

Ofgem: 'Microbusiness Strategic Review: Policy Consultation'

Consultation response from the
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This consultation response has been drafted by the named academic members of the Centre, who retain responsibility for its content.

As an academic research centre, we welcome explicit citation and sharing of this consultation response and the research cited within it. If you would like to discuss the evidence in more detail, please feel free to contact the centre or the named academics.

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CCP Consultation Response: Ofgem 'Microbusiness Strategic Review: Policy Consultation'

Overall we welcome Ofgem's proposals to improve the conduct of brokers, increase the transparency of commissions and providing microbusinesses with increased protections around their decision to switch. The comments below should thus be placed in this overall context. The proposals are a step in the right direction, but we have some concerns about whether their structure may limit their effectiveness.

We make two main points:

1. Placing the emphasis on suppliers to monitor and police broker behaviour introduces complexities and uncertainties which would not be present with the direct regulation of brokers by Ofgem.
2. When increasing the transparency of commissions, the precise form in which the information is presented to consumers will be important.

The issue of broker behaviour

As discussed in Deller and Fletcher (2019)¹, Deller and Fletcher (2018)² present a range of evidence from Ofgem's 2014 micro and small business (MSB) survey indicating that these customers are unhappy with the conduct of brokers. This is concerning because Deller and Fletcher show that there is a strong association between MSBs using a broker as their main choice method for their current energy deal and switching energy supplier. If MSBs have a low opinion of brokers (the main way to search the market for better deals), it may reduce the likelihood of an MSB switching supplier to a potentially better energy deal.

Regarding brokers' sales approach, 48.8% of MSBs were quite or very dissatisfied compared to only 19.7% that were quite or very satisfied. Similarly, regarding MSBs' overall opinion of brokers, 45.3% of MSBs held a quite or very negative opinion compared to only 22.4% who held a quite or very positive opinion.

In terms of the factors driving MSBs' negative opinion of brokers, Deller and Fletcher (2018) find that excessive marketing contact is key. While 15.7% of MSBs recalling 1 to 5 broker approaches in the 12 months prior to the survey held a 'very negative' opinion of brokers, this rose to 52.7% for MSBs recalling over 50 approaches or too many approaches to specify. This relationship is confirmed in ordered logit regressions that control for a wide range of MSB characteristics.

This evidence is our basis for supporting Ofgem's moves to improve broker behaviour.

Supplier monitoring of broker behaviour

To improve broker behaviour Ofgem proposes:

1. A principles-based requirement for suppliers to ensure the brokers they work with conduct themselves appropriately;

¹ Deller, D. and A. Fletcher (2019), Consultation response to 'Ofgem: Opening Statement – Strategic Review of the microbusiness retail market call for evidence', Centre for Competition Policy, available at:

<http://competitionpolicy.ac.uk/documents/8158338/28916580/CCP+Response+Ofgem+Review+Microbusiness+Market.pdf/7700148b-faaa-ea13-5d7e-542e6214bc78>

² Deller, D. and A. Fletcher (2018), 'Micro and Small Businesses' Satisfaction with the UK Energy Market: Policy Implications', Centre for Competition Policy Working Paper 18-9, available at:

<http://competitionpolicy.ac.uk/documents/8158338/24898393/CCP+WP+18-9+complete.pdf/785c6290-7ebe-350a-0af2-6b97a1fb7a0d>

2. A requirement that suppliers only work with brokers signed up to an alternative dispute resolution scheme; and
3. Supply licence changes applying sales and marketing rules to suppliers and the brokers they work with.

Delegation of Monitoring to Suppliers

With these arrangements Ofgem is delegating responsibility for monitoring and policing broker behaviour to suppliers, which raises significant questions. First, there is the tension between supplier and consumer interests. A supplier will naturally want to 'win' the comparison performed by a broker, while a consumer wants a broker to perform an unbiased and comprehensive search across the market to identify the best deal for them. Hence, Ofgem is relying on suppliers to perform a monitoring activity which potentially goes against their profit-maximising self-interest. Furthermore, how is a supplier to assess whether a broker has performed an unbiased and comprehensive search without obtaining information about rivals' prices and commissions? One might be concerned that gathering this information could help facilitate collusion between suppliers.

The incentives to perform effective monitoring may also be affected by the fact that suppliers and brokers are in a bargaining relationship. The relative proportion of a supplier's (broker's) business that comes through a particular broker (supplier) is likely to affect the credibility and significance of threats to stop dealing with a broker due to poor behaviour. The larger the proportion of a supplier's business that comes through a particular broker, the weaker their position may be in trying to alter broker behaviour, even if they want to. Similarly, if a particular supplier's commissions form only a small element a broker's revenue, the supplier's threat to end a relationship with a broker may be of limited concern to the broker. This latter point is potentially more relevant under Ofgem's principles based approach where individual suppliers may make different interpretations as to what is acceptable behaviour by brokers. Indeed, does Ofgem expect suppliers to discuss and agree what constitutes appropriate broker behaviour? Or does it want them to battle it out in the hope that it leads to higher standards of broker behaviour being adopted?

It is also important to remember that suppliers' incentive to comply with the new licence conditions depends on the probability of being found to have breached the conditions and the penalty that results from being caught. This means that Ofgem will need to continue to monitor broker behaviour to identify cases of suppliers not enforcing the required standard on brokers. It also raises the question of how penalties for non-compliance should be set: do all suppliers using a poorly behaved broker receive the same penalty or are the penalties set proportionately according to the amount of business a supplier does with a broker? Similarly, to what extent are penalties reduced if a supplier made efforts to monitor broker behaviour, but these ultimately proved ineffective?

