

Impact Assessment

Review of non-domestic objections

Impact Assessment

Publication date: 28 July 2016

Contact: Consuelo Pacchioli, Senior Economist

Team: Business Consumers and TPIs

Tel: 0203 263 7000

Email: NonDomesticRetail@ofgem.gov.uk

Overview:

This is an Impact Assessment of the current policy regime for supplier objections to consumers switching to another supplier in the non-domestic market. We recommend retaining the current rules, as set out in the standard conditions of the Gas and Electricity Supply Licences (SLCs), which prohibit transfer blocking other than in certain specified circumstances.

This document assesses the impact that rules governing the use of objections have had on consumers and competition, compared to an alternative case where there are no exceptions to the absolute prohibition on objections. Our analysis suggests that, overall, the current regime delivers net benefits to business consumers, but there are some areas with residual consumer detriment. We will tackle these areas next, as outlined in our decision letter.

Context

As part of the existing switching process, gas and electricity suppliers are ordinarily prohibited from objecting to a customer changing supplier, but may object in specific circumstances set out in the relevant Standard Licence Conditions (SLCs)¹. Supplier objections are a long-established feature of GB gas and electricity markets, for both domestic and non-domestic consumers and are regulated under SLC 14.² For non-domestic consumers, suppliers can object to the customer transfer where there is a provision in the contract that allows them to prevent the transfer and they may rely on this term at the time of the transfer request.³ The most common contract terms relied on are those which prevent a switch during a fixed term period or when a customer is in debt.⁴

Ofgem rationale behind the introduction of these rules⁵ was to introduce a regulatory framework enabling suppliers and consumers to effectively agree in their contract how they will manage their relationship when switching, and complying with their contract. This should allow suppliers to develop commercial arrangements other than those prescribed by the SLCs and be better targeted toward consumers' needs, by way of negotiation.⁶ Suppliers have been advocating that the right to object to a switching request lets them offer consumers better prices and innovate in other ways.

This Impact Assessment (IA) is designed to be read in conjunction with our decision letter. Our review of the objections process has links with the Switching Programme, Retail Market Review (RMR) follow-up measures introduced to improve engagement among microbusinesses, Competition and Markets Authority (CMA) remedies,⁷ and our wider work on third party intermediaries. Our recommendation to keep the current objections regime has also been taken in the expectation that some of these initiatives will help to address some of the current areas of consumer detriment.⁸ Our decision will feed into Ofgem's Switching Programme, ie the design of the new Central Registration System.

¹ For the purpose of this document, the reference to SLCs apply to both gas and electricity unless otherwise specified.

² Non-domestic customer transfer blocking is governed by SLC 14.2.

³ A supplier can also object if: (i) it agrees with the customer that the transfer was initiated in error, (ii) in the case of electricity, if not all of the related meter points are being transferred together, or if there are outstanding charges in respect of Green Deal charges, and (iii) in the case of gas, transitional provisions exist for contracts formed before 2004.

⁴ Furthermore, in the non-domestic market objections rules differ for gas and electricity consumers (eg wording in the reasons for which suppliers can object).

⁵ Ofgem, '[Transfer objections: stronger rights for industrial and commercial consumers: Decision document](#)', August 2003.

⁶ We believe that microbusiness consumers may not possess enough bargaining power to successfully negotiate contracts. As such, since 2013, Ofgem's work in the non-domestic market has been focused on introducing protections for microbusiness consumers. These are summarised in table1.1 at p.17.

⁷ CMA, '[Energy market investigation: Final Report](#)', June 2016.

⁸ Ofgem, '[Decision on Non-Domestic Objection Review, July 2016](#)'.

IAs are a vital part of our policymaking process and provide a valuable way to assess the impact of important policy proposals. Ofgem has a statutory duty to undertake and publish IAs for important matters – those involving a major change or having a significant impact on regulated businesses or consumers.

Associated documents

[CMA Energy Market Investigation, Final Report](#) (June 2016)

[Moving to reliable next-day switching](#) (February 2015)

[Supplier Objections: a call for evidence](#) (February 2015)

[Implementation of the Retail Market Review non-domestic proposals – decision to make licence modifications](#) (June 2013)

[The Retail Market Review – Findings and initial proposals](#) (March 2011)

Contents

Context	2
Associated documents	3
Contents	4
Executive summary	5
1. Introduction	14
Objections in GB market and past Ofgem work.....	14
The current review.....	17
2. Methodology and approach for IA	24
Purpose of this Impact Assessment.....	24
Baseline and alternative case.....	25
Welfare standard.....	26
Changes in the non-domestic market.....	26
Use of cost-benefit analysis.....	28
Balance of qualitative and quantitative assessment.....	29
Different user groups.....	29
3. Assessment of benefits	31
<i>Benefit 1: Lower customer bills through fixed term contract objections</i>	31
<i>Benefit 2: Lower customer bills through debt loss avoidance</i>	41
<i>Benefit 3: Protection from erroneous transfer</i>	45
<i>Benefit 4: Costs are paid by consumers who incur debt and not spread across whole customer base</i>	47
<i>Benefit 5: Greater choice of supplier across business customer segments</i>	48
<i>Benefit 6: Price certainty for consumers</i>	50
<i>Benefit 7: Ability of consumers to maintain informal working capital</i>	51
<i>Benefit 8: Avoidance of transitional costs</i>	52
4. Assessment of costs	54
<i>Cost 1: Higher bills through inability to switch</i>	54
<i>Cost 2: Ability to pay considerations</i>	57
<i>Cost 3: Reduced ability to switch under a fixed term contract</i>	58
<i>Cost 4: Lack of supplier incentives to proactively target debt</i>	59
<i>Cost 5: Cost of debt/capital for company to provide financial buffer</i>	60
<i>Cost 6: Friction and impact on future switching</i>	61
<i>Cost 7: Transitional costs</i>	64
5. Assessment summary	65
Quantified benefits.....	65
Breakdown by consumer size.....	66
Non-quantified benefits and costs.....	66
Impact of Competition and Markets Authority remedies.....	68
Overall assessment.....	68

Executive summary

As part of the existing switching process, gas and electricity suppliers are ordinarily prohibited from objecting to a customer transfer, but may object in specific circumstances set out in SLC 14.2.⁹ Where objections are permitted, the existing supplier is entitled to a period (the objection window)¹⁰ in which it can determine whether to object to the transfer.

Our most recent evidence confirms that the most common reasons for objections are contractual terms relating to (i) a fixed term period (here on referred to as 'fixed term contract objections'), where the vast majority of business consumers are on fixed term contract, and (ii) debt. In the former case, consumers cannot leave their current supplier before the end of the fixed term contract or if they had not correctly followed termination procedures. In the case of debt, the customer's attempted transfer will be objected to if they have outstanding debt with their current supplier.

Unlike the domestic market, a key feature of the non-domestic retail market is that there is no obligation to supply, ie the supplier is not required to supply and offer terms to electricity and gas business consumers that make a valid request.¹¹

This review explores the role of objections in non-domestic retail energy markets. In particular, we are seeking to understand:

- (i) The impact of objections on consumer engagement,¹² switching and competition more broadly.
- (ii) Whether objections represent an effective tool for management of risks in the non-domestic market,¹³ ie if they deliver consumer net benefits in terms of lower prices and better quality of service.

⁹ The objections regime only apply to contracts that are defined in SLC 14.2. In particular deemed contract are not in scope of the SLC, hence suppliers cannot block a transfer away from a deemed contract. Typically a deemed contract will occur where a customer moves into a new property and has not agreed contractual terms with a supplier who is supplying energy to that property or where a fixed term contract expires and there are no explicit provisions for terms and conditions for the period immediately after expiry.

¹⁰ In electricity, under the Master Registration Agreement, this period is "five working days". For gas, under the Uniform Network Code, the window varies to enable a three-week switch to be achieved and could be "as low as two working days depending on the number of public holidays and other non-business days".

¹¹ This is one of the main differences between the domestic and non-domestic market. In the former, SLC 32 requires (with specified exceptions set out in SLC 32(2) of the Electricity Supply Licence and SLC 32(2) and (3) of the Gas Supply Licence) suppliers to offer terms to all domestic consumers that make a valid request.

¹² With an understanding of how this changes according to the customer size.

¹³ These are: (i) contractual risks, where a customer leaves a fixed term contract before its end which brings additional costs in relation to the selling of (unconsumed) energy that was bought in advance, and (ii) credit risks, where a customer with outstanding debt leaves their current supplier.

This Impact Assessment (IA) reviews supplier objections to switching requests in the non-domestic retail market in both the electricity and gas markets. The analysis provides details by size of consumer (ie microbusinesses¹⁴ and larger businesses).

Over the calendar year 2014 (the latest available full calendar year for our data), there were circa 590,000 switching requests. The most recent available data for objections (September 2015) finds that 21% of non-domestic switching requests are objected to;¹⁵ this equates 30% for microbusinesses and 12%¹⁶ for larger than microbusiness consumers.¹⁷

Our IA evaluates the current regime of objections against the alternative of the same market where objections are prohibited without exception. In other words, this is the same market we referred to the CMA in 2013 and not a perfectly competitive market. In conducting our analysis we took into account the nature of energy as an essential service, as well as its unique characteristics in comparison to other sectors. These are:

- (i) The broad range of costs suppliers have to face given the volume of energy consumed by business consumers (this would not vary as much in telecoms for instance). Energy has a significant marginal cost relative to fixed costs, ie the energy commodity makes up a significant proportion of the price.
- (ii) The large volume of energy accounted for in business contracts makes it difficult for suppliers to manage their portfolio of consumers.
- (iii) Unlike most other utilities, energy involves reselling a commodity. As a result, the risk of closing out wholesale positions that have become unhedged as a result of a customer switching away is an additional cost faced by suppliers.
- (iv) Energy supply has only a single point of provision (consumers can have two bank accounts or two mobile phone contracts but only one energy provider at a time).

¹⁴ We define a microbusiness as a non-domestic electricity consumer with annual consumption not more than 100,000kWh or a non-domestic gas consumer with annual consumption not more than 293,000kWh, or a non-domestic consumer with fewer than 10 employees and an annual turnover or annual balance sheet total not exceeding €2 million. This differs from the CMA's 'Relevant Segment' definition of non-domestic consumers, to which their price transparency remedy applies. See footnote 27.

¹⁵ The weighted industry average of switching requests objected to, taking into account that many more objections relate to microbusiness consumers is 28%. For comparability reasons with statistics from Ofgem previous (2011) review we refer to the simple average objections rate in the text. In 2011 the industry rate of objections was 25% or less of total transfer requests; however data referred to a small set of suppliers.

¹⁶ These figures are calculated using data from 21 suppliers out of the 23 suppliers we requested information to.

¹⁷ Note that our 2015 data spans only until the third financial quarter. Compared to 2014, the proportion of objections for microbusinesses in 2015 was broadly the same and decreasing for larger businesses (ie 3% less).

We look at both quantifiable and non-quantifiable costs and benefits. Our assessment considers these together, but only makes a quantified estimate where we consider the information is sufficiently robust to do so. Where there is uncertainty in our estimates of quantified costs and benefits, we have considered different scenarios. This leads to a range for our quantified and net benefits assessments, as opposed to a single figure.

Costs and benefits have been derived from evidence received from a request for information (RFI) under which 23 suppliers with a combined market share of 98% for electricity and 78% for gas provided data on their non-domestic supply business.¹⁸ The data received through the RFI also highlighted key areas of residual consumer detriment stemming from potential non-compliance with SLCs and in relation to microbusinesses.

Our analysis concludes that there are significant net benefits to consumers from supplier objections and therefore it would not be in consumers' interests to remove or modify the relevant licence conditions.

Benefits

Description and scale of key quantified benefits

Our estimate of quantified benefits from the objections regime compared to an alternative regime where objections are not permitted is **£83.5-683m**¹⁹ per annum (p.a.).

The two largest quantified benefits relate to the tariff premiums suppliers would charge if objections were to be removed from the market.

- This is largest for the premium related to debt objections (£40-409m p.a.). Objecting to an indebted customer's request to transfer is an effective way for suppliers to manage bad debt and credit risk. Without objections, we consider that firms would expect to make a larger provision for bad debt, and this would be reflected in higher prices for all consumers.
- Fixed term contract objections allow suppliers to object to a customer's attempt to switch during the period of a fixed term contract. This allows suppliers to hedge their consumers' estimated energy requirements over the duration of the contract, reducing wholesale price risk. We estimate the benefit of this reduced

¹⁸ A mandatory RFI was sent to our sample of non-domestic suppliers in November 2015. Our analysis refers to data collected from all 23 suppliers, except SSE for the second part of the RFI (one supplier with relevant market share) whose data arrived too late to be analysed. Nonetheless, we sense-checked their data to ensure that they would not skew industry trends and we do not believe it would have had an impact on our analysis.

¹⁹ IA figures have been rounded to the nearest whole number unless they are on the 0.5 decimal place.

risk premium, and avoided losses on closing wholesale positions, to be between £61.5-302.5m p.a.

The breadth of the ranges for the risk premium indicates that there is some uncertainty around the estimates. We have used direct market evidence (eg RFI evidence of prices paid by different types of consumers on fixed versus variable contracts, and prices paid by consumers with debt who are served by suppliers who object on grounds of debt versus those served by suppliers who do not object on these grounds) to arrive at these estimates rather than anticipate non-tariff change estimates in the future, for example, increased use of exit fees or security deposits.²⁰

The remaining quantified benefits include the transaction costs of unwinding wholesale positions in the case of breaking fixed term contracts (£6m p.a.), the costs of recovering fees paid to third party intermediaries (TPIs) (£4m p.a.), increased fees for debt recovery without objections (<£1m p.a.)²¹ and reduced numbers of erroneous transfers (<£1m p.a.).

Non-quantified benefits

There are a number of benefits that it was not possible to quantify due to lack of data, but that we considered as part of our analysis.

Two of the largest non-quantified benefits relate to the fact that there is no obligation to supply in the non-domestic market. Suppliers told us that, in the absence of objections:

- New businesses may be charged a high risk premium or not be supplied given their absence of a financial track record.
- Suppliers, especially smaller suppliers, have stated that they may face greater credit and wholesale price risks. This could deter entry and expansion, and reduce the number of suppliers in the market, at least for more risky consumers.

We found that objections were not used by suppliers in all instances (ie some suppliers choose not to object for debt and at least one supplier offers fixed term contracts that can be broken early where 30 days notice is provided); this should translate into offers that correspond to consumer needs. This would suggest that,

²⁰ Some suppliers have voluntarily provided to us their own price increase estimate if objections were to be removed from the market. Although they vary, these would seem overall to be higher than the tariff premiums we have calculated in our analysis.

²¹ To avoid double counting, we subtract both the cost of unwinding wholesale positions in the case of breaking a fixed term contract, the cost of recovering fees paid to TPIs, and any increased fee for debt recovery without objections from the risk premium charged in the absence of fixed term contract objections. This is because we expect the risk premium charged on tariffs when objections are strictly prohibited to be reflective of these costs.

where a customer values the flexibility to move away from a given contract, suppliers are providing offers which allow for this against the payment of a higher risk premium.

In addition to offering lower prices, we found that objections also allow suppliers to be less concerned about debt recovery,²² allowing businesses to be provided with informal working capital.

