

## Telecom Plus PLC response to Supplemental Notice of Possible Remedies Oct 15

### Introduction

We are extremely concerned by the CMA's decision to consider as a possible remedy the prohibition of evergreen tariffs and their replacement with a fixed term default tariff.

We believe it critical to determine the motive behind the original submission of this proposal by two of the largest energy suppliers, and to explore why alternative proposals from smaller, pro-competition challenger suppliers have not received the same attention.

We stress that it is imperative for the CMA to learn from past failed interventions into the energy markets and avoid repeating the mistakes.

#### 1. **What is actually being proposed?**

The prohibition of the use of evergreen tariffs in order to encourage consumer engagement; and their replacement with a fixed term tariff with no termination fees; i.e. a new 'default' tariff.

The objective?

To ensure that un-engaged consumers are prompted at least once annually to engage in the market and consider finding an alternative to their current tariff.

The reality?

A single additional prompt to currently un-engaged consumers that will have a wholly immaterial impact given the existing Cheapest Tariff Messaging (CTM) obligations.

The new 'default' tariff will simply replace the existing evergreen SVT.

Conclusion:

This proposal amounts to no more than the introduction of an obligation upon energy suppliers to send all consumers a single renewal notification annually.

#### 2. **Who made the proposal?**

Two of the largest suppliers in the country suggested this possible remedy as an alternative to Remedy 11.

Why? Remedy 11, albeit fraught with implementation challenges, fundamentally challenges the status quo of the retail energy markets: namely the ability for suppliers to inflate the tariffs they charge to un-engaged consumers in order to maximise profits or fund deeply-discounted customer acquisition strategies.

In practice, the proposed remedy amounts to the maintenance of the status quo with the introduction of an additional single annual customer communication, which will have marginal impact given the current CTM obligations.

The fact that both the proposing suppliers emphasise that the default tariff must be set by suppliers strongly suggests that they wish to preserve the flexibility to continue to adopt their existing business models.

We wholeheartedly agree with the CMA's conclusion that this possible remedy is not an alternative to Remedy 11 (or a version thereof), and are adamant that some form of pricing control/cap along the lines of Remedy 11 is critical to prevent the continued exploitation of inert consumers by energy suppliers.

We are alarmed that the CMA has issued a supplemental notice of a possible remedy based on the suggestions of some of the largest energy suppliers, who have the most to lose from an increase in competition, as opposed to listening louder to those of the smaller challenger

suppliers that have succeeded in winning significant numbers of customers from the established suppliers through innovative business models and treating customers fairly.

We are surprised that the prohibition of evergreen tariffs is even being considered by the CMA as a possible remedy, as we see no merit in this proposal whatsoever.

And we are deeply frustrated that the proposal we suggested of a maximum delta between the most expensive and cheapest tariff offered by a supplier, which goes to the very heart of addressing the exploitative practices that the CMA are rightly concerned about, has been wholly ignored.

### 3. **Failure to learn from past interventions**

Ofgem's RMR resulted in the introduction of the CTM obligations. We have seen no evidence that this license condition has created a material increase in internal switching rates. This new possible remedy in reality amounts to a single additional piece of correspondence sent by an energy supplier to an un-engaged customer. It is not the 'silver bullet' that it may appear: for a supplier that bills its customers monthly and sends an annual statement, it simply amounts to a 14<sup>th</sup> annual customer communication to encourage them to engage with the market and consider switching.

Furthermore, there is ample evidence of energy suppliers riding roughshod over the clear intentions of narrowly defined interventions. A couple of examples: (i) Ofgem's letter of 27<sup>th</sup> Oct 2015 to all suppliers relating to the inclusion of collective switch tariffs in the CTM obligations (an attempt to close down a grossly exploited loophole); (ii) BG's manifest exploitation of the original white label derogation with its Sainsbury's brand, and the adoption of a clear two-tier pricing strategy to circumvent the risk of cannibalisation of their established BG customer base posed by the CTM obligations.

It is therefore neither surprising that the prescriptive nature of Remedy 11 is wholly unpalatable to most energy suppliers (as it restricts their ability to continue to exploit un-engaged customers), nor that both suppliers who proposed this alternative remedy emphasise the vital importance of suppliers setting their own default tariffs.

We urge the CMA not be distracted by alternative proposed remedies that could inadvertently enable these exploitative business practices to continue.

