

Jonathan Blagrove
Microbusiness Strategic Review
Vulnerability and Consumer Policy
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Dear Mr Blagrove,

Microbusiness Strategic Review: Policy Consultation

The Federation of Small Businesses (FSB) is pleased to respond to the above-named consultation. FSB is the United Kingdom's (UK) leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that's led by our members, for our members. FSB is also the UK's leading business campaigner, focused on delivering change which supports smaller businesses to grow and succeed. Our lobbying arm starts with the work of our team in Westminster which focuses on UK and English policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with Governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

FSB welcomed Ofgem's recognition in the 2019-21 Forward Work Programme that microbusinesses face many of the same issues as domestic consumers. And we welcomed Ofgem's subsequent commitment to better understand the issues faced by microbusinesses and to act where necessary.

In May, 2020, FSB published our report, *Time & Energy: An FSB review of the microbusiness energy market*.¹ This report summarised data gathered via a UK-wide FSB survey of 1136 small businesses in April 2019. The dataset in the published report was subsequently refined to remove businesses that had 10 or more employees (i.e. are not microbusinesses), had no control over their energy tariff (e.g. provided as part of a lease), were home-based (so likely on a domestic energy tariff), described themselves as 'mobile' businesses, or who did not use metered electricity. This left a dataset of 709 microbusinesses on metered, non-domestic energy tariffs.

We were pleased with the opportunity to provide this data to Ofgem's Microbusiness Strategic Review Call for Inputs.

¹ <https://www.fsb.org.uk/resource-report/time-and-energy.html>

Awareness: Knowing about opportunities and risks

Question: What are the most effective ways to ensure that microbusinesses can access key information about the retail energy market?

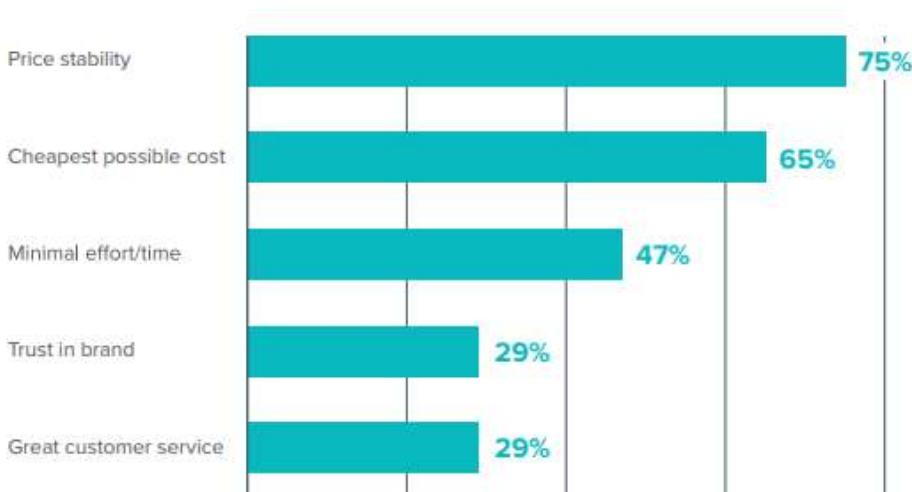
Recent FSB research suggests that the two most important individual factors for microbusinesses when choosing their energy tariff are:

- Cheapest possible deal (top choice for 36%)
- Price stability (top choice for 33%)

However, looking at the decision factors that microbusinesses highlight in their top three (rather than simply those ranked first) gives a more rounded view of their broader priorities when choosing a new tariff (Figure A). When doing so, the importance of 'minimal effort/time' becomes more obvious, clearly demonstrating the market drag effect of 'opportunity cost' for microbusinesses.

Figure A: Most important considerations for microbusinesses when choosing their new energy tariff (ranked top three)

Source: FSB Energy Market Survey, 2019



Although cost is an important factor for all businesses, the cost of energy must be compared to other costs associated with running a business – like paying for staff, rent, tax, machinery, goods and services – and the indirect costs associated with devoting time and resource to these things. Therefore, many microbusiness owners choose to rely on a TPI or broker to make these decisions for them. Fair and transparent access to such a trusted service is vital for small firms.

FSB has previously supported the introduction of published tariffs for small firms, but do not see these as mutually exclusive to the role that brokers play. These published tariffs provide transparency and a price to beat, offering a sense-check. Ofgem should look at how market data is published in a way that provides this market overview in a simple format and focusses on just the essential data.