Were the objections regime to be removed entirely and no objections permitted, there would be transition costs to changing the *status quo*. This may include, for example, potential changes to contracts, the introduction of risk mitigation mechanisms, potential changes to the hedging strategy and debt management practices, as well as system costs for the objections regime. These could be material in the short term but are likely to be small in the medium term.

Costs

Description and scale of key quantified costs

Our best estimate of quantified costs from the objections regime is **£18m** per annum. This is made up of two costs; where switches are delayed while objections reasons are being addressed (£5m p.a.) and where switches are blocked (£13m p.a.). The main reason for the difference in magnitude between the costs and benefits is that, whereas our quantified benefits materialise for all type of consumers (ie microbusinesses and larger consumers) through lower tariffs, costs are only incurred by the small subset of consumers who are switching and whose transfer to another supplier is objected to.

Non-quantified costs

The most prominent non-quantified cost is the impact that objections may have on rates of switching. Neither economic theory nor empirical evidence come to clear conclusions about the effect of switching costs on equilibrium prices and consumer welfare. However, switching costs, such as the ones imposed by objections, may have the effect of creating customer stickiness and reducing sensitivity to a price-differential. Maintaining the objections regime could translate into lower switching rates if this is perceived to be a friction in the switching process which makes the transfer more difficult (eg this could be a reduction of approximately 3% in

²² Suppliers have mentioned this to us repeatedly. Furthermore, analysis of data collected in our RFI highlighted that (i) larger debt recovery exists for ex-customers as opposed to current customers and (ii) there are higher debt recovery costs (especially for microbusinesses) for ex-customers as opposed to current customers whose transfer has been objected to.

microbusiness switching rates²³). There are clear benefits in terms of price for those able to switch, as better prices tend to be offered to new consumers.

As their objections rates are significantly higher than larger business consumers, it is especially important for microbusinesses to get better deals on their energy bills. Objections act as a barrier to switching; in their absence, consumers may be able to transfer more easily to better offers. They also add more complexity to the switching process and may act as a deterrent to engagement. An objection could lead to confusion, especially if consumers are less aware of circumstances in which objections can be raised, such as small business consumers. This is particularly true if the objection is accompanied by existing supplier retention marketing, if the customer is not clear about the terms of the new contract they have signed, or if the transfer blocking notice is not sufficiently clear.²⁴

Further considerations include whether debt objections mean that suppliers have less incentive to target debt so that it is quickly repaid; the costs of providing informal working capital; and whether costs should be spread across all consumers where consumers are unable to pay.

Changes in the non-domestic market

We are conscious that there are two sets of changes that affect how the market functions and could lead to different benefits and costs in future; one set relates to changes introduced relatively recently, and the other to potential future changes.

The changes below were brought in by Ofgem within the last three years, and therefore may have only partially fed through into our data sample.²⁵

- **August 2013:** enforceable Standards of Conduct were brought in for treatment of microbusinesses.
- **April 2014:** the definition of a microbusiness was expanded to include 160,000 more businesses, and suppliers were required to publish the contract end date and termination date on every bill or statement of account. Narrow termination windows were also banned for new contracts.
- **May 2015:** new protections were introduced on automatic rollover contracts and renewals, with i) the maximum notice period reduced from 90 days to 30 days for microbusinesses, ii) renewal letters required to publish information to

²³ Based on current switching rates (ie 16% for non-half-hourly electricity consumers), and if we assume all microbusiness transfer requests that are currently objected to translate into successful transfers when objections do not exist.

²⁴ This is especially important in the absence of a cooling-off period for business consumers. This is a period in which consumers have a given number of days, ie 14 calendar days in the domestic market, to change their mind on the purchase of an energy contract. This is further complicated by the lack of information on the range of offers available to business consumers.

²⁵ See paragraphs 1.11 to 1.16 and table 1.1.

support the ability of the customer to search the market, and iii) clear acknowledgement of a consumers' termination notice.²⁶

It may take more time for these changes to fully deliver consumer benefits. For example, additional information provided by the supplier on the contract end date and termination date should bring, over time, a reduction in the number of fixed term contract objections.

Furthermore, following their investigation, the Competition and Markets Authority (CMA) has introduced remedies that will further affect the market.²⁷ These proposed changes include:

- **Price transparency:** suppliers will need to disclose prices of all available acquisition and retention contracts to certain non-domestic consumers²⁸. This will increase price transparency and allow for tariffs to be compared by consumers, TPIs and price comparison websites.
- **Auto-rollover reform for microbusinesses:** termination notice will be allowed at any point until the last day of a fixed contract, with the prohibition of any exit or termination fees for rollover contracts for microbusinesses.
- **Database:** those microbusinesses on default tariffs for more than three years will be accessible to other suppliers to try to create more switching.
- **Randomised control trials:** the current objections regime is heavily influenced by communications between suppliers and consumers, so there is a potential role here for trialling new means of communication.

In light of the decision of the CMA to introduce price transparency measures for a subset of microbusinesses,²⁹ and the effects this will have on this segment of the market, we may consider reviewing objections under a narrower definition of microbusinesses in future.

Conclusions

Assessment of quantified benefits and costs

There is evidence that, in relation to the quantified cost and benefit analysis, the benefits of maintaining the existing objections regime clearly exceed the costs in our

²⁶ See paragraphs 2.17-18 and table 2.1.

²⁷ CMA, '[Energy market investigation: Final Report](#)' June 2016, Chapter 17.

²⁸ The CMA apply their price transparency remedy to a 'Relevant Segment' of the market. In the Energy Market Investigation: Final Report, this is defined as non-domestic electricity consumers with single meter points meeting all of the following criteria: falling under profile classes 1 to 4; consumption threshold equal to or below 50,000kWh per year; and on simple meters. For non-domestic gas consumers, this applies to consumers with small supply points only, which will include microbusiness consumers with consumption levels of less than 73,200kWh per year.

²⁹ See footnote 28.

scenarios (by £83.5-683m p.a.).³⁰ Importantly, the IA results do not vary between microbusiness consumers and larger business consumers.³¹ The net benefit is primarily due to the lower tariffs (ie reduced risk premiums charged on tariffs) in the presence of objections and the fact that all consumers (irrespective of their size) benefit from lower bills as a result.

We have some direct evidence of these risk premiums as there are four suppliers who do not use debt objections and one supplier that offers a tariff where consumers can leave a fixed term contract at any time, with a 30 day notice period and no early termination fee. We have further included sensitivity analysis to account for different scenarios that could materialise when our estimates carry a level of uncertainty.

Summary of quantified benefits and costs of the current objections regime

Quantified benefits	£m p.a.
Risk premium without fixed term contract objections	61.5-302.5
(Transaction costs of purchased energy requiring sale)	6
(TPI recovery costs)	4
Risk premium without debt protection	40-409
(Reduced debt recovery fees)	<1
Protection from erroneous transfer	<1
TOTAL BENEFITS (range)	102-701.5
Quantified costs	£m p.a.
Higher bills from delayed transfer	5
Higher bills from blocked transfer	13
TOTAL COSTS	18
Quantified net benefit (range)	£83.5-683m p.a.

Assessment of all benefits and costs

Our internal research on experiences in international markets shows that, at first sight, there does not seem to be a direct correlation between the existence of objections and switching rates, ie countries with no objections do not always have higher switching rates and vice versa.³² However, we still consider the level of

³⁰ There are approximately 3.8 million electricity and gas meters at non-domestic premises. Our net benefits come to £22-180 p.a. per meter point. However, it should be noted that: (i) it is very frequent for non-domestic consumers to have more than one meter per customer account, and (ii) as this is an average figure, but business consumers vary from very small to large industrial and commercial businesses; this makes it difficult to understand what the increase in the total bill would be.

³¹ For a detailed breakdown of costs and benefits of objections by customer size, see table 5.2. p. 66, Chapter 5 of the present document.

³² For example, Belgium and Italy have high switching rates in the absence of objections, however, this is not the case for France and Poland. Conversely, Finland and GB have high rates of switching while permitting objections. However, given that this is high level analysis, we do not expect to generate concrete correlations between the existence of objections and switching rates. In addition, objections are only one aspect of market functioning and other variables may have an impact on switching rates.

consumer engagement in the market and switching as a key consideration in the major non-quantified costs of current regime, listed below:

- Maintaining the objections regime could reduce the number of potential switching requests if this is perceived to be a barrier to switch.
- If we assume that consumers only switch to better tariffs, restrictions on switching are likely to lead to customer detriment.
- A more active customer base could in turn play an important role in driving effective competition between firms.

In the absence of objections, the following major issues could materialise (considered here as non-quantified benefits of the current regime):

- Certain business consumers could be refused supply of energy or charged a higher risk premium, eg for newer businesses or businesses with a poor credit rating.
- Insofar as suppliers may not be able to identify financially riskier consumers, they may choose to recover any increased debt costs from across their customer base, resulting in all consumers paying higher prices.
- There could be more market segmentation and less choice of suppliers for riskier business consumers.

Our conclusion is that:

- We view the objections regime as an efficient and cost-effective way to reduce risks for energy suppliers.
- Our analysis concludes that the current objections regime delivers net quantified benefits for business consumers and therefore it would not be in consumers' interests to remove or modify the relevant licence conditions.
- Given the magnitude of these net benefits, we believe the non-quantified costs are unlikely to change our overall conclusion to retain the current objections regime.
- The policy changes introduced by Ofgem in recent years have not necessarily fed through yet and, combined with market changes that will be brought by some of the CMA remedies on microbusiness consumers, may have an impact on current market outcomes.
- We may consider reviewing objections under a narrower definition of microbusinesses in future.
- There are some areas of consumer detriment, particularly with respect to microbusinesses which may be caused by non-compliance with SLCs. We tackle our next steps in the decision letter.

1. Introduction

Objections in GB markets and past Ofgem work

Introduction of objections in the non-domestic retail energy market

- 1.1. Consumers who search for the best energy deal and switch help drive competition between energy suppliers. Business energy consumers' right to choose their supplier is currently limited, because the incumbent supplier can object to the customer's switch to a new supplier. Where a customer intends to switch to a new supplier, the existing supplier is entitled to a period (the objection window)³³ in which they can determine whether to object to the transfer under certain specified conditions.
- 1.2. Objections were introduced in GB markets at the advent of non-domestic competition. The trade-off that Ofgem had to face at the opening of the energy markets was how to potentially foster competition through facilitating more open markets (eg via more market entry) and to ensure this continues to be stimulated by an active demand base, so that objections do not represent a barrier to engagement.
- 1.3. Objections initially existed only in the gas market³⁴ and their terms were mandated in a more prescriptive way in the Standard Licence Conditions (SLCs). Following concerns that supplier objections represented an obstacle to the expected, commercial operation of the market, these rules were amended in 2003³⁵ with the intention to make them commercially neutral, and extended to cover the electricity market.
- 1.4. Ofgem therefore proposed that the terms of the Gas Supply Licence and the Master Registration Agreement (MRA) be changed to place the onus on the supplier and customer to agree in their contract how their relationship should be managed. We considered that the flexibility around the commercial arrangements could allow the supplier to tailor the arrangements to meet the needs of their consumers.
- 1.5. In taking this decision, we concluded that the objections mechanism could:

³³ In electricity, under the Master Registration Agreement, this period is "five working days". For gas, under the Uniform Network Code, the window varies to enable a three-week switch to be achieved and could be "as low as two working days depending on the number of public holidays and other non-business days".

³⁴ The original Standard Licence Conditions (SLCs) introduced by the 1995 Gas Act included permission for the supplier to object. When the electricity market opened to domestic competition in 1998, rules for objections were located in the Master Registration Agreement (MRA). At the time of the Supply Licence Review (2006), objection rules were removed from the MRA and put into the electricity SLCs.

³⁵ Ofgem, '[Transfer objections: stronger rights for industrial and commercial consumers: Decision document](#)', August 2003.

- (i) Have practical advantages, eg as a way of avoiding erroneous transfers particularly for consumers with multisite portfolios.³⁶
- (ii) Help speed up the process of fixing problems by ensuring that consumers and suppliers need not always pursue legal action, for example, in cases of debt recovery or breach of contract.

1.6. These provisions still exist today.

Non-domestic market outlook

- 1.7. Non-domestic energy consumers range from small users, such as microbusinesses, to larger users, such as industrial and commercial consumers. Despite only making up a relatively small proportion of all consumers, non-domestic users account for around 65% of total electricity consumption and around 40% of total gas consumption.³⁷
- 1.8. Non-domestic retail markets have historically been characterised by higher levels of entry and expansion since market liberalisation than domestic markets. Suppliers other than the former gas and electricity incumbents have acquired much greater market shares among larger non-domestic gas consumers.
- 1.9. Smaller non-domestic consumers are affected by many of the same barriers to engagement as domestic consumers. One particular problem has been around these consumers' understanding of their contract terms,³⁸ so in 2014, we introduced new rules in this area as part of the Retail Market Review (RMR) reforms. Nevertheless, nearly half of all microbusinesses remain on default contracts (49% for electricity and 37% for gas),³⁹ and as with the domestic market, many smaller non-domestic meter points have never switched supplier.⁴⁰

³⁶ Around 1% of transfers are made without the customer's permission. The main reason behind erroneous transfers continues to be incorrect metering points (75% of cases).

³⁷ Ofgem, '[Retail Energy Markets in 2015](#)', September 2015, Chapter 2.

³⁸ Our [BMG Survey](#) (2016) found that 78% of all respondents have read or glanced through their current contract (48% in 2014).

³⁹ By default contracts, we mean contracts that have not been negotiated between the customer and the supplier, ie rollover, deemed, out of contract or evergreen contracts. At the end of a fixed term contract, a customer can renegotiate their contract with their supplier (moving onto a retention contract) or switch to a new supplier (acquisition). If they do not contact the supplier, a supplier can extend the fixed term period without the customer's assent (a rollover contract). If a customer does not have a fixed term contract, they are usually supplied on a deemed contract (classified as out-of-contract prices offered after the end of a fixed term contract if the customer does not agree a new fixed term contract, but the expired contract made provision for the prices after expiry) or supplied on a default evergreen contract.

⁴⁰ Our [BMG Survey](#) (2016) found that a third of businesses have not switched in the last five years and nearly half of these (44%; 16% of all businesses) have never considered switching. This is, however, a decrease compared with 2014 (39% and 19% respectively).

- 1.10. The trend in non-domestic prices, which are often bespoke and tend to be less transparent, has varied depending on the size of the customer; on average, prices per kWh increased for electricity consumers and smaller gas consumers between 2013 and 2014, and fell for larger gas consumers. Very small business consumers, most of which are on fixed term contracts, continue to pay much more for their energy (although lower per unit than the prices paid by domestic consumers).⁴¹

Past objections reviews and regulations introduced to help microbusiness engagement

- 1.11. Over the years, Ofgem has kept the objections policy under review to ensure it operates in the best interests of consumers, both in the domestic⁴² and non-domestic markets.
- 1.12. Following up complaints from non-domestic suppliers and TPIs about the misuse of objections as well as our monitoring on complaints data, we investigated reasons for objections in the context of the RMR in 2011. Our review revealed that the vast majority of objections were due to fixed term contract reasons⁴³ and almost a quarter of transfer requests made by business consumers were objected to.⁴⁴
- 1.13. This review also led us to believe that some suppliers' use of the objections process and their treatment of customer notifications may not be compliant with certain requirements of SLC 14. As a result, in November 2011, we published an open letter reminding suppliers of their licence obligations grouped into these categories:
- (i) General prohibition and allowable reasons for objection.
 - (ii) Customer notification that the supplier prevented the transfer.⁴⁵
 - (iii) Customer notification of the grounds of the objection.⁴⁶
 - (iv) Customer notification of how the customer may dispute or resolve the objection.