### 4. **The perception that higher levels of switching alone indicate a healthy competitive market working in the interests of consumers needs to be challenged.**

The CMA has correctly identified that competition within the energy markets is not currently leading to the majority of consumers benefitting. Indeed it is resulting in exactly the opposite - a detrimental impact through the artificial inflation of SVTs to cross-subsidise deeply discounted acquisition tariffs.

However the solution cannot solely be to drive higher levels of switching to the cheapest tariffs as this is self-defeating: the process of switching supplier is costly. Not only must the gaining supplier typically fund PCW brokerage fees and other marketing costs, there are material administrative costs borne by both supplier parties.

Higher levels of switching lead to higher costs being incurred by suppliers. These must inevitably be passed onto consumers and therefore drive price inflation.

Currently this inflation is entirely borne by un-engaged customers on SVTs.

This is the crux of the issue that the CMA has correctly identified – however this proposed remedy will do little to address it.

The suggestion that, in isolation, higher switching rates will lead to lower prices for all consumers is flawed, as it ignores the substantial higher industry costs that this increased switching would create.

Rather, we propose a remedy that would deliver the understood objective of Remedy 11: - to prevent suppliers from funding deeply discounted acquisition tariffs for a minority of customers through the exploitative inflation of SVTs charged to the majority of customers, and ensure that competition is working for the benefit of all consumers, as opposed to yielding detrimental consequences for the majority.

In conjunction with various of the other proposed remedies aimed at increasing consumer engagement, we believe the following suggestion would be straightforward to implement, avoids the risks associated with setting a specific safeguard tariff, and represents a proportionate and effective remedy:

**Introduce a maximum permitted 'delta' (£ or %) that a supplier is permitted to charge its SVT customers relative to the cheapest price that it charges its newly acquired customers on more competitive tariffs.**

Customers would be sheltered from the expense of mass switching programmes and protected from the exploitative business models currently adopted by many suppliers.

Suppliers would be able to continue to compete effectively with one another for new customers, but not at the expense of their established customer bases.

## Response to Supplemental Notice of Possible Remedies

- a) This remedy would have very little impact in encouraging customers to engage more frequently with the market.
- i. The current CTM obligations require suppliers to ‘engage’ with their customers on every formal document that they send them about cheaper tariffs. As a supplier who sends our customers a regular monthly bill and an annual statement, our customers already receive 13 CTM notifications from us per annum. Sending a 14<sup>th</sup> will have no additional benefit, and will simply add to the ‘information overload’ that our customers already face, resulting in additional supplier cost and even lower engagement.
  - ii. We dispute the validity of the assertion that levels of engagement displayed by customers who have previously switched to a competitive fixed term tariff upon receiving an “end of deal”<sup>1</sup> prompt, or “end of fixed-term notice”<sup>2</sup> will be even vaguely similar to the levels of engagement displayed by un-engaged customers on the SVT upon the receipt of a renewal notice for a tariff they didn’t even know they were on.
    - i. Customers on a fixed term deal are inevitably more likely to engage upon receipt of an “end of deal” prompt because they are, by definition, already aware of the benefits of switching and likely to be facing a steep increase in costs if they don’t engage.
    - ii. Customers on an SVT or ‘default’ tariff are highly unlikely to show the same level of engagement because they are neither pre-conditioned to know about switching, nor are they actually facing an “end of deal” scenario – if they do not engage, they will simply remain on the default tariff and continue to pay the same price.
- b) We do not believe that this remedy would be effective in protecting those customers who fail to engage in the market if suppliers are permitted to set the ‘default’ tariff, any more than the current SVTs do.

An extension to SLC7 alone would fail to address this problem satisfactorily as inefficient suppliers (or those incurring material acquisition costs) would in practice have the ability to justify charging prices that reflect their inflated cost bases, as opposed to the underlying true cost to serve (as currently displayed in the margin analysis within the Ofgem Segmental Statements).

We urge the CMA to consider, amongst its remedies, our proposal of introducing a maximum delta that a supplier can maintain between the cheapest tariff it offers and the most expensive. This would naturally prevent the gross exploitation of these customers that is currently displayed by large and small suppliers alike, whilst not stifling competition:

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<sup>1</sup> Scottish Power Proposed Alternative Remedy Para 4 within CMA Supplemental Notice of Possible Remedies.

<sup>2</sup> Centrica Alternative Remedy 11 Proposal Para 11 within CMA Supplemental Notice of Possible Remedies.