Open Energy

Though this Microbusiness Review focusses on the energy retail market of today, FSB urges Ofgem not to lose sight of the developing smart-market of the future. FSB's previous report, *Open Energy: Using data to create a smarter, cheaper and fairer market*², explored proposals to give energy customers more control over their smart meter data, arguing that this will make the value of having a smart meter much greater.

Open Energy is the name we give to the reforms that can solve many of the energy market's problems. It is a set of policy reforms designed to change the terms of the energy market in favour of customers and innovators, primarily by making market information available through machine readable open APIs and giving energy customers' power over their meter and contract data. These reforms are designed to make switching easier, by eliminating information asymmetries and uncertainty about price and service quality, and to make data available to innovators to allow a new generation of technology that connects individual usage with the demands of the overall grid, and to better integrate people's energy consumption by, for example, giving electric cars the information, they need to charge when electricity is cheapest, whenever that might be. The report argues for three main reforms under the 'Open Energy' umbrella:

² <https://www.fsb.org.uk/resources-page/open-energy-using-data-to-create-a-smarter--cheaper-and-fairer-energy-market-pdf.html>

1. Access to public data - like tariffs - in a standardised, machine-readable, persistently updated format, to give a clear view of the supply side of the market.
2. Give domestic and SME customers the ability to provide third parties access to domestic and SME usage data, meter and contract information, and other characteristics used to determine how much a customer has to pay.
3. Give domestic and SME customers the right to let third parties act on their behalf and to move them between suppliers.

This model supports the “Access, Assess, Act” that is used by the CMA to model the customer choice process – businesses and domestic customers need to be able to access the possible offers available to them in the market; they need to be able to assess what tariffs and pricing offers are best for them using their own characteristics; and they need to be able to act to make a transaction, or nominate someone else to act on their behalf.

The short-term outcome of this, we argue, would be an energy market that was more responsive to price signals of efficiency, and in which domestic customers could get the best deal much more easily. The long-term outcome would be a market that unbundled many of the roles currently performed by suppliers and allowed for greater specialisation in specific types of energy service, such as demand-side response, while lowering the barriers to entry for newer service providers.

As well as improving the functioning of the energy market for consumers, these reforms would improve demand response by making adaptation to time-of-use electricity pricing easier – through smart home technology that can shift usage to off-peak times, for instance – which would overcome the problem of intermittency that faces many renewables. This would help solve the problem that the shift towards low-carbon generation will otherwise face, and deliver significant environmental benefits.

Browsing: Searching for deals

Question: Do you agree with our proposal to strengthen the requirements to present a written version of the Principal Terms to customers?

FSB supports Ofgem's view that increasing the transparency of broker costs will allow consumers to make more informed contract choices and assess the value of services offered by brokers in identifying energy contracts. Much of the mis-selling in the market is anecdotally to be on verbal calls where the call recording does not include statements made before the "script". Having a written contract, combined with a cooling off period, should enable the small business customer to review and make a more informed decision.

Question: Do you agree with our proposal to require that suppliers disclose the charges paid to brokers as part of the supply contract, on bills, statements of account and at the request of the microbusiness customer?

Like any other business, TPIs are entitled to make a profit in return for providing a valuable service to the customer. In a transparent and well-regulated TPI market, the customer would be able to trust that the service they had paid for was worth the money. However, this is currently not the case and, despite the fact that many TPIs provide an excellent service to customers, trust in the market is in short supply.

In principle, a requirement on suppliers to disclose the charges paid to brokers, could be a very positive move that could reduce harm to the customer. However, how this is presented, especially given that suppliers have different ways of calculating commission, will be of critical importance. For example, one supplier may pay a commission per kWh consumed, but another may pay a fixed commission for a consumption banding, or even a commission based on rate per day. TPIs themselves may operate different business models – such as charging a fee based on savings against an inflated renewal quote and not putting charges behind the supplier bill.

Question: Do you think that further prescription or guidance on the presentation and format of broker costs on contractual and billing documentation would be beneficial? If so, how should broker costs be presented?

FSB believes that having the annual commission rate displayed as an absolute and as a percentage of the annual bill should be sufficient. Conversion into a 'per kWh' figure could cause unusually high and

misleading figures on very low consumption supplies. We note that Ofgem has not provided guidance on what a reasonable commission level would be but we have seen examples of several pence per kWh, which is a significant proportion of the overall bill, especially on Gas. Overall margins on microbusinesses bills – for both direct suppliers and TPIs - should be no different to those of domestic customers.