⁴¹ In 2014, the average domestic price in pence per kWh was 14.3 for electricity and 4.7 for gas, whereas for non-domestic consumers, this was 10.0 for electricity and 2.9 for gas. This compares to 13.5 pence/kWh for electricity and 4.3 pence/kWh for gas for very small business consumers (these are defined by DECC as electricity consumers with consumption between 0-20Mwh and gas consumers with consumption between 0-278MWh).

⁴² We firstly examined the case for removing objections as part of our 2006 Supply Licence Review. The focus of this was on removing a domestic suppliers' ability to block transfers on grounds of debt. In December 2006, we said we intended to retain the current circumstances in which an objection may be raised (more information can be found in our [Supply Licence Review Further Proposals](#), Appendix 7, page 94).

⁴³ Eg the customer failed to provide notice of their intention to terminate a fixed term contract.

⁴⁴ Ofgem, '[Retail Energy Markets in 2015](#)', September 2015, Chapter 3

⁴⁵ SLC 14.3 sets out the requirements for the supplier to notify the customer of the objection, the ground for it and how to dispute or resolve it.

⁴⁶ SLC 7A sets out the requirements for suppliers supplying energy to microbusinesses, in relation to notification of terms and conditions, information on bills and notification of the termination period.

- 1.14. This open letter was a precursor to Ofgem’s work aiming to introduce a number of protections for microbusinesses in the SLCs, in recognition of their weaker negotiating power and ability to engage in the market.
- 1.15. This started with the introduction of legally binding Standards of Conduct (SoC), which took effect on 26 August 2013, and apply to billing, transfers and contract information.⁴⁷
- 1.16. Additional measures were introduced to improve engagement among microbusiness consumers as part of the implementation of RMR. These measures are summarised in Table 1.1 below.

Table 1.1: Ofgem remedies in the non-domestic market following RMR 2013

Date	Measures introduced
Aug 2013	<ul style="list-style-type: none"> • Fairer treatment for microbusiness. We introduced enforceable Standards of Conduct that require suppliers to treat microbusiness consumers fairly. These standards apply to billing, transfers and contract information. In the event of a conflict with SLC 14, the SoC prevail.
Apr 2014	<ul style="list-style-type: none"> • Protecting more businesses (up to further 160,000) by expanding the definition of a microbusiness. This includes access to the services of the Ombudsman. • Clearer and simpler process, requiring suppliers to publish the contract end date and termination notice date on every bill or statement of account, and banning narrow termination windows.
May 2015	<ul style="list-style-type: none"> • New protection for microbusiness on automatic rollovers and contract renewals, with i) the maximum notice period reduced from 90 days to 30 days (bringing more consistency in the renewal process); ii) renewal letters required to publish information to empower customer to better search the market, and; iii) the supplier requirement to provide clear acknowledgement of a consumers’ termination notice.

The current review

Aim and context for the current review

- 1.17. The present review aims to determine the role of objections in non-domestic retail energy markets. In particular, we are seeking to understand:

⁴⁷ The non-domestic Standards of Conduct (SLC 7B) apply to microbusiness consumers as per Ofgem definition and also cover customer transfers. In the event of a conflict with SLC 14 the SoC prevail. Therefore any contract term relied on for an objection must be “fair”.

- (i) The impact of objections on consumer engagement,⁴⁸ switching and competition more broadly.
 - (ii) Whether objections represent the best way for suppliers to manage risks (as described above) in the non-domestic market, and hence whether it best delivers consumer benefits.
- 1.18. The current review of objections was triggered by two factors. Firstly, as a follow-up to the 2011 review, this investigation is in line with our commitment to keep this policy under review and ensure it operates in the best interests of consumers. As in the past, we remain concerned that objections could act as a barrier to switching, with negative impacts felt particularly by microbusinesses.⁴⁹
- 1.19. Secondly, Ofgem's Switching Programme, aimed at enabling a more reliable, faster switching process, relies on the conclusions of the current objections review to determine whether objections will remain a feature of the switching process.⁵⁰
- 1.20. To inform our review, we published an open letter in February 2015 to seek initial views from suppliers, consumer associations and other stakeholders on removing objections in both the domestic and non-domestic markets,⁵¹ or other ways of enabling consumers to benefit from competition.
- 1.21. In their responses, all but one supplier were broadly in favour of retaining objections.⁵² They argued that:
- (i) Objections do not stifle competition, but rather enable suppliers to manage wholesale market risk cost-effectively, which in turn enables them to offer better long term, fixed price deals to consumers.
 - (ii) In the absence of objections, they would be less likely to offer terms to consumers that they view as a credit risk, and less likely to offer long term fixed price deals.⁵³
 - (iii) They consider objections are cheaper (and fairer) than security deposits, extensive credit vetting, higher termination fees, using bailiffs and debt collection agencies, and recovering debt in court.

⁴⁸ With an understanding of how this changes according to the customer size.

⁴⁹ Our [BMG Survey](#) (2016) found that propensity to have switched in the last five years increases with business size to 70% of businesses with 10-49 employees, while businesses without employees are significantly less likely to switch than the average (60%).

⁵⁰ [Ofgem, 'Forward Work Programme 2015-2016'](#), March 2015

⁵¹ Full responses to our call for evidence can be found on our [webpage](#).

⁵² One supplier was of the view that objections raised on the basis of a customer being in a fixed term contract may not in the interest of certain microbusiness consumers, potentially slow down competition in this segment of the market.

⁵³ Our recent research indicates that 92% of small businesses and microbusinesses have a fixed term contract and around two-thirds of these are for longer than one year.

- (iv) Objections allow them to target costs towards those consumers who cause them, and as such, allow suppliers to offer lower prices; ie without objections, costs would be spread across all consumers.
- 1.22. Consumer associations highlighted that Ofgem’s objections review should give due consideration to the impact of the absence of a duty to supply in the non-domestic market and target their focus on microbusinesses’ market experience.⁵⁴

Scope of the current review

- 1.23. Building on the call for evidence feedback and in order to carry out our assessment, we issued a formal information request (RFI)⁵⁵ to 23 suppliers with a combined market share of 98% for electricity and 78% for gas.⁵⁶
- 1.24. Our RFI was split into two parts. Part 1 was intended to help us better understand supplier practices around objections over time (from the fourth financial quarter of 2013 to the third quarter of 2015).³⁶ We also requested from each supplier a more in-depth sample of 100 objected transfer requests in September 2015, chosen to be representative of the distribution of all objected transfer requests in that period.⁵⁷
- 1.25. This data enabled us to identify trends in objected transfer requests, including reasons for objections that could indicate areas of concern, and thereby consumer detriment which future reform of the objections regime might address. We provide a summary of findings from this part of the RFI in paragraphs 1.30-1.43 that follow.
- 1.26. This part of the RFI also included qualitative questions to further help us understand suppliers’ switching and objections processes. This enabled us to reveal potential SLC and SoC compliance issues which we intend to consider as part of our next steps.⁵⁸
- 1.27. The second part of the RFI covered tariffs paid on different types of contracts by different categories of consumers, and information on debt and debt recovery. We also asked broader questions around strategic decisions, for example, on hedging strategies and the type of contract offered to consumers. Data collected in this section was mainly from 2014.

⁵⁴ Responses to our call for evidence can be found on our [webpage](#).

⁵⁵ In November 2015.

⁵⁶ This is due to the fact that some suppliers only provide energy for one of the fuels. For example, Crown Energy, Regent Gas and Contract Natural Gas Ltd currently only operate in the gas market, while Haven Power and Dual Energy only operate in electricity. Furthermore, some suppliers only target consumers of a certain size. For instance, Utility Warehouse only provides a non-domestic supply to microbusinesses, and ScottishPower and Good Energy Limited currently do not supply larger than microbusiness gas consumers.

⁵⁷ In this sample data, we asked for the dates of the objections, multiple objections, transfer request receipts, contract end dates, proposed transfer dates and new registration, as well as the reason for the objections.

⁵⁸ These are outlined in our decision letter published alongside this IA.

- 1.28. For both part 1 and 2 of our RFI, we requested data split by fuel type and by size of business consumers (ie microbusinesses in line with Ofgem's definition, or the individual supplier's definition in cases where this was larger,⁵⁹ and large I&C consumers). A combination of data collected in the two parts of the RFI has been used to carry out the Impact Assessment which we describe in Chapters 2-5 of the present document.
- 1.29. Finally, we supplemented the information received from the RFI submissions through bilateral meetings with stakeholders,⁶⁰ as well as separate discussions to clarify some of this data.⁶¹

Summary of key findings on suppliers practices around objections

- 1.30. The data collected on the number of objections shows a slight decline in the industry level's rate of objections since our last review in 2011, when we found that, on average, suppliers were objecting to 25% or less of transfer requests. In Q3 2015, the average proportion of transfer requests objected to was slightly less than 21% across the industry.⁶²
- 1.31. Microbusinesses are much more likely to be objected to than larger business consumers, with an average objection rate of 30%⁶³ for the former compared to 12% for the latter. The proportion of objections for microbusinesses fluctuated between 26% and 33% from the fourth quarter of 2013 to the third quarter of 2015, whereas larger business consumers objection rate fluctuated slightly less, between 12% and 17%.⁶⁴
- 1.32. Microbusiness consumers are also less likely to see the supplier's objection withdrawn,⁶⁵ with an average withdrawal rate of 4%, compared to 13%⁶⁶ for larger business consumers. While new rules were introduced from 2013 to protect microbusiness consumers, some of it had no retrospective effect and may not have fully fed through to benefit consumers at the time spanning our

⁵⁹ This is 14 out of the 23 suppliers who responded to our RFI.

⁶⁰ This included both suppliers and consumer representatives.

⁶¹ This was carried out over the period October 2015 to May 2016.

⁶² As explained in the executive summary (p.6) and in footnote 15, we use a simple average across the industry for comparative purposes to findings of our 2011 review. The weighted industry average tells us that the average proportion of transfers requests objected to is 28%.

⁶³ We know from our RFI that 14 out of the 23 suppliers we received data from apply a larger definition for microbusinesses than the Ofgem definition. We therefore think that this percentage may be overstated, as it would include consumers which would not fall under our narrower definition.

⁶⁴ These figures are calculated using data from 21 suppliers.

⁶⁵ An objection is withdrawn by a supplier when the customer has successfully resolved the reason for the objection or the initial objection was raised in error. Lower rates of withdrawals for microbusinesses may indicate that there are compliance issues with transfer block notices. This is investigated in our further work

⁶⁶ See footnote 63.

data set.⁶⁷ As for others, we will need to continue to monitor the market closely, including compliance with SLCs as we outline in our decision letter.

- 1.33. In such cases, consumers could potentially face financial harm, and a negative switching experience could adversely affect their perceptions of suppliers and the industry. This could lead to fewer consumers wanting to go through the process of switching supplier in the future. Less switching could reduce competitive pressure on the market, which is needed to ensure good outcomes for consumers.

Reasons for objections

- 1.34. Confirming the 2011 trends, a significant majority of objections (78% of our sample), were raised because the customer was trying to switch during a fixed term contract period or had not correctly followed termination procedures. Within the termination procedure category, the reason for the objection varies. Over half of the consumers in this group were still in a contract with the supplier, and in 12% of cases, the supplier had not received a termination notice.
- 1.35. The second most common reason for objections (18%) is outstanding debt as specified in the supplier's contractual terms. The remaining 4% of objections were the result of: (i) not all related metering points being applied for, (ii) erroneous transfers, (iii) the customer's request, or (iv) objections made in error.
- 1.36. When we consider microbusiness consumers only, the objections relating to a customer's attempt to switch during a fixed period or relating to termination procedures increases to 83%. The number of objections on grounds of debt is lower than the industry average, at 13% in our sample. The high frequency of these reasons (ie a fixed term period or termination procedure) may indicate microbusinesses do not fully understand their contract terms and conditions.

Multiple objections

- 1.37. As is the case in the domestic market, multiple objections⁶⁸ remain an issue among business consumers. However, there has been some improvement in the number of multiple objections since the 2011 investigation (with a decrease of from 82% of transfer requests in receipt of more than one objection, to 59% in 2015).⁶⁹
- 1.38. This could be interpreted as a positive sign that suppliers' letters communicating the reasons for objections are effective in helping consumers

⁶⁷ See paragraph 1.16.

⁶⁸ Cases in which more than one objections is raised in relation to the same meter point.

⁶⁹ See footnote 15 on the comparability of figures.

to resolve these and successfully switch to a new supplier. However, as we did not request samples of these letters in the 2015 RFI, it is an area we may wish to further explore.⁷⁰

Time left on contract

- 1.39. Our analysis showed that, of the transfer requests in our sample, 69% submitted a proposed transfer date on or before the contract end date. For these consumers, transfer requests were made so early in the contract that an objection was raised on average 405 days before the contract end date. Most of these cases were microbusinesses. While we do not know what duration of contract these consumers were on, we can view this in light of the typical duration of microbusiness contract is 1 to 2 years.⁷¹
- 1.40. The outstanding duration of contracts at the time of the objection could indicate compliance issues in the following areas:
- Consumers experience difficulty at the stage of precontractual negotiation, where there are specific requirements for suppliers supplying energy to microbusinesses in relation to information provided at point of sale.
 - Consumers may not engaging fully in the contract renewal and switching processes.
 - Suppliers (or TPIs) may have unclear communication with their consumers, for example. Bills must be sufficiently clear and intelligible to enable consumers to understand their contract end date, termination procedure and transfer window.
- 1.41. The first two scenarios are especially relevant as there is no statutory cooling off period⁷² offered to business consumers.

Time taken by the supplier to process the switch

- 1.42. We found that the time between the proposed transfer date and the date of registration with the new supplier is longer for those who do not observe the requirements of submitting their transfer request on or before the relevant date⁷³ (up to 16 days for businesses of all sizes and 18 days for microbusiness consumers only, compared to 0 and 1 day respectively for those consumers who observe the relevant date). This highlights the importance of business

⁷⁰ As above, next steps are highlighted in the decision letter that is published alongside this document.

⁷¹ Our [BMG Survey](#) (2016) found that the majority of businesses (93%) have a fixed term contract for their gas or electricity supply and pay by direct debit (86%). Around two-thirds of businesses with a fixed term contract report that the duration of these are for either one (32%) or two (34%) years.

⁷² A 'cooling off' period allows a customer to change their mind, terminate their new contract and go back to their original supplier.

⁷³ In SLC 7A, the Relevant Date means the date which is maximum 30 days before the date any fixed term period of a Micro Business Consumer Contract is due to end. We have taken 30 days as the relevant date for our calculations, across both microbusiness and larger I&C consumers, though the relevant date may vary, especially for larger consumers.

consumers' understanding of their contract renewal process in relation to objections.

Change of tenancy

- 1.43. Industry sentiment towards change of tenancy (CoT) flags⁷⁴ and the treatment of them does not seem to have changed since our investigation in 2011. Our data indicates that a number of suppliers may be ignoring CoT flags within their objection process. It is a contravention of the Master Registration Agreement (MRA 16.1 and 16.2) for an incumbent (losing) supplier not to check the validity of a CoT flag before objecting.⁷⁵ We also found that, as the gaining supplier, 10 respondents confirmed that they gain no evidence or insufficient evidence of the new tenancy.

