have made the right decision and, if required, seek alternative proposals during the seven days.
2. A cooling off period allows the customer to be more decisive at the point of sale as the microbusiness is aware it can change its mind or continue to seek quotes from other providers whilst knowing it can at least benefit from the prices offered at the point of sale.

Broker charges

Microbusinesses using a broker rely on the broker to offer satisfactory prices but have no visibility of the level of commissions earned by the broker and may not be offered the best prices due to conflicts between financial incentives and customer benefits. Reliance on a broker means missing the opportunity to talk directly to providers to benchmark.

6. Do you have evidence demonstrating the extent and impact of malpractice by brokers dealing with microbusinesses? We are seeking both evidence demonstrating consumer harm in the form of both financial and non-financial detriment.

See the introduction above.

Dialogue

7. Can you provide evidence demonstrating the extent and impact of any consumer detriment caused by providers approaches to dialogue with consumers about debt management issues? We are seeking both qualitative and quantitative evidence about demonstrating consumer harm in the form of both financial and non-financial detriment.

We support the view that providers should treat microbusinesses who are in payment difficulties and face disconnection fairly under the Standards of Conduct obligations.

However, bad debt is a significant cost to providers, ultimately resulting in increased costs to all microbusinesses due to the level of risk. Whilst it is inevitable that some microbusinesses' circumstances may change, leading to insolvency and bankruptcy, business owners should pay for the energy they consume and not treat payment for utilities as lower down the priority list than other goods/services they procure.

We agree with Ofgem's previously published views that enforceable license protections of this nature are not necessary or desirable for non-domestic consumers, where the nature of the detriment is different to domestic consumers and where equivalent issues of vulnerability and fuel poverty do not exist.

Exit

8. Are you aware of microbusinesses facing significant and impactful issues when they come to exit a contract with their provider?

Yes. Microbusinesses often forget about their obligation to provide 30 days' written notice to cancel at the end of their fixed term. This causes delays in transfers, dissatisfaction and is generally obstructive to the transfer process. We believe the requirement to terminate a contract in writing should be removed and that the receipt of a transfer order should be deemed notice to terminate from the microbusiness. The existing provider should be able to object to transfer if the microbusiness is within a fixed term at the effective transfer date.

9. Please provide evidence of the extent and impact of consumer detriment caused by the issues you have commented on in response to the above question. We are seeking both quantitative and/or qualitative evidence demonstrating consumer harm in the form of both financial and non-financial detriment.

N/A

Should you wish to discuss any of the above points in person our Chief Executive Officer, Chris Earle, would be delighted to do so in person or over the phone at a convenient time.

For any queries, please do not hesitate to contact me via email on [REDACTED] or by telephone on [REDACTED].