Question: What challenges do you think suppliers and brokers may face implementing these proposals?

Suppliers will need to adapt their billing systems to cope with the requirement to disclose broker commission on their invoices. But there will be other challenges, related to how the market works in reality. For example:

- Many TPIs are sub brokers of larger aggregator brokers that also take a cut of the commission. Suppliers may not know the commercial arrangements of the aggregator broker, potentially creating a market distortion.
- Suppliers that currently operate fixed commissions may need to be more flexible on varying commission levels in order to stay competitive.
- There may be a commercial risk of customers sharing contracts with other suppliers to get a better deal during the cooling off period, despite any non-disclosure clauses.

Contracting: Signing up to a new contract

Question: What do you think the impact of our proposal to introduce a broker conduct principle will be? Are there any particular reasons why suppliers/brokers couldn't achieve the broker conduct principle?

FSB has long supported a code of practice for non-domestic TPIs, setting out customer engagement standards (professional and honest behaviour, transparency of information and effective monitoring). Various models for how such a code of practice might work have been put forward by Ofgem, suppliers and those operating within the TPI industry itself, all following the same broad principles. And FSB recognises that many suppliers have their own voluntary codes of conduct that govern their relationships

with TPIs. However, FSB believes any such code would need to be market wide and universal to be truly effective.

FSB was disappointed that this issue was not directly addressed by the CMA market investigation in 2017. However, the CMA did formally acknowledge the problem:

"TPIs have the potential to help customers engage with energy markets and reach good outcomes. However, this may be undermined if customers do not trust TPIs. Our evidence suggests that there have been long-standing concerns about the conduct of a minority of TPIs; that some TPIs may not offer customers the best tariffs for the customer; and that customers lack information about how they pay for TPIs' services. These issues may not apply to all TPIs, but they may affect customer perception of all TPIs. This may deter the use of TPIs and form a barrier to higher levels of engagement."

FSB welcomes the introduction of a broker conduct principle, but we have concerns that the responsibility to manage this would fall exclusively on suppliers. This may act as a barrier to new entrants coming into the market, other than as sub-brokers of established TPIs. The conduct of sub-brokers and aggregated brokers perhaps needs to be brought into these proposals.

A market wide code of conduct – underpinned by a licence agreement - should also incorporate Letters of Authority (LOAs), which formally recognise brokers as representatives of the customer. Not including this represents a missed opportunity to avoid mis-selling, ensuring a customer approved (ideally signed) LOA exists to place a contract, and introduce an element of standardisation across the industry. Currently, different suppliers have different requirements for LOAs,

In the short term, FSB wants to see increased scrutiny around the system for giving consent for trusted TPIs to operate on behalf of their clients, through LOAs. Good TPIs have a valuable role to play in the energy market, yet there is evidence that LOAs received by some suppliers are not being dealt with adequately, leading to unnecessary delays for potential switchers. This is a key barrier to engagement. If businesses cannot get access to information about their contract and consumption, it leaves them in a poor position to exploit their own data and make informed choices around their energy use.

Question: Do you agree that our proposal to introduce specific sales and marketing requirements on suppliers and the brokers they work with is important to help customers make more informed choices and increase trust in and effectiveness of the market? If so, do you agree that face-to-face marketing and sales activity should be covered alongside telesales activity under these proposals?

FSB believes TPIs can play an important role in helping smaller businesses secure the best possible energy deals. The role of a TPI will become even more important as energy bills increasingly include costs associated with additional products and services, such as energy efficiency advice, renewable sourced energy and smart technology.

In general, FSB supports Ofgem's proposals to introduce specific sales and marketing requirements on suppliers and brokers. A more complete documentation of the sales process (rather than just the sales script) would provide greater transparency and trust. However, we would like to understand more about how this would happen in practice, particularly around face-to-face conversations. Would these be required to be recorded on an audio device or would they be left to after-meeting notes of the sales rep? If the latter, how is the completeness ensured?

Question: Do you agree that our proposal to introduce a cooling-off period for microbusiness contracts represents an effective way to protect consumers during the contracting process? If so, do you agree that the length of the cooling-off period should be 14 days?

FSB supports Ofgem's proposal to introduce a cooling-off period for microbusiness contracts, believing this is a long overdue reform. It will help in areas where a verbal contract has been incorrectly approved by a person not authorised to do so. But it will also place a greater onus on those selling the service to ensure that the (potential) customer is fully informed, empowered to make decisions, and bought-in to the contract on offer. A failure to ensure any of these will likely lead to a subsequent cancellation of the contract in the following 14 days.