⁷⁴ A change of tenancy flag indicates to the outgoing supplier that the customer is a new owner or occupier of the premises and the outgoing supplier should have no valid grounds to object to the transfer of the customer to another supplier.

⁷⁵ Furthermore, SLC 11 obligates suppliers to be a party to, and comply with, certain industry codes including the MRA; therefore a breach of the MRA amounts to breach of SLC 11.

2. Methodology and approach for IA

Purpose of this Impact Assessment

- 2.1. This IA has been used to make an evidence-based assessment of whether or not to keep the current objections regime in the non-domestic market. It aims to identify all the impacts, costs and benefits of the current regime on consumers' outcomes and highlight areas of concern within the existing regime. To support the development of our decision and our evidence base, we received help from staff at Cambridge Economic Policy Associates (CEPA).
- 2.2. Our IA will also support our review of next steps in relation to the objections regime in the non-domestic market and outline the balance between qualitative and quantitative assessments of the impacts on consumers, through identifying the key sources of consumer detriment.
- 2.3. We have developed this Impact Assessment (IA) in line with Ofgem's Impact Assessment guidance.⁷⁶ We have used multiple sources of data to identify and assess benefits, costs and distributional effects of policy around supplier objections in the non-domestic retail market.
- 2.4. Section 5A of the Utilities Act 2000 imposes a duty on us to conduct IAs in certain cases. This is usually where it appears that a proposal is important (unless the urgency of the matter makes it impractical or inappropriate to comply with the statutory requirements).⁷⁷
- 2.5. Our analysis focusses primarily on objections raised (i) when a customer attempt to switch during a fixed term period ('fixed term contract objections')⁷⁸ and (ii) on grounds of debt.
- 2.6. The data received through the RFI also highlighted other areas where compliance issues may be occurring and may be causing the consumer detriment experienced, particularly with respect to microbusinesses. This has informed our recommendations for next steps.⁷⁹

⁷⁶ Ofgem, [Impact Assessment Guidance](#), October 2013

⁷⁷ We think that the proposals that this IA relates to are important for the purposes of Section 5A UA 2000. As such, this IA has been prepared in accordance with section 5A UA 2000 as our statutory IA and is being published in conjunction with our decision letter.

⁷⁸ Fixed term contract objections also include cases in which the customer has not correctly followed termination procedures (eg not submitted their termination notice), and account for 78% of objections raised. Debt objections account for 18% of objections raised. These figures are across the industry, ie for all business consumer sizes and both fuel types. See paragraphs 1.34. and 1.36.

⁷⁹ See paragraphs 1.30. to 1.43. and our decision letter.

- 2.7. Ofgem’s regulatory objectives with the current review of objections, in line with our consumer outcomes, are:⁸⁰
- **Lower bills**, arising from efficient risk management by suppliers, and greater competition driven by customer switching.
 - **Better quality of service**, such as avoiding erroneous transfers and ensuring reliable, faster switching processes, where disputes are addressed effectively by the existing regulatory mechanisms.
- 2.8. The IA we describe in the following sections will allow us to determine whether our regulatory objectives are fulfilled by the current objections regime or whether reforms are needed.

Baseline and alternative case

- 2.9. Our baseline case for the IA is the *status quo*, ie with objections raised that rely on contractual terms typically relating to debt and fixed term contracts. We have sought to assess these separately to test whether only these should remain as part of our policy recommendations.
- 2.10. Our alternative case is based on what suppliers would do in the same market, but where there exists no exception to the absolute prohibition for the supplier to object to a customer transfer. We have used direct market evidence for our alternative case where possible, for example, by looking at suppliers who do not object for debt, and one tariff where the price is fixed but the customer can switch at any time before the contract end date with no termination fee, as long as they give 30 days’ notice.
- 2.11. Under both our baseline and alternative case, we assume certain behaviours from suppliers, eg continued use of credit checks and security deposits to cover the payment of bills.
- 2.12. In our alternative case, as a reaction to the removal of objections, suppliers could introduce additional mechanisms, such as early termination charges or more significant security deposits. However, suppliers have noted that these mechanisms are imperfect in that security deposits may not be possible for certain consumers (eg consumers with a very high volume of consumption). Early termination charges are added to any existing debts and may not be recovered in full.

⁸⁰ As noted in Chapter 1, the purpose of the review includes understanding the impact of objections on consumer engagement and competition, as well as understanding whether objections represent the best way for suppliers to manage risks in the non-domestic market.

- 2.13. As an approach, we use pricing as the main channel through which suppliers reflect the additional risk in our alternative case, which is what we currently observe in the market from those suppliers who do not use debt or fixed term contract objections. Currently certain suppliers do not take on financially riskier consumers and we would expect that this would increase in the alternative case.

Welfare standard

- 2.14. The welfare standard assumed for this analysis considers total consumer benefits. This would take into account the pricing and availability of tariffs to consumers in both the short term and long term, as a function of consumer and supplier behaviour, as well as market features. However, due to current changes in the market (as previously described), results over time became difficult to determine accurately. There is particularly uncertainty in estimating objection trends in the future given the unknown impact of the recent CMA remedies. Due to this uncertainty, we have chosen to model annual (as opposed to dynamic) costs and benefits in our assessment. This is to say the analysis assumes an immediate transition would occur, and does not model changes over time.
- 2.15. Our analysis is based on an assessment of the current state of the non-domestic market in relation to objections. We calculate per annum costs and benefits that are a function of tariffs paid and levels of objections in the calendar year 2014. Our calculations are based on data received by suppliers from the RFI and complemented by information received through bilateral meetings with stakeholders.⁸¹
- 2.16. In our analysis we tried, whenever possible, to see whether trends for objections over time captured the effects of any of the new rules we introduced to protect microbusinesses.⁸² For the most recent rules,⁸³ the data is unlikely to have captured in full the effects of these changes.

Changes in the non-domestic market

- 2.17. We are conscious that there are two sets of changes that affect how the market functions and could lead to different costs and benefits in future. One set relates to changes introduced by Ofgem relatively recently and are summarised in table 1.1 above. The second set relates to changes that will be brought to the market by the Competition and Markets Authority (CMA) remedies⁸⁴ and the potential impact that these could have on objections. For

⁸¹ We described the scope and content of our RFI in paragraphs 1.17-1.43.

⁸² See Table 1.1, pp.17.

⁸³ Eg rules on auto rollovers, which entered into effect on 30 April 2015.

⁸⁴ CMA, ['Energy market investigation: Final Report'](#) June 2016, Chapter 17.

illustrative purposes we provide a summary of main remedies and recommendations as well as our first thoughts about their potential impact on objections in Table 2.1 below.⁸⁵

- 2.18. We note that it is very difficult to capture the impact of one change alone on market outcomes. There is an argument to be made that it would be beneficial to let the market settle and these changes to take effect in delivering consumer outcomes, before introducing yet more changes.

Table 2.1: CMA final remedies and recommendations on microbusinesses and first thoughts about their potential impact on the objections regime

Remedy/ Recommendation	What it does	Potential impact on objections
Tariff reform	Suppliers have to disclose the prices of contracts to certain non-domestic consumers either through a quotation tool on their website or through price comparison websites. In electricity, this includes- PC 1-4, on Simple Meters ⁸⁶ less than 50,000kWh p.a. In gas, this includes less than 73,200kWh p.a. Allows full access to all tariffs for third party intermediaries, price comparison websites and consumers. Suppliers must disclose their out-of-contract (OOC) and deemed contract prices on their websites.	As price transparency increases, microbusinesses should be better able to compare offers and agree to contracts that best suit their needs. At the same time, this could translate in more transfer requests, hence potentially more objections to transfers, eg for consumers on fixed term contract.
Auto rollover reform for microbusinesses	Allow termination notices at any point up until last day of initial and rollover fixed periods. Prohibits any no-exit clauses or termination fees in auto-rollover, OOC and evergreen contracts. Prohibits suppliers putting consumers on higher rate tariffs once notice is given.	As suppliers will be banned from imposing termination fees or exit clauses for the rollover period, this may result in increased switching. Allowing termination notice until the last day represents one step forward, but it may not reduce the volume of fixed term contract objections. This is based on our finding that 5% of microbusinesses objections relate the incorrect

⁸⁵ As the CMA final report is published shortly before our publication, this table does not aim to exhaustively cover all CMA remedies and recommendations which may have an impact on objections. More work will be done in future to analyse impacts of potentially broader remedies in more detail.

⁸⁶ The CMA define Simple Meters as meters with three registers or less or smart and advanced meters where the consumer is on a tariff with three rates or less.

		respect of termination procedures, for example.
Database	Database of microbusinesses who are on default tariffs for more than three years. Allows for marketing from other suppliers.	Unclear impact on objections as it will depend on the terms and conditions that apply to such contracts and whether they are effectively negotiated by the business consumers and/or effectively communicated by suppliers.
Randomised control trials	Recommendation to Ofgem to carry out programme of trials to increase engagement in the microbusiness segment.	Gives a clear path for trials and amendments to communications with consumers. As current regime of objections is heavily based on communication given to consumers (both at the point of sale and when an objection is raised), this could have positive impact on objection rates.

2.19. As a result, in light of the decision of the CMA to introduce price transparency measures for a subset of microbusinesses,⁸⁷ and the effects this will have on this segment of the market, we may consider reviewing objections under a narrower definition of microbusinesses in future.

Use of cost-benefit analysis

2.20. Forecasting the future is difficult, especially in a market with the complexity of the energy sector, but we have supplemented our evidence base with extensive stakeholder engagement, additional survey evidence, an internal review of both international and domestic approaches to objections (including in other sectors), and a consideration of previous work conducted on objections in the non-domestic and domestic markets.

2.21. The review of international approaches to objections looked at alternative credit risk mitigation mechanisms and sought to evaluate how these were delivering benefits to consumers. The countries and sectors considered included countries with objections (for debt, fixed term contract reasons, or both) as well as those without objections. This helped us appreciate the extent of alternative tools, but also highlighted that it is difficult to identify a clear

⁸⁷ See footnote 27.

correlation between the existence of objections and the functioning of retail markets (eg switching rates, retail prices, etc).

- 2.22. Although not very common, objections rules similar to Ofgem's approach exist in Northern Ireland gas and electricity markets and in the GB water market for business consumers.⁸⁸ Alternative tools to objections also exist, for example in Ireland, although objections are not permitted, in 2011, the Commission for Energy Regulation introduced debt flagging. The losing supplier raises a flag on receipt of the pending loss notice, alerting the gaining supplier that the customer had an outstanding debt to the old supplier. Therefore, new suppliers know which consumers are likely to have a higher risk of default, and have the choice of whether to take them on.⁸⁹
- 2.23. In using the data received as part of our RFI, we have assumed that objections are legitimate, ie debt objections are for consumers in debt and fixed term contract objections are where switching is not permitted under a fixed term contract.⁹⁰

Balance of qualitative and quantitative assessment

- 2.24. We have tried to quantify the impacts of our policy considerations, where possible, to derive robust estimates. For some areas of analysis, quantification of impacts was not possible; either because the impacts are intangible, difficult to measure, or adequate data was not available. Where this was the case, we focused on the expected impact in qualitative terms. Such an approach is consistent with best practice guidance.⁹¹
- 2.25. The use of qualitative evidence is then based on the expected magnitude or materiality of this benefit or cost compared to our regulatory objectives. These are set out in paragraph 2.7. above.

Different user groups

- 2.26. We consider the issues around objections from the perspective of different customer types. This includes a distinction between microbusinesses and larger businesses.
- 2.27. The smallest microbusinesses are likely to have similarities to domestic consumers (although a key difference is that microbusinesses carry a

⁸⁸ We understand this is for large business consumers in England and Wales and for all business consumers in Scotland.

⁸⁹ Commission on Energy Regulation, '[Customer Bad Debt in Electricity & Gas Markets](#)', June 2011.

⁹⁰ Ie objections relying on SLC 14.2.

⁹¹ Ofgem, '[Impact Assessment Guidance](#)', October 2013.

significant risk of going out of business). There is no ground to object on the basis of a fixed term contract in the domestic market,⁹² but there is in the non-domestic market. A further difference between the domestic and non-domestic markets is that there is no obligation to supply in the non-domestic market, while this exists in the domestic market.

- 2.28. There are examples of firms treating smaller business consumers in a way that is more akin to domestic consumers. One such example is a tariff by one of the suppliers that offers a fixed term contract with 30-day notice required and no exit fee if they leave early.
- 2.29. However, most businesses are going to be very different to domestic consumers with multiple sites, significantly larger consumption, direct energy procurement teams, extensive use of TPIS, and a stronger negotiated position with their current supplier.
- 2.30. Different groups should not necessarily be treated the same. The value of objections to suppliers is likely to be greater with larger consumption microbusinesses (such as SMEs) and larger businesses (for both debt and fixed term contract objections) relative to very small businesses.
- 2.31. However, the cost of objections for microbusinesses may be greater overall, given that they tend to be more disengaged and less well-resourced than larger businesses. In a market with no obligation to supply and if objections were removed, microbusinesses may also be more at risk given that they do not have the same financial track record as larger businesses, and therefore may face a tariff premium to reflect this uncertainty (or not be served).

⁹² There is only a specific right to object where, if at the time the request is made, Outstanding Charges are due. In the SLC 14, Outstanding Charges are defined as the amount of any charges for goods and/or services (other than Charges) which are due to the licensee from a Domestic Customer, have been demanded of that Domestic Customer by the licensee in writing at least 28 days previously and remain unpaid.

3. Assessment of benefits

3.1. In this section, we discuss the benefits of retaining objections in the non-domestic market (this includes non-quantified benefits of the current regime, considered as avoidance of issues that could materialise in the absence of objections). These are listed against regulatory objectives identified in the paragraph 2.7 above.

Table 3.1: Summary of quantified benefits

Quantified benefits	£m p.a.
Risk premium without fixed term contract objections	61.5-302.5
(Transaction costs of purchased energy requiring sale)	6
(TPI recovery costs)	4
Risk premium without debt objections	40-409
(Reduced debt recovery fees)	<1
Protection from erroneous transfer	<1
TOTAL BENEFITS (range)	102-701.5

Benefit 1: Lower customer bills through fixed term contract objections

Quantification of benefit

3.2. The benefits from fixed term contract objections are estimated as:

- Reduced risk premium charged for fixed term tariff £61.5m p.a. to £302.5m p.a.
- Avoided transaction costs on sale of purchased energy = £6.4m p.a.
- Avoided administrative costs to recover TPI fees = £3.9m p.a.

Description

3.3. The main benefit of the current regime is the lower risk premium that is charged in the presence of fixed term contract objections. If energy that is purchased at the start of a contract for hedging price is no longer required, a risk is incurred by the supplier and thus a higher risk premium would be charged in the absence of fixed term contract objections. Even where prices have not fallen, there will be a transaction cost for selling the energy back into the market. There is also a cost in recovering fees paid to TPIs for a customer, who has then gone on to break their contract.

3.4. When a customer enters a contract with a new supplier, this new supplier notifies the incumbent supplier of the transfer request. It is at this point that the incumbent supplier is able to raise an objection if they can rely on a

contractual term, such as the customer remaining under a fixed term contract with them. The requested switch is therefore blocked.

