

Katie Brennan  
Retail and Market Processes  
Ofgem  
9 Millbank  
London, SW1P 3GE

7 March 2011

Dear Katie,

**Re: Consumer Focus response to consultation on practices concerning Fixed Term Offers in the domestic retail energy market**

Consumer Focus strongly welcomes Ofgem's consultation, although we are concerned at the length of time taken to launch a consultation on fixed term offers, given the evidence of consumer detriment and poor practice.

In August 2009 there were a number of media stories<sup>1</sup> about consumer detriment associated with the ending of fixed term offers. Further stories about a different supplier appeared in the national press in February 2010<sup>2</sup>. Consumer Focus's open letter on energy tariffs<sup>3</sup> in December 2010 further highlighted concerns about the sales, marketing and operation of fixed term offers. It is disappointing therefore that Ofgem did not publish this consultation until January 2011.

We hope that our wider concerns about supplier behaviour, raised in the open letter, will be addressed in the Retail Market Review document to be published later in March.

**Chapter 2, Question 1**

**Have we outlined in the chapter the full array of suppliers' practices with respect to fixed-term offers?**

Your summation covers market practices well, but we would stress that the key concern with fixed term offers (which is consistent across suppliers) is information. There has been significant poor practice to date by suppliers. They have been consistently unwilling to provide clear and sufficiently visible information, such as termination fees or the procedure for rolling customers onto a new tariff when a contract comes to an end.

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<sup>1</sup> <http://bit.ly/4C5VPC>

<sup>2</sup> <http://bit.ly/c4mbai>

<sup>3</sup> <http://bit.ly/etuoPE>

Ofgem does mention the lack of information in this chapter. For Consumer Focus the provision of limited information or poor quality information is central to consumer detriment in this area as it leads to consumers making poor choices, regardless of the potential money-saving nature of various fixed-term offers.

### Chapter 3, Question 1

Based on evidence in chapter 2 or any additional evidence you may have, do you agree that our concerns are valid?

Consumer Focus agrees with Ofgem's concerns. We are, however, particularly worried by your view that suppliers are consistently breaching four out of the five overarching standards of conduct with their fixed-term offers as this sets a precedent with regard to future consumer confidence and detriment.

This calls into question the value of non-binding standards if they are so easily flouted. If Ofgem believes that the standards are being breached, it must intervene much more quickly or make the standards binding on suppliers.

From our experience in the non-domestic market, we feel it is crucial that suppliers are able to prove the existence of communications which have 'not been received' by consumers or suppliers; many cases that come to Consumer Direct regarding non-domestic rolled-over contracts arise because consumers either did not hear from their supplier or the supplier said the consumer did not cancel the contract in the exact manner necessary. This could be accomplished through the mandating of suppliers' use of Royal Mail's 'Track and Trace' service or equivalent mechanisms of proof of delivery. We recognise the cost burden this entails; Ofgem might like to consider cheaper alternatives. Regardless, information regarding these procedures needs to be clear to consumers so as to be carried out as intended. Follow-up automatic emailing would augment any postal contract reminder and should also be recommended at almost no cost to suppliers.

### Question 2

Do you believe there are any additional areas of practice around fixed-term offers which may raise concerns?

It would be worth Ofgem investigating whether fixed-term offers are good for the general health of the retail market, regardless of whether the individual consumers who sign up for such offers benefit. We have some concerns that the pricing that does not reflect market fundamentals (such as prevailing wholesale prices) could be cross-subsidised by consumers on variable tariffs to the extent that the latter end up with unfairly high prices.

The increasing popularity of fixed-term offers might be dividing the market up into two groups rather than helping push (produce?) fair retail prices for all consumers; this is especially worrying given the different income groups predominantly using or not using fixed-term offers respectively. To improve consumer confidence in the supply market, Ofgem should consider whether this concern can be substantiated.

## Chapter 4, Question 3 (sic)

### What is your opinion of the options set out in this chapter?

Consumer Focus favours Option 4. We believe Option 1 is unlikely to produce the required improvements. We are concerned that Options 2 and 3 do not go far enough as the 'existing rules' on which they would be built on, or based around, are being flouted and/or do not clarify the market rules in consumers' interest. Furthermore, our reading of the options suggests that implementing either Option 2 or 3 would leave domestic consumers less formally protected than small businesses, which to us does not tally with Ofgem's historical and primary role in protecting the interests of domestic consumers. While we support increased protections in a variety of areas for micro-businesses, we are not comfortable with them having more protections than domestic consumers in, for example, the length of the rollover (if any) permitted.