Question: What challenges do you think suppliers and brokers may face implementing these proposals?

There is a risk that customers may share their contract information with other suppliers and brokers in search of a better deal, thus generating inefficiencies in switching. It is unlikely that suppliers and brokers not already operating in the domestic sector will have systems in place to monitor cooling off

periods. This will need to be factored into any implementation period. Many smaller brokers – frequently sub-brokers – may require training on the new rules.

Question: Do you have any comments on the associated draft supply licence conditions in Appendix 1 of this document?

The concentration of power and influence of the suppliers over the brokers may lead to a situation where brokers become no more than sales agents of the suppliers, rather than working in the best interests of the consumer. There is a risk that this could lead to target hitting behaviours to maintain relationships with suppliers. This could include the possibility that suppliers may encourage “off contract” rewards to encourage broker loyalty, paying brokers for achieving sales targets which is behind the bill but not transparent to the customer. This is already seen as a behaviour with some suppliers offering ‘double’ commissions for certain types of business at times.

Question: Do you think there are other changes which would better address the consumer harm that has been identified?

A more neutral solution would be to increase the scope of the Energy Ombudsman, to review broker mis-selling with the power of levelling fines proportional to the offence. This should be coupled with a mandatory code of practice. Many of these brokers will be very small entities with varying legal structures, including sole traders that lack the protection of limited liability companies.

Dialogue: Two-way communication with service providers

Question: Do you agree that our proposal for a mandated ADR scheme represents an effective way to fill the existing consumer protection gap where a microbusiness has a dispute with their broker?

FSB supports Ofgem’s proposals for a mandated alternative dispute resolution (ADR) scheme that can be enforced in the cases where there is no legal contract between the broker and the business customer. However, like the broker conduct principle, if the responsibility to regulate sits with suppliers then there is a potential conflict of interest. FSB believes this responsibility should sit with an independent body such as the Energy Ombudsman. A single, simple avenue for recourse is better than various voluntary schemes in terms of the customer journey.

Small businesses are, on the whole, not well equipped to deal with disputes. They often do not have the resources to dedicate to pursuing a problem, whether that be negotiating its resolution informally, robustly through ADR or through the courts. So, simplicity is paramount.

Question: What challenges do you think suppliers and brokers may face implementing our proposal regarding dispute resolution?

The initial issue will be one of clear communication of process. For example, in cases of alleged broker mis-selling, would the initial dispute be raised with the supplier, with the supplier then raising a complaint against the broker? In many cases, the business customer would not have a contractual relationship with the broker, but the broker does have a contractual relationship with the supplier. So, a direct complaint to the supplier would be the clearest path for the customer, particularly in cases where they may not even remember who the original broker was. This gets more complicated in terms of sub-broker relationships.

Joining an ADR scheme may be a prohibitive cost for start-up brokers, and so we could see some form of consolidation in the industry with concentration on broker aggregators, which may be a good thing in terms of enforcing compliance.

Exiting: Switching away from an old contract

Question: Do you agree that termination notice requirements represent an unnecessary barrier to switching and should be prohibited? If so, do you agree that a prohibition on notification periods should apply to both new and existing contracts?

FSB supports Ofgem's view that termination notices are an unnecessary barrier to switching and we see no issue with a prohibition of such terms being immediately applied to existing contracts. Indeed, a blanket change should be simpler to communicate and manage. We also see no issue in applying this to "Evergreen" contracts.

Question: Do you agree that our proposal to require that suppliers continue to charge consumers on the basis of the rates in place prior to a blocked switch for up to 30 days represents an effective approach to limiting the financial impact of switching delays? If so, do you agree that the time period should be 30 days?

FSB does not believe there should be a limit of 30 days where the delay is due to the slow response from the incumbent supplier. Covid-19 has demonstrated the potential for existing services to be interrupted and delayed.

We would also advocate for a similar process where there is a change of tenancy.

Question: What challenges do you think suppliers and brokers may face implementing our proposals regarding improving the switching experience?

There are obvious cost concerns due to having to process documents faster to avoid additional costs. For brokers, tracking the progress of a switch is impossible where there is no access to ECOES or Xoserve, but this is being addressed in other workgroups.

I trust this helps to adequately clarify FSB's position. If you would like any further information or input from FSB, please contact our Head of Policy Research, Andrew Poole, at andrew.poole@fsb.org.uk.

Yours faithfully,



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