- 3.5. When a fixed term contract is signed, suppliers soon after purchase the estimated energy to be consumed during the length of that fixed term contract.⁹³ This is required in order to provide pricing certainty to a customer under this fixed term contract and to reduce the risk exposure of a supplier to changes in wholesale costs. This is due to the higher volume of energy supplied to business consumers in comparison to the domestic market, and represents a fundamental difference to other sectors, for example, mobile phone contracts.⁹⁴
- 3.6. We found 78% of objections are related to early termination of a fixed term contract and non-compliance with termination procedures.⁹⁵ The objection acts as a risk mitigation mechanism; in the absence of this category of objections, there would be increased risks for both the existing and new supplier.
- 3.7. Without objections, and where a customer breaks their contract, ie leaves before the end of their fixed contract term, an incumbent supplier could face the following risks in the absence of an objection:
- Where there is a breach of contract, there are costs of dealing with the legal approach associated with the breach, eg communications with the customer or any court procedure.
 - The hedging undertaken by a supplier means that a supplier would have purchased energy that will not have been used. Where prices have remained the same, there will be a transaction cost for selling the energy back into the market. Where the price differs, this is referred to as a mark-to-market loss.
 - Retained consumers continue to contribute to suppliers' fixed costs, eg opex and administration, these costs would need to be spread over other consumers if objections are removed.

⁹³ This is based on estimated usage, so does not represent a perfect hedge as the profiling and volume of use is likely to be different in practice than in theory. Suppliers thus operate a rolling hedging programme to ensure that all energy is purchased prior to consumption.

⁹⁴ There are further reasons why energy supply is different to mobile phone supply. These include the range of costs, the volume of consumption and resulting difficulty for portfolio management, the difference in the essential nature of the service, and the fact that there is a singular point of provision in energy (you may have multiple contracts with mobile phones). In addition, there is a large marginal cost for energy with a different billing system (standard charges and usage charges). A closer example may be water services, where we understand that Ofwat may consider inclusion objections for both debt and contracts in Great Britain.

⁹⁵ This increases to 83% when we consider microbusinesses only.

- Where a TPI has been paid for obtaining the customer,⁹⁶ this fee represents a sunk cost or has administrative costs associated with its recovery.
- 3.8. It is not only the existing supplier that carries risk for a customer leaving their fixed term contract in the absence of objections. For the new supplier, there are also risks from consumers breaking their contracts with their existing supplier:
- There are unrecoverable administrative costs from arranging supply for this new customer.
 - The new supplier would have hedged the expected usage of the new customer if that customer has entered into a fixed term contract; if the contract with them is voided as the customer is still under contract with the existing supplier, there is unused energy that the supplier has bought but no longer has a customer for.
 - If their contract with a new customer is valid, the new supplier may be concerned about bad debt if the customer faces a large financial penalty from breaking their contract with their previous supplier.
- 3.9. The magnitude of these risks depends on whether the switch would have been blocked in a market without fixed term contract objections and the time taken to resolve this. We would expect these additional risks may be reflected in the behaviour of suppliers.
- 3.10. In a world where fixed term contract objections are prohibited, suppliers may increase their prices to mitigate losses from consumers who break their contracts early, or they could use alternative mechanisms. Supplier representations have indicated that pricing is the most efficient method for suppliers to cover the risks of consumers breaking their contract terms or offering shorter duration fixed term contracts. Suppliers also said that, alternatively, more risky consumers may be excluded from provision, ie not offered contracts. Survey evidence⁹⁷ indicates that microbusinesses and larger non-domestic consumers value the certainty of a fixed term contract, so there would be clear consumer detriment if fixed term contracts were no longer available.
- 3.11. In terms of other potential risk mitigation mechanisms; when asked about the use of exit fees or early termination fees (this may be a notional amount or cost-reflective, eg mark-to-market clauses, most likely depending on the volume of energy consumed) as alternative tools to mitigate these risks,

⁹⁶ Our [BMG Survey](#) (2016) indicates that TPI usage is 39%. Our bilateral discussions with suppliers indicated that this figure may be higher, with some smaller companies acquiring consumers almost exclusively through TPIs.

⁹⁷ BMG Research, '[Micro and Small Business Engagement in Markets](#)', March 2015.

suppliers said that for most business consumers these would not be a viable option, except for a very small portion of microbusinesses. This is because the consumer has left them at this stage (ie after payment of the exit fee), which leave the supplier having to incur further costs for debt recovery and with a reduced expected value of the amount recovered when this happens. This means that exit fees would not be a perfect substitute for tariff increases in reflecting this risk.

- 3.12. One supplier offers a fixed price contract with the ability for consumers to switch at any point before the end of their contract with no termination fee, as long as 30 days' notice is provided. We see a higher tariff accounting for this risk. If there were to be a termination fee included in the contract, we expect that this would offset some of the risk premium included directly in the tariff price. This is a different apportionment of costs, although there are benefits for efficiency in targeting costs toward those who impose them.

Method to quantify benefit

- 3.13. There are three benefits quantified under this heading:

- *Reduced risk premium charged for fixed term tariff:* there are costs where a customer breaks their fixed term contract, most notably the risk that energy purchased at the beginning of the contract for hedging is no longer required and prices have fallen such that the supplier faces a loss on this energy.
- *Avoidance of transaction costs on purchased energy requiring sale:* for this non-required energy that is sold back to the market, even where prices have not changed, the supplier faces a transaction cost.
- *Avoided administrative costs to recover TPI fees:* for those contracts originated through a TPI and where a payment has been made by the supplier for obtaining a fixed term customer, there will be time required to recover these fees or a lost cost where this is non-recoverable.

Reduced risk premium charged for fixed term tariff – high case (£302.5m p.a.)

- 3.14. Data collected from suppliers informed us that the majority of consumers on fixed term contracts do not break their contract. As a proportion of switching requests, 16%⁹⁸ of objections related to fixed term contract objections, based on RFI submissions.

- 3.15. With fixed term contract objections existing, the price offered with a fixed term contract should include no provisions for risk of a customer leaving their

⁹⁸ This is based on our RFI findings that 21% of transfer requests are objected to, and 78% of objections are related to fixed term contract objections.

contract, as any attempted switch before the contract end date can be blocked. For those consumers not on a fixed term contract (ie on variable tariffs), a customer is free to leave the contract any time (provided they give notice if this is in the terms and conditions; this a mandatory maximum 30 days for microbusiness consumers). If suppliers expected that leaving the contract was increasingly likely, we would expect their hedging strategy to be closer to that of a variable tariff. For example, if no consumers were expected to abide by their contractual terms, we might expect there to be no delineation in the medium term between a fixed and variable tariff.

- 3.16. We observe from our RFI data that, for variable tariffs, there is a tariff premium above fixed term tariffs of 11-30% on an industry basis for our four different groups (electricity microbusinesses, electricity larger than microbusinesses, gas microbusinesses and gas larger than microbusinesses).
- 3.17. This tariff differential is used for our calculation. However, as not all consumers would leave their contracts in the absence of objections, the full differential would be an overestimate. For the reasons highlighted in paragraphs 3.10.-3.12. above, ie there are likely to be several drivers behind the risk premium we currently observe between variable and fixed term tariffs, we assume that only a proportion of the total risk premium we observe would be charged in the absence of objections.
- 3.18. At present, fixed term contract objection rates are at 14% of consumers for electricity and 18 % for gas. We assume that, without objections, these consumers would be able to successfully leave their fixed term contract as part of the switching request. This is therefore the customer base we use for the calculation of benefits. In addition, we conservatively assume that other mechanisms used by suppliers or other market dynamics⁹⁹ would further reduce the value of the premium. We therefore use 20% of the tariff differential from variable and fixed term contracts, as the total risk premium would be charged to consumers that are allowed to leave their contract early. Using this percentage, and the 11-30% tariff differential, gives us a reduced risk premium of 2-6% on the average price of a fixed term contract.¹⁰⁰

Reduced risk premium charged for fixed term tariff – low case (£61.5m p.a.)

- 3.19. There are two differences in our high case estimate compared to our low case estimate: i) a lower proportion of consumers are assumed to be able to break their contract and switch to a new supplier, and ii) we use lower consumption figures for assessing tariffs (this is based on the average consumer rather than the average consumer that is objected to).

⁹⁹ Eg the observed tariff premium between fixed and variable contracts may be a function of the fact that the variable charge likely covers more disengaged consumers, who less aware of what they are paying.

¹⁰⁰ This is based on multiplying the 14% and 18% customer base by the 11-30% tariff premium.

- 3.20. We have previously noted that a new supplier also faces risks if a prospective customer is still under contract elsewhere. In the absence of objections, we would expect suppliers to be more vigilant in checking whether a customer is under contract before accepting a switching request in order to insulate them from this potential risk. This may reduce the number of switching requests that proceed when they should not.
- 3.21. There are other reasons why the risk premium could be lower in practice. For example, early termination penalties may deter consumers from switching, or the foregone recovery of a security deposit. This means that our assumption that all consumers currently objected to would be able to leave would be an overestimate.
- 3.22. For our alternative estimate (ie the low case), we reduce the number of consumers who are able to leave their fixed term contract early by 25%. We take it that 75% of consumers objected to would leave their contract (ie of those attempted transfer requests objected to for fixed term contract reasons; 14% for electricity and 18% for gas).
- 3.23. We expect that the risk premium charged on tariffs in a market where objections are prohibited without restriction, will include costs such as: (i) the cost of unwinding wholesale positions in the case of breaking fixed price contracts, and (ii) the costs of recovering fees paid to TPIs. As data was available, we have quantified these costs below and subtracted them from reduced risk premium calculation to avoid double counting.

Avoidance of transaction costs of purchased energy requiring sale (£6m)

- 3.24. The level of the transaction cost depends on the amount of energy that needs to be sold back into the market, multiplied by the loss (estimated using a bid-ask spread) on each unit. The bid-ask spread charged (ie the difference between the buy price and sell price at a particular point in time) is taken from an Ofgem review of wholesale markets in 2015.¹⁰¹
- 3.25. Based on discussions with suppliers, we understand that energy bought as part of hedging is sold back into the market. Even if the wholesale price remains the same, purchasing and selling energy will incur a transaction cost, in this case captured by the bid-ask spread.
- 3.26. We estimate the amount of energy requiring sale, using the following calculation:

¹⁰¹ Ofgem, '[Wholesale Energy Markets in 2015](#)', September 2015.

$CO \times DCON \times DREM$

where CO = number of fixed term contract objections, DCON = average daily consumption,¹⁰² DREM = average days remaining on the contract.

3.27. This information is taken from RFI submissions.

Avoided administrative costs to recover TPI fees (£4m)

3.28. We calculate the administrative costs to recover TPI fees by estimating the number of hours to resolve this issue with TPIs, multiplied by the hourly cost of staff to achieve this. This hourly cost is informed by Full Time Equivalent (FTE) hourly charges provided in RFI submissions.¹⁰³

3.29. We have estimated the time required to resolve TPI issues using the following calculation:

$CO \times TPIp \times TPIh$

where CO = number of fixed term contract objections, TPIp = proportion of contracts brokered by TPIs, TPIh = hours to resolve TPI fee with broken contract.

3.30. The number of objections are from RFI submissions, an Ofgem survey is used to estimate the proportion of contracts brokered by TPIs,¹⁰⁴ and the hours taken to resolve TPI fee recovery is informed by RFI submissions. While we use a common value on usage for both microbusinesses and larger business consumers, we understand that TPI usage is higher with microbusinesses because larger consumers are more likely to have internal energy procurement teams.

3.31. The proportion of contracts brokered by TPIs is 39% for micro and small businesses¹⁰⁵ according to our survey evidence.¹⁰⁶ This uses an estimate of three hours of time. The hourly FTE cost is supported by information provided to us in the RFI submission on suppliers' labour costs.

¹⁰² We have based this on the annual consumption of those consumers that have been objected to. We have used the figures derived from each of our four groups, ie electricity and gas microbusinesses, electricity and gas larger than microbusinesses.

¹⁰³ The hourly charge used is based on a FTE earning, annual salary of circa £25,000.

¹⁰⁴ BMG Research, '[Micro and Small Business Engagement in Markets](#)', March 2015

¹⁰⁵ BMG Research define a microbusiness as a non-domestic consumer with up to 9 employees and a small business is defined as having between 10 and 49 employees.

¹⁰⁶ This has been checked against evidence collected as part of our discussions with stakeholders; suppliers have indicated that this proportion seems a conservative assumption.

Confidence in quantified benefit

- 3.32. There is some uncertainty around the risk premium estimate, reflected in the breadth of the range used for our assumption of benefits from fixed term contract objections. A supplier's attitude to risk may be a key determinant.
- 3.33. The reduced risk premium charged for a fixed term tariff is a significant benefit under our analysis. In our counterfactual case where objections are prohibited without exception, other mechanisms may be used to prevent those under contract from switching, eg legal recourse through courts for breach of contracts. However, based on the comments suppliers have provided to us concerning the costs and viability of alternative mechanisms,¹⁰⁷ we consider it more likely that a supplier would build in a risk premium to cover these cases, and thereby that the figures used should be appropriate for our high case. This is based both on discussions with suppliers and what we currently observe in the market where a higher risk premium is, on average, charged on variable tariffs.
- 3.34. For the tariff premium that may be charged, we have a case from one supplier who offers a fixed price contract with the ability for the customer to switch at any time before the contract end date with no termination fee as long as they give 30 days' notice (this is direct market evidence). The tariff difference between this contract and the same suppliers' fixed price contract is 34%. This compares to the 2-6% risk premium included within our high case calculation.
- 3.35. For purchased energy requiring sale, we received information on energy usage and the level of objections to help us estimate the administrative costs. Given the length of time remaining on contracts found in our information request, transfer requests have been made in some cases soon after a customer has entered into a contract. It may be possible that the consumers' expected usage has not been fully hedged at this point as suppliers have indicated that they hedge over the space of the first month of a contract. Where the supplier has not completed hedging, our figure would be slightly overstated.
- 3.36. Administrative costs to recover TPI fees are assumed to occur in each case where a TPI has been used and a customer leaves a contract. There are reasons why suppliers may choose not to pursue this, eg preserving a relationship. This does, however, represent a cost that we think suppliers would look to include in their tariff levels.
- 3.37. The hourly cost of staff is based on a limited data set from suppliers and, even if not wholly accurate, it represents the best estimate with information available. This figure is consistent with what we would expect.

¹⁰⁷ See paragraph 3.11.

- 3.38. Our estimates do not model dynamic changes in the number of objections. While this is unlikely to be the case in practice, this represents our best evidence at present, in the absence of other robust estimates.