Supplier	Tariff	Annual cost <sup>3</sup>	Delta
EON	SVT	£1,077	
EON	1 year Fixed v16	£1,045	<b>£32</b>
EON	Collective	£800	<b>£277</b>
First Utility	SVT	£1,140	
First Utility	1 year Fixed	£829	<b>£311</b>

- c) We see no reason to differentiate between residential and micro-business customers.
- d) We do not agree that the wording of the end of fixed-term notifications would be critical to the effective functioning of this remedy because we do not believe that the possible remedy will have any material effect (see (a) above).  
 However we would urge the CMA to review the amount of time and effort spent, and cost incurred by Ofgem during the RMR in designing prescriptive format CTM notices, and worrying about the specific wording used.  
 As an industry, ‘we have been down this road before’, and there is little evidence to suggest the efficacy of introducing yet another communication (either prescribed by Ofgem, or by the suppliers) to send to customers on SVTs in terms of engaging them with the market
- e) The default tariff should be variable in order to enable suppliers to at least continue to provide some form of consumer protection in times of extreme wholesale commodity price volatility, and in order to prevent the confusion incurred by mass tariff proliferation (for consumers, the regulator (in terms of monitoring tariffs), and the media), and to prevent the exploitation of ‘windows of opportunity’ by suppliers: for example if a supplier participated in a collective switching programme and ‘won’ a significant cohort of customers, then in a fixed price default tariff environment, at the point of their contract renewal the supplier could temporarily manipulate its default tariff in order to either retain or exploit those renewing customers.
- f) We do not believe that this remedy will be effective, and therefore do not have strong views on how it should be implemented.  
 We would, however, take the opportunity to highlight the additional cost that some of these proposals (e.g. an Ofgem consumer communications programme, or an Ofgem switching site) will incur, not to mention the material costs associated with switching (typically PCW brokerage fees and marketing campaigns – see (4) above) all of which will ultimately be borne by consumers.
- i. We view this remedy as little more than a single additional customer communication and therefore do not believe it would require a long phase-in
  - ii. We see no reason why our most loyal customers (all of whom have switched to us) would benefit from being subjected to yet more information from us before customers who joined us more recently. We would be deeply concerned by the additional costs incurred by suppliers in adopting ‘above the line’ marketing campaigns in distinct

<sup>3</sup> All figures are average across all regions, at the Ofgem standard user consumption profile.

geographic regions, which would then simply be passed onto consumers via the 'default' tariff

- iii. We would be deeply concerned by the additional costs incurred by Ofgem in undertaking a direct consumer communications programme, which would then be passed onto suppliers and in turn passed onto consumers via the 'default' tariff. The idea that it would be in the consumer's interest to receive cold calls, endless letter box drops and other direct marketing activity as a result of 'regulated' targeted marketing displays a material lack of understanding of UK consumer attitudes towards necessary household service providers, and should be strongly opposed.
  
- g) We believe that sensationalist nomenclature is not helpful. We strongly oppose the scaremongering approach of calling the SVT/ 'default' tariff an 'emergency' tariff as this will be misunderstood by most consumers, and will fundamentally undermine existing low levels of trust in suppliers: consumers will inevitably interpret this as suggestive of both threat and danger, as well as a risk of disconnection. We view this as an extremely dangerous and disproportionate proposal, and we would vehemently oppose any intervention along these lines: in the interests of clarity and transparency, would recommend sticking to 'what it says on the tin' in terms of a 'default' or 'standard' tariff.
  
- h) As the only supplier to compete with, and actively acquire customers on, a range of three variable/evergreen tariffs, we are understandably concerned by the proposal to prohibit evergreen tariffs. We seek urgent confirmation that the CMA would not actually propose to prohibit all evergreen tariffs through this possible remedy, but rather to solely address 'default' tariffs (which are currently synonymous with evergreen or SVTs for all suppliers other than ourselves). Our customers have virtually all (apart from new occupants of already supplied properties) made the active choice to be supplied by us on a variable tariff, and they value the peace of mind that this brings.  
  
We believe that it would indeed be appropriate for Ofgem to monitor and publish the numbers of customers on a genuine default tariff (i.e. consumers who have NOT made the active decision to be on that tariff, either by having never switched from their former monopolistic supplier, having moved into a property with whom they do not yet have a relationship/dialogue, or having 'rolled off' a fixed term contract). But we re-iterate that these populations are fundamentally different from customers who have engaged with the market and actively chosen an evergreen variable tariff, such as the range we make available to our customers.
  