Along with limiting the ability to charge termination fees, Ofgem must ensure that suppliers adhere to the existing standards of conduct, with suppliers required to provide certain pieces of information as a minimum of compliance. This should include the length of time the tariff runs and any termination fees, both details and other key ones being presented on a single clear and prominent document. There should be scope to present this information on a consumer's bill without creating further visual 'clutter'.

Given the length of time that has already elapsed since evidence of problems emerged, which have affected hundreds of thousands of customers, Ofgem should seek to take action as quickly as possible.

With regard to consumers being required to opt-in (rather than the current opt-out implicit in rollovers), our position is that if two of the big six suppliers already operate in this manner then the costs and complexities cannot be too onerous. If consumers were put on potentially more expensive standard tariffs, this could again be mitigated by enforcing the existing standards. Before their fixed term offer comes to an end, consumers must be properly informed as to what tariff (and at what cost and terms and conditions) they are about to be put on, thus vastly reducing the likelihood of such situation actually occurring.

The opt-in approach also forces suppliers to compete to retain customers and so puts pressure on prices and thus increases overall benefits. A more innovative approach to tariffs outside of price may also result, for fixed-term users and others.

We are not convinced by Ofgem's view that Option 4 could result in another barrier to entry for smaller suppliers. Two small suppliers (First Utility and OVO) either offer no fixed tariffs or non-rollover fixed tariffs respectively, so the idea that forcing opt-ins on suppliers would affect the competitive fringe seems unfounded based on a glance at current market offerings.

Consumer Focus remains similarly unconvinced by Ofgem's assertion that 'suppliers use Fixed Term Offers as a way to both reduce costs and better manage their hedging strategies. This can be particularly important for smaller suppliers'. Small suppliers do face significant problems in obtaining wholesale energy thanks to low forward power market liquidity but the additional fixed-term tariff impact on this fundamental problem would be minimal at best. Furthermore OVO offer two of the 17 currently available fixed/capped direct debit dual fuel tariffs (all the rest are from the big six); only three of the 12 electricity equivalents are from small suppliers also. Clearly small suppliers do not agree with Ofgem's view that fixed term tariffs are crucial to their strategy.

However, Consumer Focus would welcome views from small suppliers on this issue. If there are genuine concerns with Option 4 which can be definitively demonstrated, then we would be willing to reconsider these arguments. In such case, Options 2 and 3 would represent the next best option for consumers. We would note, however, that your equivalent body in communications, Ofcom, has just proposed to ban all rollover contracts for domestic consumers of landlines unless they choose to opt-in. Given that energy is an essential service, we would argue that similar protections are needed by this group of consumers.

Finally, we repeat our concern that any consumers who benefit from fixed term deals might be cross-subsidised by other consumers. Hedging is, if anything, more disconnected from fixed-term retail tariffs than from conventional (variable) tariffs, that by definition follow hedging strategies as prices move up and/or down.

In terms of value for money for consumers, what is really important is the calculation of the risk premium prevalent in fixed term tariffs. If it is set 'too low' ie outturn future wholesale prices are higher than the suppliers' forward looking forecasts then consumers should benefit. In the opposite scenario consumers could lose out ie outturn wholesale prices are lower than forecast. Therefore the calculation of the risk premium is key. If any change can ensure a more efficiently calculated risk premium then the 'true costs' to consumers will be better articulated thus improving the efficiency of the market.

We contend that Option 4 is better as it ensures this as a 'truer' calculation of the risk premium can be put to customers ie the risk premium has probably been too low, as the risk to suppliers is minimised where automatic rollovers are possible.

#### Question 4

Do you believe there are any additional options which we should consider? If so please provide details.

If resources permit we would be interested in Ofgem's views on how the supply market in Britain could provide US-style wholesale-linked tariffs<sup>4</sup> and whether there are regulatory structures inhibiting their existence. We think that many (principally non-low-income and non-risk-adverse) consumers would be keen to access such a tariff so as to enjoy the fairness of prices linked to current wholesale market conditions with an overall price benefit when considered from a long-term perspective.

#### Question 5

Do you envisage any obstacles to the implementation of options discussed in this document, other than those already outlined?

No.

Yours sincerely,

Andrew Hallett  
Policy Advocate

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<sup>4</sup> See for example the Columbus, Ohio gas market