Non-quantified benefit

- 3.39. We have not looked to quantify any potential mark-to-market profit or loss on the sale of purchased energy.¹⁰⁸ While it is logical to assume that that more consumers would look to break their contract when prices are falling, we do not think it appropriate to include a quantification of this for current consumers. There are variations in price and service between suppliers that may negate small changes in wholesale prices and we have observed that smaller business consumers, especially microbusinesses, tend to be less engaged or – in the absence of price comparison websites – less aware of the offers available.¹⁰⁹ This means that the relationship between wholesale prices and switching may not be strong in practice. The proposed price transparency CMA remedy may help address this asymmetry of information.
- 3.40. There could be a difference between the treatment of smaller and larger consumers where they try to break a contract. For smaller consumers leaving under contract, the costs to the supplier of taking private legal action to prevent the switch may exceed the expected benefits of doing so. The business may therefore be able to switch, and the cost of the losses spread across all consumers.
- 3.41. In practice, it may be that suppliers will use private litigations to enforce the terms of their contract with the customer where there are no objections. This is based on the incentive/deterrent effect; whereby if they do not pursue small claims, others may be encouraged to take the same action, ie leave the contract, as the costs they impose are spread across the broader user base and not directly incurred.
- 3.42. For larger consumers, due to the larger bills and larger volume of energy purchased for the contract, the cost of dealing with the breach may be justified based on the expected benefits from this action. The risk from large businesses may therefore be more directly imposed on those who create the risk.

¹⁰⁸ Although some suppliers had voluntarily provided us their own projections.

¹⁰⁹ Our [BMG Survey](#) (2016) found that approximately two-thirds of all micro and small businesses (64%) report they switched gas/ or electricity supplier in the last 5 five years. The proportion of all businesses that have switched supplier in the last 12 months was only 25% in 2015 (which compares to 23% in 2014). This is despite the trend of decreasing wholesale prices.

3.43. As our research on experiences in international markets highlights, in the absence of objections, the number of switching requests when under contract could increase or decrease:¹¹⁰

- If consumers become aware that fixed term contract objections do not exist and they are able to break their contract without cost, the number looking to switch may rise. This would increase the benefits of retaining fixed term contract objections as more consumers would not honour their contractual agreements, creating significant costs, such as the mark-to-market losses discussed above. The likely outcome is an increase in prices offered on fixed term contracts to account for the higher risks incurred, as discussed above.
- In the event that certain categories of consumers would be too risky to supply for some suppliers, it may be that switching is restrained by the lack of advantageous offers in the market. This outcome may also materialise if suppliers were forced out of the market or entry and expansion is deterred by the additional risks suppliers have to face in the absence of objections.
- The number of switching requests when under fixed term contract could potentially decrease if objections were removed. Under the current objections regime, there is little detriment from seeking to change contract (eg once termination procedures have been followed correctly and debt has been repaid). However, if suppliers impose significant exit fees and there is a significant switching cost imposed on the customer, these consumers may be deterred from switching as the costs would exceed the benefits from doing so.
- We do not think that there is a robust method to estimate this change, nor the effect it would have on prices. For example, where switching requests increased, this competition could lead prices to decrease as there are less 'sticky' consumers.

3.44. We are concerned that increased risks on companies could potentially drive suppliers out of the non-domestic market, reducing competition overall or in certain segments (eg for microbusinesses). We also note that the current objections regime has not prevented suppliers from innovating or using other ways to mitigate these credit risks. We would expect suppliers to continue innovate and design offers that correspond to consumer preferences.

¹¹⁰ As noted above in footnote 32 and paragraphs 2.21-2.22. However, objections are only one aspect of market functioning and it may not be possible to identify the effects of objections on the retail market in isolation from other variables.

Magnitude of non-quantified assumptions¹¹¹

3.45. We provide information on the likely magnitude of these issues below.

Table 3.2: Non-quantified benefit – Lower customer bills through fixed term contract objections

NON-QUANTIFIED BENEFIT	IMPACT
One-off mark-to-market loss	MEDIUM
Dynamic changes in fixed term contract objections	LOW/MEDIUM

Residual customer detriment within current regime

3.46. The high rate of objections related to being in a fixed term contract indicates that microbusiness, even when engaged enough to attempt to switch supplier, may not be aware of their precise contractual terms and conditions. As such, if their transfer to a new supplier is delayed or blocked, consumers may end up paying higher rates.

Benefit 2: Lower customer bills through debt loss avoidance

Quantification of benefit

3.47. The benefits from debt objections are estimated as:

- Reduced risk premium due to higher debt recovery = £40m-409.2m p.a.
- Avoided additional cost for debt recovery = £0.2m p.a.

Description

3.48. The information gained through supplier RFI submissions indicates that there are both: i) higher costs for debt recovery from ex-consumers relative to existing consumers, and; ii) lower levels of debt recovery from ex-consumers relative to existing consumers.¹¹²

¹¹¹ Estimated in relation to impact on competition, eg resulting in fair prices for consumers, entry and expansion in the supply market, and encouraging informed switching which indicates an active customer base, among other factors.

¹¹² Discussions with suppliers have indicated that amounts of debt left unrecovered from ex-customers (ie those who have been permitted to switch to a new supplier) may be as high as 50% of outstanding debt.

- 3.49. Debt objections provide a method to keep a customer in contract until the debt is paid off. Analysis of RFI data and stakeholder engagement, suggest that it is likely that debt objections lead to a higher proportion of recovery of sums owed to suppliers. As mentioned in the executive summary and paragraph 2.10, there are four suppliers who do not object to consumers who are in debt. Suppliers who do not object for debt reasons note that use of debt objections can result in indebted consumers continuing to consume more energy and accumulate further debt with them, so the issue is multifaceted.
- 3.50. In the absence of debt objections, we would expect suppliers to charge higher tariff prices to reflect the additional risks they face. There are companies who do not currently object for debt but instead charge a risk premium on their tariffs (and potentially other mechanisms) to cover off these risks.

Method to quantify benefit

- 3.51. There are two benefits quantified under this heading:

Reduced risk premium due to higher debt recovery – high case (£409m)

- 3.52. Data received from suppliers enabled us to calculate the tariff charged on fixed price contracts, in aggregate, for those suppliers who do not object for debt. This is 13-41% higher than fixed price contracts for those suppliers who use debt objections for our four different groups (electricity and gas microbusinesses, and electricity and gas larger business consumers).
- 3.53. We estimate the benefit based on the number of debt objections multiplied by the tariff premium on fixed price contracts offered by those suppliers who do not object for debt, relative to those suppliers who do object for debt.¹¹³

Reduced risk premium due to higher debt recovery – low case (£40m)

- 3.54. In our low case, we take the smallest positive differential among our four suppliers to be conservative with our estimate. This leads to a tariff premium of 6-22% across our four tariff differential categories, compared to 13-41% in our base case. This is to reflect the fact that current tariffs charged may be due to other differences apart from debt objections, and that we wish to be conservative in our estimate.

¹¹³ An alternative approach would be to use levels of debt provision due to non-recovery for ex-customers relative to existing customers. We have checked our results using such an approach to ensure that our findings are robust.

- 3.55. In addition, as with our risk premium for fixed term contract objections, we use the lower consumption figures for assessing tariffs (ie the consumption of an average user rather than average consumption of those consumers who were objected to).
- 3.56. As above with fixed term contract objections, we expect that the risk premium charged on tariffs in a market where objections are prohibited without restriction will include costs such as the costs of recovering fees paid to TPIs. As data was available, we have quantified these costs below and subtracted them from the reduced risk premium calculations to avoid double counting.

Avoided additional costs for debt recovery (£0.2m)

- 3.57. This is estimated based on the number of debt objections multiplied by the additional debt recovery costs faced for ex-consumers, relative to existing consumers. The information is taken from RFI submissions. This relates to the costs associated with debt recovery, not the debt provision related to the principal (which leads to the benefit noted above).
- 3.58. Debt recovery costs are approximately 17.5% higher for ex-consumers relative to existing consumers at the industry level. This is based on costs reported for existing consumers relative to ex-consumers on a per customer basis. There were circa 67,000 objections for debt in 2014.

Confidence in quantified benefit

- 3.59. For the avoided costs of debt recovery, we are confident in the number of objections and have clear evidence on the additional costs of debt recover for ex-consumers, relative to existing consumers.
- 3.60. Our calculation of the reduced risk premium for higher debt recovery is derived from analysing the tariffs of those suppliers who do not object for debt against those who do. This would lead to a higher tariff premium observed in the current market, as those consumers who perceive themselves to be a debt risk (and prefer the flexibility of moving away from their current supplier) will go to those who do not object for debt. In practice, we are not sure that consumers would respond in such a way, particularly with the current lower level of price, offer transparency, and engagement, especially among microbusinesses. So this is potentially an overestimation.
- 3.61. Although we would not expect all suppliers' tariffs to be the same, we think that having four suppliers (with a significant market share) mitigates the risks of these changes unduly influencing our findings, and that such an estimate is not biased in either direction. The use of a range of risk premiums in our assessment further mitigate this concern.

- 3.62. There may be an argument that, if improved debt recovery occurred, it could reduce the risk premium charged over time, as the supplier becomes better at recovering these funds and so does not need to charge higher tariffs. This will, however, depend on the amount of outstanding debt given the typically significant volume of energy consumed by business consumers, and how quickly the sums overdue can be recovered. As noted before, the incurrence of such risks in the absence of objections could: (i) drive suppliers out of the market or deter entry and expansion, and (ii) stop the provision of informal capital to business consumers that are more at risk or increase the use of security deposits. All of these outcomes would carry significant consumer detriment.
- 3.63. In our analysis, we do not vary the number of debt objections over time. In the presence of companies who do not object for debt and those who do, where consumers are aware of this, those riskier consumers may choose to select those suppliers who do not object if the premium charged is lower than their expected benefit from being able to switch without an objection. If this leads to a different outcome, our assumption of a constant level of objections would be inaccurate. We also note, as discussed above that debt objections do not constitute a high proportion of the total level of objections.¹¹⁴

Non-quantified benefit

- 3.64. Suppliers have noted that the removal of debt objections may lead to behavioural change in the form of debt hopping, as observed in other countries where debt objections do not exist.¹¹⁵ This is where certain consumers realise that they are able to switch contracts while indebted to the incumbent supplier. Such behaviour affects the recoverability of costs from consumers and would likely be reflected in the charging of a tariff premium to take this into account. In the absence of a duty to supply in the non-domestic market, consumers should be wary to act this way as this would translate in a bad credit rating for their businesses. This could lead to a refusal to supply the customer by the new supplier or a higher price charged to account for the higher credit risk incurred. As such, we do not think that debt hopping is a likely scenario in the absence of a duty to supply, as it would be risky from a customer perspective, and could lead to consumer detriment.
- 3.65. An alternative outcome with no debt objections may be that there is a big premium charged to reflect the additional risk for suppliers to take on consumers with a poor credit score or there would be the need for a large

¹¹⁴ I.e. 18% of objections are for debt (which compares to 6% in domestic).

¹¹⁵ An example of this may be Ireland. CER analysis shows that 0.4 – 3% of switching requests are raised with a debt flag. Debt flags are triggered when debt is greater than €225 for domestic consumers, €600 for small businesses and €1,200 for medium sized businesses. Further, our research on experiences in international markets shows that in the Belgian electricity market, the rate of switching is high (25% p.a.), yet the percentage of arrears on utility bills is also high (34%).

security deposit upfront, again, a cost to the customer. Data from tariffs offered by four suppliers who declared not to be using debt objections are 13-41% higher than prices paid by consumers of suppliers who object for debt.

- 3.66. The escalation of debt recovery methods, eg having bailiffs recover debts or legal action rather than phone communications, may mean that there are negative effects for consumer welfare when an ex-customer has final debt outstanding. This could lead to greater disengagement in the market and negative perceptions that add to consumer detriment, although it is difficult to quantify the more forceful debt recovery methods.
- 3.67. The extent of the risk premium is linked to the expected loss on what is owed to a supplier (ie debt provision). We do not model any change in debt recovery that may occur from removing debt objections in terms of a one-off cost (ie before a risk premium is included on contract prices). A supplier has a clear incentive to reduce the loss already.

Magnitude of non-quantified assumptions

Table 3.3: Non-quantified benefit – Lower customer bills through debt loss avoidance

NON-QUANTIFIED BENEFIT	IMPACT
Non-supply or higher risk premium for newer businesses	MEDIUM/HIGH
One-off change in debt provision	MEDIUM
Impact of debt hopping	LOW
Change in debt collection methods	LOW

Residual customer detriment within current regime

- 3.68. Some suppliers told us that they apply no minimum or a very low minimum duration for outstanding debt when they consider whether to object on these grounds. It may be the case that some of the existing suppliers procedures in relation to their definition of outstanding debt may cause consumer detriment.

Benefit 3: Protection from erroneous transfer

Quantification of benefit

- 3.69. The benefit from the erroneous transfer objection is equal to £0.3m p.a.

Description

- 3.70. A number of objections relate to erroneous transfers,¹¹⁶ ie transfers that should not be taking place as they were not triggered by the customer. If this erroneous transfer happens, there is a cost to resolve it. This may be significant as the typical business customer has a multisite portfolio. If an objection catches this error, these costs are not incurred. Having the objections regime overall may lead to these erroneous transfers being caught.

Method to quantify benefit

- 3.71. In our calculations, we use the number of objections for erroneous transfers, the time taken to resolve them and the cost of doing so. The estimate is based on a simple multiplication of the three factors.
- 3.72. The time taken to resolve the erroneous transfer and cost of Full Time Equivalent (FTE) are informed by the RFI submissions, with the number of objections relating to erroneous transfers taken directly from this.
- 3.73. Based on our estimates, there were circa 7,000 objections due to erroneous transfer in 2014. The time taken to resolve this is assumed to be three hours, with our FTE hourly cost estimate informed by RFI submissions.

Confidence in quantified benefit

- 3.74. Our estimate for the time taken to resolve the error is only informed by our RFI submissions, rather than being a direct figure. We are not assuming that all erroneous transfers are caught by the objections regime; we only include those that are noted as being for this reason in our RFI submissions.

Non-quantified benefit

- 3.75. We have assumed that the objections to erroneous transfers are valid. If this is not the case, then the benefits would not accrue and consumers may incur a cost as their switch is blocked.
- 3.76. We have not included the cost of exit fees that may be applied should a customer leave in error. This will be applied as the customer departs. However, the customer will come back to the company when the erroneous transfer is resolved. We would expect that in these cases the exit fee would be reimbursed, but this is still an additional administrative burden.

¹¹⁶ See footnote 36.

Magnitude of non-quantified assumptions

Table 3.4: Non-quantified benefit – Protection from erroneous transfer

NON-QUANTIFIED BENEFIT	IMPACT
Impact of exit fees for erroneous transfer	LOW

Residual customer detriment within current regime

3.77. Residual customer detriment was not identified under this heading.

Benefit 4: Costs are paid by consumers who incur debt and not spread across whole customer base

Quantification of benefit

3.78. There is no quantified benefit included under this heading.

Description

3.79. Under our assumptions on the benefits of objections, we have not made any reference to who bears the cost of tariff premiums - this applies to consumers who do not pay their debt and/or look to break a fixed term contract.

3.80. Informational asymmetries mean that, at present, suppliers cannot necessarily identify riskier consumers with accuracy. As such in the absence of objections, the additional risks from such consumers may be spread across the customer base, rather than those consumers imposing risk facing the risk premium themselves.

3.81. From the perspective of efficient markets, we would want those incurring the costs to face these costs. Consumer research indicates a strong preference for ensuring the customer who incurs debt is liable to pay it off.¹¹⁷

3.82. This is a clear distributional effect that is not captured in quantitative terms as part of this assessment.

¹¹⁷ More information can be found in the [Ofgem Consumer First Panel Year 6, Wave 4](#). While this is for domestic consumers, we would expect the same attitude to apply to treatment of businesses.