- i) We see no reason why any energy supplier should be treated differently from other suppliers in this respect. Indeed we view the fundamental cost advantage that small suppliers benefit from as a result of the ECO/WHD exemptions as the partial root cause of many of the exploitative business practices that have emerged in the energy markets in recent years, as suppliers who face this full

cost are incentivised to inflate their SVTs in order to bridge the gap by offering deeply-discounted loss-leader tariffs.

- j) We do not know how suppliers would circumvent this particular remedy, but we are confident that some would seek to, for example by manipulating their default tariff if they were permitted to do so (see (e) above). Given Ofgem's recent highlighting of the use of Collective Switching campaigns by certain suppliers as a means of circumventing CTM obligations (see (b) above), we would urge the CMA to be acutely aware of this risk when determining their final remedies.
- k) The proposal to prohibit evergreen tariffs would result in an energy market that is characterised by fixed term contracts.

From our first-hand experience of the mobile phone marketplace, we see the emergence of an entirely contracted marketplace as detrimental to functional competition: from a supplier perspective, the objective becomes to tie consumers into contracts with Early Termination Fees (ETF) in order to ensure longevity. From a consumer perspective there is simply no appetite to look around for alternative suppliers during contract because they feel trapped by the fear of an onerous ETF. Meantime the mobile contracts include inflationary price rises and a lack of flexibility around altered circumstances that act to penalise consumers.

We would propose that rather than prohibiting evergreen tariffs, the CMA should consider **prohibiting ETFs associated with fixed term contracts**, thus ensuring that competition is not stifled by the proliferation of inflated ETFs being used by suppliers as churn-prevention mechanisms.

A further, related remedy that would categorically address the exploitation of un-engaged customers upon receipt of an end of fixed term contract renewal notice (who end up being auto-rolled onto an artificially inflated SVT as a default) could be to oblige suppliers to transfer all such un-engaged customers onto the cheapest (as opposed to most expensive) relevant tariff that they offer at the time (either fixed or variable) without any potential ETF payable.

- l) We believe that for the majority of the period over which the CMA has investigated the retail energy markets, customers electing to enter fixed-term contracts have been able to benefit from benign wholesale market conditions in terms of generally low volatility and, more recently, material price deflation.
  - i. Several of the submissions of longer-standing suppliers responding to the July 2015 notice of possible remedies, highlighted that supplying customers on evergreen tariffs that are under-pinned by a long term hedging strategy provides an element of protection from the risk of 'bill shock' resulting from wholesale commodity pricing volatility that is not provided by fixed term contracts upon renewal. This benefit has been largely ignored due to not being relevant during the past 5-7 years.
  - ii. Moving to a marketplace dominated by fixed-term contracts will result in a material transfer of wholesale commodity price risk from suppliers to consumers: in the following circumstances they could be fundamentally disadvantaged by being exposed to a considerably higher price rise upon renewal (bill shock) than would have been the case had they remained on an SVT, and are currently entirely unaware of this risk:

- i. When the wholesale energy markets inevitably return to an inflationary trend in due course
- ii. If pricing volatility increases: this could occur for any number of reasons such as geopolitics, weather (see Centrica's example of Pennsylvanian wholesale volatility during the Polar Vortex<sup>4</sup>), unintended consequences of regulatory change (for example the materially increased balancing cost volatility that is emerging from increasing renewable energy generation and industry balancing reform)

We therefore urge the CMA to reconsider their current perception that an energy market dominated by fixed term tariffs would represent a healthily functioning competitive market.

- m) The key point to note is that any incremental costs incurred by suppliers would ultimately be borne by consumers themselves. There are two clear financial costs that the proposed remedy would create:
- i. The additional piece of communication will have a small cost
  - ii. The process of switching supplier: as highlighted in (4), not only must the gaining supplier typically fund PCW brokerage fees and other marketing costs, there are material administrative costs borne by both supplier parties.

The most important cost may not be financial: in the fixed line communications marketplace, in which we have first-hand experience, we have witnessed a 'race to the bottom' on price, and concurrent cost-reduction programmes to fund this. The result has been a decline in customer service as support centres are outsourced and off-shored.

Further to our response to the July 2015 notification of possible remedies, we very strongly believe that the CMA must avoid any interventions that solely focus on price, which will inevitably lead to further deterioration in the already poor service levels offered by many energy suppliers to the detriment of consumers.