If the challenges for suppliers of monitoring broker behaviour, or the liability arising from poorly behaved brokers, becomes too great one risk is that some energy suppliers may stop using brokers and revert to just using their own sales agents to attract new business. Such a situation would seem undesirable from the consumer perspective as sales agents would not perform the comparison of offers from different suppliers which brokers provide.

Given these issues, we feel that direct regulation of third party intermediaries offers some advantages. Nevertheless, we recognise that direct regulation by Ofgem may require primary legislation and so may not be feasible in the short-term. However, we suggest Ofgem is clear when speaking to government about the potential benefits direct regulation may have over those proposed in the consultation document.

The Specific Licence Conditions

Regarding the specific broker conduct principle, we note that the bullet points on pg37 of the consultation mainly relate to contracting rather than the issue of excessive broker marketing contact which our research highlights.

Second, we suggest that the draft broker conduct licence condition on pg51 of the consultation document is relatively vague. In particular, we suggest that further elaboration is required concerning the meaning of “fair” and “transparent” in respect of the broker conduct. It seems reasonable that additional guidance be given to suppliers regarding examples of practices that meet or do not meet these conditions. Furthermore, we suggest that a key issue is the ‘quality’ of the comparison being performed by a broker, i.e. the number of suppliers/tariffs being compared. We suggest that Ofgem consider whether a specific requirement for brokers to be explicit to consumers about the number of suppliers they are comparing is warranted. Even if Ofgem does not publicly elaborate on the meaning of the broker conduct principle, it seems important that a clear internal view is formed regarding what practices represent good behaviour and which behaviours are unacceptable.

Poor Telesales Practices

Concerning the excessive cold calling of some brokers, Ofgem is again delegating responsibility for solving this issue to another organisation, this time the Information Commissioner’s Office (ICO). This means addressing the issue becomes reliant on the resources and capabilities of the ICO.

Ofgem views the primary way to resolve the excessive marketing contact issue is for individual businesses to sign up to the Corporate Telephone Preference Service (CTPS). This has two issues. First, this places the emphasis on resolving the issue on individual MSBs taking a positive action, given Ofgem’s/the CMA’s questions about whether some MSBs are sufficiently engaged with the energy market, one may wonder whether these MSBs are likely to sign up to this service. Related to this is extent to which MSBs know this service exists.

Second, rather than providing a targeted solution to energy broker behaviour, the CTPS is a catch all service stopping all unsolicited marketing calls reaching an MSB. Hence, when signing up to the CTPS an MSB is forced to weigh up the benefit of ending energy brokers’ nuisance calls against losing marketing calls for other services which might be useful.

The presentation of brokers’ commissions

While we support the broad thrust of making broker commissions more transparent to consumers, we note that a range of detailed issues could emerge. As a result, Ofgem will need to monitor how commissions are being displayed and how consumers are using this additional information.

The first point to note, is that in a simple model of a rational consumer performing a price comparison the consumer should really only care about the final total price they are charged for energy. The percentage of the price received by different parties along the supply chain does not directly affect the utility of the consumer.

However, in a world where consumers have partial information about the full set of prices available in the market, revealing the size of the broker’s commission may prompt additional search activities by the consumer. They may try to go to the supplier directly or they may be prompted to see if an alternative broker has a lower commission. However, in each of these scenarios there is the risk that MSBs will go through a process that leads to, or increases, dissatisfaction with the market. There is no guarantee that a supplier contacted directly will match the underlying energy price which they offer through a broker: the specific premise of brokers is that they have bargaining power to push down the underlying energy price. Similarly, if a consumer goes to a second broker there is no guarantee

that they will offer a contract from the supplier (or at the same underlying energy price) identified as the cheapest by the first broker.

Related to this point, the timing of receiving information about the size of broker commissions is important. To maximise the additional search activity described in the paragraph above it seems necessary for an MSB to receive the information prior to them entering into a contract with a broker/supplier. MSBs may be less inclined to respond if they only receive this information as part of the contract terms and conditions or less able to respond if it seen on a bill once they are already in contract.

For consumers to make an informed switching decision it seems important that before entering into a new contract a broker makes a consumer aware of up front: (a) the number of energy suppliers a broker is comparing, (b) whether any of the recommendations are based on factors others than price, and (c) the size of commission the broker is receiving. If Ofgem is only going to require commission rates to be included in the terms and conditions of a contract and rely on the cooling off period for customers to exit deals where the commission seems unreasonable, it is important for Ofgem to collect evidence to assess the effectiveness of this approach. This evidence should include: (i) consumers' awareness of commission rates, (ii) for those who are aware, whether the commission information meant they changed their switching decision, and (iii) for those who are not aware, would knowing the commission rate information have altered their switching decision.

Equally, that an MSB will shop around after seeing the commission paid to a broker depends on them fully understanding the information that they are receiving. This understanding is likely dependent on the precise form in which the commission charge is displayed. This may be a complex issue given that the structure of commission fees can vary between brokers. The structuring of the additional information is particularly important because there is the risk that more information could lead to consumer confusion and some consumers making 'worse' decisions than if the commission information was not displayed. We suggest that Ofgem consider whether a more prescriptive approach to the display of commission information is appropriate. In this process of evaluation it seems valuable that those devising the MSB take full account of the lessons around bill messaging that other parts of Ofgem have learned with relating to the domestic energy market. Indeed, there could be benefits from conducting randomised control trials to understand how MSBs are likely to respond to different forms of commission information.