Non-quantified benefit

3.83. There is no robust methodology available to question the values of this spreading of costs across the consumer base in this setting, especially given that people place different valuations on equitable outcomes. So we have included this as a qualitative consideration only.

Magnitude of non-quantified assumptions

Table 3.5: Non-quantified benefit – Costs are paid by consumers who incur debt and not spread across whole consumer base

NON-QUANTIFIED BENEFIT	IMPACT
Spreading of costs across consumer base	MEDIUM

Residual customer detriment within current regime

3.84. Residual customer detriment was not identified under this heading.

Benefit 5: Greater choice of supplier across business customer segments

Quantification of benefit

3.85. There is no quantified benefit included under this heading.

Description

3.86. There is no obligation to supply in the non-domestic market. A possible outcome of the removal of objections would be that suppliers choose not to serve certain categories of non-domestic consumers (eg those without a proven credit record or those who have a history of default). In addition to those existing suppliers who choose not to serve certain consumers, higher risks may deter new entrants to the supply market or drive suppliers out of certain market segments, ie those that are more financially risky.

3.87. The level of the microbusiness segment competitiveness is an area of concern in the CMA final report. Recently we have seen a decrease in the price paid by



the smallest business consumers, broadly reflecting lower wholesale costs.¹¹⁸ We would be concerned about any lessening of competition from policy changes, for example, the ability of small suppliers to offer fixed term contracts due to the risks from hedging in the absence of objections and the impact that this could have on prices paid by those consumers.

Non-quantified benefit

- 3.88. We do not quantify the benefit from a greater choice of supplier. To be able to do this, we would need to foresee the likely effects on competition and the number of firms serving non-domestic consumers. We would then need to estimate the value placed on this additional choice and the tariff impact.
- 3.89. We do not think that we can derive a robust estimate for this benefit, although the costs to consumers are likely to rise as the market becomes more concentrated and this industry structure leads to higher tariffs. One argument may also be that, as certain segments of the customer base become more risky, these consumers may not be served.

Magnitude of non-quantified assumptions

Table 3.6: Non-quantified benefit – Greater choice of supplier across business customer segments

NON-QUANTIFIED BENEFIT	IMPACT
Reduction in numbers of suppliers in market (overall or in relation to more risky market segments)	MEDIUM/HIGH

Residual customer detriment within current regime

- 3.90. Residual customer detriment was not identified under this heading.

¹¹⁸ [DECC data on prices paid by business consumers](#) show that the (four year) increasing trend in electricity prices for very small business consumers stopped in 2015, when prices decreased by 3% compared to 2014. Prices have, at the same time, increased for all other business consumers. In gas, prices for very small business consumers followed the industry decrease, but the magnitude of the decrease is smaller for smaller businesses. Small business consumers continue to pay much more for their energy than larger business consumers.

Benefit 6: Price certainty for consumers

Quantification of benefit

3.91. There is no quantified benefit included under this heading.

Description

3.92. With no obligation to supply in the non-domestic market, it may be that without the ability to object, suppliers choose not to offer fixed term contracts. The vast majority of non-domestic consumers are on fixed term contracts (circa 90% in both gas and electricity when including rollover fixed term contracts). There is a clear benefit in the price certainty that this contract provides over varying periods.

Non-quantified benefit

3.93. We do not quantify the value of price certainty for consumers. If contracts were based on willingness to pay, eg demand-side drivers, you would expect a premium for certainty provided to consumers. However, there are a number of other interactions, eg supply-side drivers, that means that this does not take place. An example of this would be the additional certainty or reduction in the number of transactions required by a supplier for a fixed term customer.

3.94. In the domestic market with no fixed term contract objections, fixed term contracts remain and are widely chosen by consumers. We are not persuaded, neither have we heard such an argument from suppliers, that the outcome would differ from this case.

Magnitude of non-quantified assumptions

Table 3.7: Non-quantified benefit – Price certainty for consumers

NON-QUANTIFIED BENEFIT	IMPACT
Presence of fixed tariff or shorter duration fixed tariff	LOW

Residual customer detriment within current regime

3.95. Residual customer detriment was not identified under this heading.

Benefit 7: Ability of consumers to maintain informal working capital

Quantification of benefit

3.96. There is no quantified benefit included under this heading.

Description

3.97. The presence of debt objections means that suppliers are more confident that they will be able to recover costs incurred by their consumers. This allows suppliers to permit consumers to maintain debt. This may be thought of as informal working capital for a business customer.

3.98. Suppliers have told us that in the absence of objections, alternative mechanisms could include more security deposits or shorter billing periods (that impose additional transaction costs).

Non-quantified benefit

3.99. We do not attempt to quantify the value of this benefit. There are reasons why it may not be prudent to allow consumers to build up debt with suppliers and any value to capture this benefit would need to understand whether consumers could pay this amount.

3.100. There would also be uncertainty over the figure to use to represent the financial cost of the debt for consumers. As an example, assuming that consumers would have to go out and use alternative expensive credit tools (eg loans) leads to a large benefit from the supplier providing this working capital. Use of a less expensive deposit would give a much smaller benefit. These numbers would also change over time based on changes in financial market conditions.

3.101. In the absence of objections, there may be more prepayment or a greater frequency of billing. This creates administrative costs and would reduce the extent of this benefit if the amount of informal working capital reduces.

3.102. Total annual revenue in the non-domestic market in 2014 was around £1bn per month.¹¹⁹ If we were to assume that, on average, informal working capital was provided for one-and-a-half months (ie half of the three-month billing period), at a 5% cost of this working capital, there would be a £75m p.a.

¹¹⁹ Based on data received by suppliers who responded to our RFI.

benefit. This, however, would be offset against the cost of providing the capital.

Magnitude of non-quantified assumptions

Table 3.8: Non-quantified benefit – Ability of consumers to maintain informal working capital

NON-QUANTIFIED BENEFIT	IMPACT
Provision of informal working capital	MEDIUM
Additional use of security deposits	LOW

Residual customer detriment within current regime

3.103. There is no residual consumer detriment under this heading.

Benefit 8: Avoidance of transitional costs

Quantification of benefit

3.104. There is no quantified benefit included under this heading.

Description

3.105. If objections were removed, there would be two sets of systems and process changes. These would be for suppliers (removal of objections system and introduction of new arrangements to manage debt and contract issues), and central systems (these costs could be mitigated if aligned with the new Central Registration System that is being designed in the context of Ofgem Switching Programme).

3.106. Suppliers have indicated that they use a combination of automatic and manual processes to identify when to raise an objection. Suppliers have differing levels of automation. The presence of objections necessitates resources, in particular, in reviewing customer account information and managing IT systems.

- 3.107. No modelling has been done to isolate the impact of objections on the costs of introducing new switching arrangements protocols in the Switching Programme.¹²⁰ Ofgem’s Switching Programme expects to issue an RFI next year on the costs and benefits of proposed new switching arrangements which will identify the costs of the objections process for fast and reliable switching.
- 3.108. A further transitional cost could be the time taken for markets to adjust to the change in the regulatory environment. Suppliers (and consumers) will need to revise contracts, hedging strategies and debt management practices if objections are removed. This could impose a significant cost that could flow through to customer bills, causing additional uncertainty. We would expect the costs of this to be higher in the short term before reducing significantly in later years.

Non-quantified benefit

- 3.109. We do not have an accurate estimate of these transitional costs. The costs of transition depend on the timing of change and its interaction with the Switching Programme. If changes to systems are required, it should be cheaper to implement these as part of the wider suite of changes required for the Switching Programme, rather than modifying the new switching arrangements after they have been introduced.
- 3.110. The costs of change with respect to contracts, hedging and debt management are not easily quantifiable and would change over time. This depends on how long the market would take to adjust.

Magnitude of non-quantified assumptions

Table 3.9: Non-quantified benefit – Avoidance of transitional costs

NON-QUANTIFIED BENEFIT	IMPACT
Transitional costs	MEDIUM

Residual consumer detriment within current regime

- 3.111. Residual consumer detriment was not identified under this heading.

¹²⁰ More information on the Switching Programme can be found on our [website](#).

4. Assessment of costs

4.1. In this section, we discuss identified costs of retaining objections in the non-domestic market. These are mapped against the regulatory objectives listed in paragraph 2.7 above.

Summary of quantified costs

Table 4.1: Summary of quantified costs

Quantified costs	£m p.a.
Higher bills from delayed transfer	5
Higher bills from blocked transfer	13
TOTAL COSTS	18

Cost 1: Higher bills through inability to switch

Quantification of cost

4.2. The costs from objections are estimated as:

- Higher bills from delayed transfer = £5m p.a.
- Higher bills from blocked transfer = £13.3m p.a.

Description

4.3. Where a customer is objected to switching, they are prevented from entering into a new (potentially advantageous) contract. A customer who is blocked from switching may either see a delayed transfer, where the objection is resolved, or the switch blocked more permanently. RFI submissions have indicated that there is a tariff premium for existing consumers, relative to new consumers, and a tariff premium for variable consumers, relative to fixed term consumers. A blocked switch is thus likely to prevent a move to a lower priced tariff¹²¹.

Method to quantify cost

4.4. There are two costs quantified under this heading:

¹²¹ Qualitative evidence from our [BMG Survey \(2015\)](#) supports pricing being a key determinant of the choice of supplier.

Higher bills from delayed transfer (£5m)

- 4.5. In our calculation, we multiply the total number of days of a delay to process a switching request (ie when a switch does proceed) by the daily tariff premium faced by consumers through an inability to switch. The tariff premium we use is for a new customer tariff relative to existing customer tariffs.
- 4.6. The total number of delay days uses the average delay (measured as time in excess of 30 days from the relevant date to the completed transfer for consumers under contract¹²²) and multiplies this by the total number of successfully resolved objections.
- 4.7. We find that, in total, 35% of objections are resolved (for both debt and fixed term contract). The tariff premium for existing consumers, relative to new consumers, ranges from -7% to +7% based on our analysis.¹²³

Higher bills from permanently blocked switches (£13.3m)

- 4.8. We estimate the number of days that consumers remain on higher priced tariffs¹²⁴ when their switch does not occur, and multiply this by the tariff premium faced by consumers each day on their tariff. The tariff premium we use, to avoid an overestimation of costs,¹²⁵ is for a new customer tariff relative to existing customer tariffs.
- 4.9. The total number of delay days until resolution uses the average delay (measured as time in excess of 30 days to transfer) and multiplies this by the total number of unresolved debt objections only. We focus on debt objections as fixed term contract objections would be resolved when the contract term finishes.
- 4.10. The tariff information is taken from RFI submissions, while the time for delay is assumed to be three months. As the data is collected for 2014 only, we do not know how long it will take to resolve some of these issues. However, we

¹²² We use the 30 day figure as this is the mandatory length of the termination window for contract signed as of 1 May 2015, for microbusinesses.

¹²³ The extent of the range reflects the fact that acquisition prices are typically more advantageous than retention prices.

¹²⁴ We assume that if a customer was able to switch their supplier, they would be on a more advantageous tariff.

¹²⁵ We know in fact that at the end of a fixed-term contract, when a customer does not negotiate a new contract, such as the case when an objection is raised, consumers maybe paying out of contract rates which are significantly higher than fixed term rates. In our Retail Energy Market Report (2015) we found that these tariffs were twice as much as negotiated contract prices.

based on our assumption of a three month delay on the typical frequency of billing, ie quarterly.

- 4.11. We have used three months as the period for which a switching request is not resolved for debt objections only. The tariff premium uses the same data as set out in estimating the higher bills from a delayed transfer. We find that up to 55% of debt objections are not resolved.

Confidence in quantified cost

- 4.12. The length of time taken to resolve an objection is known,¹²⁶ as is the average tariff premium for new consumers relative to existing consumers. The extent of the cost will depend on what tariff the customer is on; for example, the tariff gain for a customer on a deemed contract moving to a new fixed contract will be higher than one moving from another fixed contract.
- 4.13. The impact on bills from a permanently blocked switch is less clear than the scenario where transfer is delayed as, by definition, these have not been resolved and so we do not know how long the customer remains on a potentially higher tariff contract before switching. We think three months is appropriate given our evidence.

Non-quantified cost

- 4.14. We do not measure the cost related to fixed term contract objections as we have assumed that the customer is not able to transfer to a lower tariff and so should not be taken into account.
- 4.15. When an objection is raised, there are communication costs incurred by all parties (the losing supplier, gaining supplier, customer, and potentially third party intermediaries) to address and resolve the objection. These are:
- i. The customer service agent's time, ie having discussions with consumers to explain why their switch has been objected to and the necessary steps they must take for the switch to be successful. In the case of microbusiness consumers, further costs would be incurred by the supplier as written communication is mandated by SLC 14.3 notifying the customer of the objection, the grounds for it, and how to dispute or resolve it.
 - ii. The consumer's time in resolving the objection in order to switch.

¹²⁶ This is the average time taken for a supplier to resolve the objection in excess of the 30 days period we described in paragraph 4.9 above.

4.16. We do not have data on the time taken by all parties to address and resolve objections, or on the magnitude of written communication suppliers are required to send to microbusiness consumers, hence were not able to quantify the impact of these costs linked to the current regime.

Magnitude of non-quantified assumptions

Table 4.2: Non-quantified cost – Cost of time to address and resolve an objection

NON-QUANTIFIED COST	IMPACT
Cost of time to address and resolve an objection	LOW/MEDIUM

Residual consumer detriment within current regime

4.17. There may be a clear case for consumer detriment in those cases where a customer had not fully understood the terms of the contract they were entering into at point of sale and thereby remaining on a contract they did not wish to be on.

Cost 2: Ability to pay considerations

Quantification of cost

4.18. There is no quantified cost under this heading.

Description

4.19. This is partially discussed in the Assessment of benefits section. There are distributive effects to consider. It may be that, for consumers who cannot pay, allowing the spreading of costs across all consumers and permitting the debt holder to transfer to a lower tariff may maximise social welfare – this depends on views on distributive impacts. An example from the domestic market would be where prepayment meter consumers are able to switch provider under the Debt Assignment Protocol. Ofgem’s Consumer Panel were in favour of switching consumers to the cheapest available tariff when they were in debt.¹²⁷

¹²⁷ Ofgem, [‘Consumer First Panel Year 6 Wave 4’](#), November 2015.



Non-quantified cost

4.20. In our opinion, there is no robust way to estimate the value of the distributive impacts in this setting.

Magnitude of non-quantified assumptions

Table 4.3: Non-quantified cost – Ability to pay considerations

NON-QUANTIFIED COST	IMPACT
Ability to pay considerations	LOW

Residual consumer detriment within current regime

4.21. Residual consumer detriment was not identified under this heading.

Cost 3: Reduced ability to switch under a fixed term contract

Quantification of cost

4.22. There is no quantified cost under this heading.

Description

4.23. This is partially discussed in the Assessment of benefits section. Where prices are falling, there is a potential benefit from being able to switch from a fixed price contract. Where prices are rising, switching is not beneficial from a pricing perspective.

Non-quantified cost

4.24. We do not quantify a value of price certainty nor price flexibility. We think that consumers value both, but could face a significant premium to achieve this in the absence of objections.