This is manifestly demonstrated by independent surveys where suppliers who are not solely focussed on being the cheapest are providing the best service to their customers – Ecotricity, Good Energy, Ovo, SSE and Utility Warehouse<sup>5</sup>.

- n) We propose an alternative remedy that we believe would be more effective in addressing the provisional AEC by ensuring that a competitive marketplace can operate, whilst simultaneously delivering lower prices for all consumers

**Introduce a maximum permitted 'delta' (£ or %) that a supplier is permitted to charge its SVT customers relative to the cheapest price that it charges its newly acquired customers on more competitive tariffs<sup>6</sup>.**

By preventing exploitative business practices, and obliging suppliers to offer fairly priced tariffs to all the customers they already have, this remedy would avoid the high costs of attempting to

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<sup>4</sup> Centrica Alternative Remedy 11 Proposal Para 42 within CMA Supplemental Notice of Possible Remedies.

<sup>5</sup> Which? Best Energy Suppliers Jan 2015, Energy Ombudsman Services complaints statistics Jun 2015.

<sup>6</sup> See Telecom Plus PLC's response to the CMA Notification of Possible Remedies Jul 2015 for details (Response to Remedy 11).

encourage all consumers to switch to another supplier (that they would ultimately pay for) and ensure that customers are protected from exploitative business models for the long term. We believe that either of these proposed alternatives to Remedy 11, in conjunction with a number of the other proposed remedies aimed at increasing consumer engagement, represents a much more effective intervention in the market than a blanket prohibition of evergreen tariffs.

- o) With the continued investigation and engagement with industry by Ofgem and DECC around Principle Based Regulation (PBR) and non-traditional business models it would seem foolhardy to rush into the implementation of material license modifications administered by the regulator. We regard our alternative proposed remedy relating to a maximum permitted delta between the SVT and cheapest tariff offered by a supplier as a much more proportionate and effective intervention to address the issue at hand, without de-railing the progress of innovative and non-traditional business models within the marketplace.

## **Conclusion**

5. We view the blanket prohibition of evergreen tariffs as being disproportionate and ineffective in addressing the AEC:

Disproportionate both in that variable tariffs are the foundation upon which we have successfully built the second largest independent supplier base in a sustainable and consumer-friendly fashion, but also because they provide consumer pricing protection in volatile and/or rising wholesale energy markets, that is at risk of being ignored.

Ineffective in addressing the AEC because in reality the proposed remedy amounts to little more than a single additional annual customer communication.

Furthermore, we do not see any rational reasoning behind preventing a healthily functioning, competitive market from emerging that could offer consumers the choice of both fixed and variable tariff options, as evidenced in the considerably more mature mortgage market.

6. We feel that the key point is being largely missed: many consumers simply have better things to do than spend time engaging with the energy markets. We need competition for those who choose to engage in the market yet protection from exploitation for those who choose not to. We do not believe that creating obscure means of seeking to engage them is the approach that should be adopted.

Rather we feel that the CMA should be focussing on protecting those consumers who are consistently being exploited via inflated SVT/'default' tariffs, and believe that Remedy 11 (or a version thereof) addresses this.

7. We very strongly disagree with both Centrica's and Scottish Power's implication that the insurance markets represent a potentially desirable 'end goal' for the energy markets<sup>7</sup>. We see very low levels of trust in, for example, the motor insurance markets, and even more extreme exploitation of customer inertia upon contract renewal than in the energy markets.

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<sup>7</sup> Centrica Alternative Remedy 11 Proposal Para 7 within CMA Supplemental Notice of Possible Remedies.  
Scottish Power Alternative Remedy 11 Proposal Para 3 within CMA Supplemental Notice of Possible Remedies.

This is not a direction of travel that the energy markets can afford to go in, and we therefore urge the CMA not to intervene with this objective in mind.

8. We view ourselves as a genuinely pro-competition supplier, as opposed to an established supplier with much to lose if the market becomes increasingly competitive. Accordingly we are disappointed that the CMA has chosen to seek broader views on an alternative remedy proposed by established suppliers, as opposed to those of the numerous challenger brands, with whom their pro-competition interests are more likely to be aligned.
9. We request that the CMA seriously consider the two alternative remedies that we have proposed. In conjunction with a number of the other proposed remedies aimed at increasing consumer engagement and potentially limiting the maximum price a supplier can charge, these could comprehensively address the AEC and be considerably more effective than the prohibition of evergreen tariffs