Magnitude of non-quantified assumptions

Table 4.4: Non-quantified cost – Reduced ability to switch under a fixed contract

NON-QUANTIFIED COST	IMPACT
Reduced ability to switch under fixed term contract	LOW

Residual consumer detriment within current regime

4.25. Residual consumer detriment was not identified under this heading.

Cost 4: Lack of supplier incentives to proactively target debt

Quantification of cost

4.26. There is no quantified cost under this heading.

Description

4.27. This is partially discussed in the Assessment of benefits section. With debt objections, suppliers are more comfortable with consumers taking on debt as they have protections to retain the customer, allowing them greater control on debt repayment than for ex-consumers. This may mean that suppliers are not incentivised to proactively target debt reduction for consumers. This is not beneficial for consumers if this restricts switching.

4.28. In addition, there may be incentives for a supplier to allow a customer to incur debt if this is preventing them from leaving. These incentives may not align with maximising consumer benefits. If this customer is not on a fixed tariff contract,¹²⁸ the benefits from retaining a customer in debt may be larger for the supplier. We do note that our evidence indicates a lower percentage of debt objections in the non-domestic market (4% for both microbusinesses and larger business consumers) when comparing to domestic consumers (5% for gas and 6% for electricity)¹²⁹.

¹²⁸ Which are the most advantageous tariffs for non-domestic consumers.

¹²⁹ SLCs determining the legitimate use of objections are very different in the domestic and non-domestic markets. Where, in the domestic market, SLC 14 sets out precisely in which instances a supplier can object to a customer transfer, but in the non-domestic market, this is left to provisions in the contract between a supplier and a customer that allow the supplier to prevent the transfer.



- 4.29. Although there is a provision for final debt for ex-consumers, this is not directly relevant because debt objections keep the customer in contract with the supplier. The main risk for a supplier is that the customer may continue to consume energy and accrue debt that is never paid off.
- 4.30. Reducing the amount of debt held by businesses would help consumers to reduce debt accumulation (and increase recovery) and be able to switch more easily while benefit suppliers because there will be fewer objections due to debt.

Non-quantified cost

- 4.31. We do not think there is a robust methodology available to quantify the impact of these potential supplier incentives to allow consumers to incur debt in the presence of debt objections.

Magnitude of non-quantified assumptions

Table 4.5: Non-quantified cost – Lack of supplier incentives to proactively target debt

NON-QUANTIFIED COST	IMPACT
Supplier incentives to target debt	MEDIUM

Residual consumer detriment within current regime

- 4.32. Residual consumer detriment was not identified under this heading.

Cost 5: Cost of debt/capital for company to provide financial buffer

Quantification of cost

- 4.33. There is no quantified cost under this heading.

Description

- 4.34. This is partially discussed in the Assessment of benefits section. The flipside of informal working capital for consumers is the cost of credit provision from suppliers (which is likely to be passed onto consumers through tariffs).



Non-quantified cost

- 4.35. We do not quantify this cost (or the equivalent benefit). It requires knowledge of the total level of debt held by companies and an appropriate cost of capital (this may be debt finance). This is complicated by timing differences in energy consumption and billing.
- 4.36. The cost of debt for a supplier should be lower than the cost of debt for a business in most cases. The extent of this depends on the size and maturity of the business; a large established business is likely to face lower debt costs than a new, small business. This should lead to a net benefit when taking the equivalent cost and benefit (both are non-quantified benefits under this heading).

Magnitude of non-quantified assumptions

Table 4.6: Non-quantified cost – Cost of debt/capital for company to provide financial buffer

NON-QUANTIFIED COST	IMPACT
Costs for providing financial buffer	LOW

Residual consumer detriment within current regime

- 4.37. Residual consumer detriment was not identified under this heading.

Cost 6: Friction and impact on future switching

Quantification of cost

- 4.38. There is no quantified cost under this heading.

Description

- 4.39. The impact that objections may have on future switching rates is the most prominent non-quantified cost of the current regime. Neither economic theory nor empirical evidence come to clear conclusions about the effect of switching costs on equilibrium prices and consumer welfare.
- 4.40. Some theories suggest that switching costs (such as the ones imposed by objections) may have the effect of creating customer stickiness and reducing sensitivity to a price-differential. This endows firms with market power over consumers, as consumers would have to bear a financial or opportunity cost

when changing supplier.¹³⁰ However, these theories equally conclude that the effect of switching costs on equilibrium prices and consumer welfare is ambiguous. Depending on the specifics of the model, such as whether it is possible to charge different prices to new and old consumers, whether consumers are forward looking, and the time horizon of the model, switching costs could make markets more or less competitive.¹³¹

- 4.41. In our assessment, we consider that maintaining the objections regime could result in lower switching rates if this is perceived to be a friction in the switching process which makes the transfer more difficult (eg this could be a reduction of approximately 3% in microbusiness switching rates¹³²). If we assume that consumers only switch to better tariffs or service, restrictions on switching consequently are likely to lead to consumer detriment not least because a more active consumer base could an important role in driving effective competition between firms.
- 4.42. We recognise that negative experiences with switching or perceived problems with the switching process may dissuade consumers from attempting it. Survey evidence indicates that objections were perceived as a barrier to switching.¹³³ If there was a good awareness of the objection regime by microbusiness consumers¹³⁴ then we may expect more consumers switching in the absence of objections than those who are currently attempting in the presence of objections, but not succeeding to transfer.
- 4.43. An objection could lead to confusion, especially for less engaged consumers, such as microbusiness consumers. This is particularly true if the objection is accompanied by existing supplier retention marketing, if the customer is not clear about the terms of the new contract they have signed or if transfer blocking notice is not sufficiently clear.¹³⁵
- 4.44. Research conducted by BMG Ltd into microbusiness engagement indicates that many business consumers distrust suppliers.¹³⁶ Frustrating experiences with the objections process may exacerbate this and lead to lesser engagement.

¹³⁰ Eg pay their debt before being able to switch with debt objections.

¹³¹ Farrell and Klemperer 2007; Klemperer 2005; 1995, (see also Dube et al. 2009; Shin et al. 2009; Cabral 2012).

¹³² Based on current switching rates (ie 16% for non-half-hourly electricity consumers) and if we assume all microbusiness transfer requests that are currently objected to translate into successful transfers when objections do not exist. However as explained in paragraph 3.21. this could potentially be an overestimate if alternatives to objections (rather than increased risk premiums) deter consumers from switching.

¹³³ BMG Research, '[Micro and Small Business Engagement in Markets](#)', March 2015

¹³⁴ This is however something we have not tested in our review.

¹³⁵ Especially in the absence of a cooling off period for business consumers and given the asymmetry of information they suffer in terms of knowing offers available in the market. This is something that the Competition and Markets Authority remedy of increasing transparency through publication of tariffs in the non-domestic market may help to address.

¹³⁶ BMG Research, '[Micro and Small Business Engagement in Markets](#)', March 2015

The survey says that 16% of businesses have never considered switching in 2015, down from 19% in the previous year.

- 4.45. This may indicate the need to look at the switching process, for example, the communications used throughout it, the timeliness of resolving an objection and how successful resolution is.
- 4.46. As explained above, key figures from analysis based on RFI data highlighted that 30%¹³⁷ of transfer requests made by microbusinesses across gas and electricity were objected to in the third quarter of 2015,¹³⁸ and that a fair proportion of these were related to problems with termination procedure (18%). We believe this is an area with significant potential to positively affect switching rates and bring about customer benefit. We cover next steps in relation to termination procedures in our decision letter.

Non-quantified cost

- 4.47. The friction and perceived barriers to switching are a key concern for the objections regime. However, it is difficult to address the source of those perceptions and we do not think that there is a good way to properly quantify the cost of this perception.
- 4.48. The recent changes to the non-domestic sector¹³⁹ may help improve perceptions of the ease of switching, but it may have yet to be felt.

Magnitude of non-quantified assumptions

Table 4.7: Non-quantified cost – Friction and impact on future switching

NON-QUANTIFIED COST	IMPACT
Friction and impact on future switching	MEDIUM/HIGH

Residual consumer detriment within current regime

- 4.49. As explained above¹⁴⁰, high rates of microbusinesses' objections flag the need to focus on these consumers' ability to engage in the market so that their

¹³⁷ Based on data from 21 suppliers.

¹³⁸ A similar proportion is observed across Q1-Q3 in 2015.

¹³⁹ See executive summary, p.11.

¹⁴⁰ See paragraphs 1.30-1.43.



transfers to new suppliers are not prevented by their lack of understanding of switching and objections procedures.

Cost 7: Transitional costs

Quantification of cost

4.50. There is no quantified cost under this heading.

Description

4.51. This is partially discussed within the Assessment of benefits section. We have discussed that there may be one-off and ongoing costs for incorporating or excluding costs for objections.

4.52. From our review of objections, we observed the issue of multiple interfaces. This is both in communications to all parties (the losing supplier, gaining supplier, customer, and potentially third party intermediary) as well as a central source to track where an objection had been raised (and whether this was resolved).

Non-quantified cost

4.53. As the modelling of this cost has not been attempted, we are unable to come up with a robust estimate of the transitional costs from incorporating/removing objections.

Magnitude of non-quantified assumptions

Table 4.8: Non-quantified cost – Transitional costs

NON-QUANTIFIED COST	IMPACT
Transitional costs	LOW

Residual consumer detriment within current regime

4.54. Residual consumer detriment was not identified under this heading.

5. Assessment summary

Quantified benefits

5.1. We provide a summary of the quantified benefits and costs, as noted in previous chapters of this IA.

Table 5.1: Summary of quantified costs and benefits

Quantified benefits	£m p.a.
Risk premium without fixed term contract objections	61.5 -302.5
Transactional costs of purchased energy requiring sale	6
TPI recovery costs	4
Risk premium without debt protection	40-409
Reduced debt recovery fees	<1
Protection from erroneous transfer	<1
TOTAL BENEFITS (range)	102-701.5
Quantified costs	£m p.a.
Higher bills from delayed transfer	5
Higher bills from blocked transfer	13
TOTAL COSTS	18
Quantified net benefit (range)	£83.5-683m p.a.

5.2. On a solely quantified basis, our analysis finds there to be material benefits in retaining debt and fixed term contract objections in the non-domestic market. However, there are several qualitative factors that cannot be quantified robustly.

5.3. There are assumptions used in deriving the quantified benefits and costs. To fully capture the net benefits of any policy decision, it is important to capture behavioural effects of changes to the regime. We are not comfortable that many of these changes can be robustly estimated.

5.4. We think that opportunistic behaviour from non-domestic consumers in the absence of objections is limited by there being no obligation to supply in the non-domestic market. The opportunistic behaviour could be seeking to leave a contract early, if the wholesale prices are falling, in the absence of fixed term contract objections or debt hopping in the absence of debt objections.

5.5. We have used scenarios to account for the uncertainty in some of our assumptions (ie for our reduced risk for debt and for fixed term contract objections) and to assess the size of the benefits. Even using our low estimates gives a net benefit of £83.5m p.a.

Breakdown by consumer size

5.6. We have further broken down the benefits and costs by the type of energy (electricity and gas) and the type of business (microbusiness and larger business consumers).

5.7. The results of this breakdown are available in table 5.2 below.

Table 5.2: Summary of quantified net benefits by consumer size

Consumer group	Quantified net benefits, £m p.a.
Gas – microbusinesses	5-15
Gas – larger than microbusinesses	9-11
Electricity – microbusinesses	60-600
Electricity – larger than microbusinesses	7-60

5.8. This analysis indicates that quantified benefits significantly exceed costs for all of our four groups. The net benefits are greater in electricity compared to gas. Overall net benefits for 'electricity – microbusinesses' is the highest of the groups.¹⁴¹

Non-quantified benefits and costs

5.9. There are a number of categories that we have not quantified. These are shown below, with an assessment of their likely impact.

Table 5.3: Summary of non-quantified benefits

NON-QUANTIFIED BENEFIT	IMPACT
Non-supply or risk premium for newer businesses	MEDIUM/HIGH
Reduction in numbers of suppliers in the market	MEDIUM/HIGH
One-off mark-to-market loss	MEDIUM
One-off change in debt provision	MEDIUM
Impact of debt hopping	LOW

¹⁴¹ This has to do with the higher number of microbusinesses electricity consumers, compared to gas, hence their higher level of consumption.

Spreading of costs across consumer base	MEDIUM
Provision of informal working capital	MEDIUM
Transitional costs	MEDIUM
Dynamic changes in fixed term contract objections	LOW/MEDIUM
Presence of fixed tariffs or shorter duration fixed term tariff	LOW
Change in debt collection methods	LOW
Impact of exit fees for erroneous transfers	LOW
Additional use of security deposits	LOW

5.10. As there are a number of benefits that have not been quantified, this would indicate that before the assessment of non-quantified costs, there are strong arguments for retaining objections.

5.11. We note the non-quantified costs below.

Table 5.4: Summary of non-quantified costs

NON-QUANTIFIED COST	IMPACT
Friction and impact on future switching	MEDIUM/HIGH
Supplier incentives to target debt	MEDIUM
Ability to pay considerations	LOW
Reduced ability to switch under a fixed term contract	LOW
Costs for providing financial buffer	LOW
Transitional costs	LOW
Cost of time to address and resolve an objection	LOW/MEDIUM

5.12. We note that there are a number of offsetting costs and benefits, eg price certainty versus flexibility, and transition cost avoidance or incurrence.

5.13. A key non-quantified cost is the friction that an objections regime may create and its impact on switching, especially for microbusinesses consumers.

Impact of Competition and Markets Authority remedies

- 5.14. The CMA suggested remedies for the non-domestic retail market which should promote greater price transparency and lead to consumers being better able to compare contracts. As consumers are aware of better offers available in the market, we would expect the number of switching requests to increase. When these consumers are under contract, this increases the number of fixed term contract objections. However, if engagement and transparency is improved from these changes, we would expect the number of objections to decrease over time as consumers make informed choices to begin with and are aware of the terms they have entered into. In other words, this would reduce the numbers of genuine switches, hence the number of objections.
- 5.15. Creating a database of consumers who have not switched in the last three years should also lead to more switching requests, though we may expect fewer objections as contracts could have expired.
- 5.16. Removing restrictions on termination notices on auto-rollover, OOC and evergreen contracts should reduce the number of objections, as we see the majority of objections are related to fixed term contracts, with termination notice being a key driver.

Overall assessment

- 5.17. Our overall assessment is that it is in the interest of business consumers (both small and large) to maintain objections as per SLC 14.2.
- 5.18. The IA indicates that there are net benefits from retaining the ability of suppliers to object for both debt and fixed term contract in the non-domestic market.
- 5.19. The annual net benefit of retaining the objection regime from our quantified analysis is £83.5-683m p.a. The wide range indicates that there is some uncertainty in the exact level of benefits, but that this is a substantial net positive, even in the low estimate.
- 5.20. There are also a range of non-quantified benefits to consider, such as the avoided potential reduction in the number of suppliers in the market. There are a number of non-quantified costs. In particular, we are concerned about the impact of objections on switching and effective competition in the market, as per our regulatory objectives. Given the magnitude of net benefits, we believe the non-quantified costs are unlikely to change our overall conclusion to retain the current objections regime.
- 5.21. The policy changes introduced by Ofgem in recent years have not necessarily fed through yet and, combined with market changes that will be brought by

some of the CMA remedies on microbusiness consumers, may have an impact on current market outcomes.

- 5.22. We may consider reviewing objections under a narrower definition of microbusinesses in future.
- 5.23. There are clear areas of actual and potential detriment that means consumer welfare is not maximised, even when objections should be retained. We look at these when considering next steps as outlined in our decision letter.