Energy market investigation

Price comparison websites

Response by

TheEnergyShop.COM

March 2015

1. Executive Summary

That people respond to incentives is one of the fundamental principles of economics.

By forcing PCWs to default to whole of market comparisons Ofgem is offering a powerful incentive for energy suppliers to dis-intermediate PCWs form the fulfilment (application) part of the switch and apply process. The fulfilment part is where commissions are earned. This will have the inevitable consequence that PCWs will suffer financial harm from this policy which will damage investment in the provision of what is widely proven to be valuable services for consumers. Competition, and consumers, will suffer.

In respect of concerns that energy suppliers will 'free ride' by using the whole of market comparison as a platform to gain free advertising Ofgem states that...

"We will monitor developments in this area to see whether these new requirements are having unintended consequences. To inform this, we welcome engagement from sites where they consider there may be gaming of the new requirements."

The logic of creating an incentive, which Ofgem then expects firms NOT to respond to, is both perverse and intellectually challenged. It is also conflicts directly with the empirical evidence about how suppliers have behaved, and continue to behave, in this kind of environment.

In this report we show that...

Energy suppliers

Energy suppliers, large and small, respond positively to incentives to cut costs by taking advantage of the whole of market requirement uniquely applied to energy PCWs to gain free advertising at the financial expense of PCWs (a cross-subsidy is imposed on PCWs).

Empirical Evidence

The entry and exit of players in the energy PCW market suggests empirically that the all of market approach is not sustainable. The number of accredited sites has fallen from a peak of 13 to the current 11. More importantly large branded operators have been replaced only partially and by much smaller unbranded players. The level of competition has weakened materially leading to a 2 firm concentration ratio of 75% with the position of the 2 leading players entrenched through the excessive commission rates they command which in turn allows them to outbid competitors on Google keywords and / or consumer cashbacks.

Consumer Focus

Consumer Focus found conclusive evidence that;

- The Confidence Code is not voluntary where PCWs require switching agreements with energy suppliers.
- The Code imposes uniquely restrictive obligations on accredited PCWs.
- There is a significant imbalance in obligations between energy suppliers and PCWs.
- Energy suppliers have shown significant resistance to signing up to a set of even minor obligations that might work to address the imbalance.
- A default whole of market requirement is a unique and unduly onerous restriction on PCWs.

Consumer Detriment

- The level of consumer detriment created by the apparent "hiding" of non commission paying deals by PCWs behind a "switch today" button is very low and immaterial when compared to the consumer detriment caused by the collective switching operator that initially raised the issue.

- In contrast, the level of consumer detriment caused by The Big Deal in their first collective switch will likely exceed over £120,000 for what was a very small group of customers (around 1,000 switchers).

Ofgem

- Ofgem's actions in the non-domestic TPI market clearly prove that "whole of market" comparisons are not an essential requirement for good intermediation.

- Ofgem has unfairly and inconsistently discriminated against the domestic PCWs by applying wildly inconsistent policies across similar parts of the energy retail market.

We have serious concerns that..

- Ofgem's decisions are inconsistent with the evidence and have changed significantly in a short space of time. It suggests a lack of rigour and consistency in Ofgem's approach and their thinking.

- Ofgem's policy decisions are being too easily influenced by press commentary and are not supported by fundamental evidence and analysis.

- Ofgem gives unmerited weighting to the opinions of a group (energy suppliers) that has a massive incentive to influence a policy decision from which that group would benefit greatly.

- Ofgem maybe improperly ignoring and / or suppressing evidence that conflicts with its policy goals.

We ask the CMA to....

- **I**nvestigate whether the Code is voluntary for accredited PCWs and, if so, whether the obligations in the Code impose an unlawful cross-subsidy from PCWs to energy suppliers.

- Whether cross-subsidies between commercial organisations are permitted under UK and / or European Competition Law and whether Ofgem has any jurisdiction or role in imposing them on organisations.

- Audit Ofgem's consultation processes to see if they are fit for purpose and that they are being followed consistently and correctly.

- Review the evidence behind Ofgem's decision to impose "whole of market" obligations to ensure decisions can be justified by the evidence

- Investigate whether Ofgem's inconsistent policies with respect to TPIs in similar and related markets amounts to prejudicial and unfair discrimination against domestic PCWs.

- Investigate whether energy suppliers and non-domestic TPIs, whether individually, collectively or jointly, are restricting the development of transparent online price comparisons in order to earn excessive returns.

- Investigate whether a monopoly / oligopoly situation exists with respect to energy PCWs and whether this has adverse effects on competition and consumers.

- Investigate whether current commission arrangements between uSwitch / moneysupermarket / moneysavingexpert and energy suppliers lock out competition and create adverse long term effects for consumers.

- Investigate the role of cashbacks in the energy retail market and whether cashbacks distort the market, erect entry barriers, stifle competition, and drive up energy prices for consumers generally and for Inactive, dis-engaged and vulnerable customers particularly.

2. Introduction

On 18 February 2015 the Competition & Markets Authority published its Updated Issues Statement. On 26 February 2015 the CMA published its working paper on Price comparison websites.

In the working paper the CMA noted that....

"We recognise the need to strike a balance between fostering trust in the use of PCWs in the energy sector and allowing PCWs the commercial freedom to innovate and promote their services. We consider that the requirement to list the whole market is a particularly stringent condition, which does not apply in other markets, and that has the potential to undermine PCWs' bargaining position with suppliers."

In the issues statement the CMA noted that...

"We recognise the need to strike a balance between fostering confidence in the use of PCWs in retail energy markets and ensuring that PCWs have a commercial incentive to remain in the market and help improve customer engagement, and we would welcome views on whether Ofgem's recent decisions and proposed changes to the Code strike the right balance."

In this document we present our views on this matter and provide, as far as we can, evidence to support our views.

3. The Background

Consumer Focus Consultation

Prior to the November 2010, the default position was that Code Accredited PCWs were required to provide all of market comparisons and were unable, up until that point, to provide a filter on what the customer saw. From November 2010 Code accredited PCWs were allowed to default to results to show ‘tariffs you can switch to using this service’. The change was introduced by Consumer Focus following an extensive consultation process that ran for 20 months.

The consultation found conclusive evidence about what impact the whole of market default was having on price comparisons sites and about the future viability of the energy price comparison sector.

Acquiring customers through PCWs represents an extremely cost efficient channel for customer acquisition. In addition to the low direct cost of acquisition compared to other routes to market, suppliers receive significant indirect cost savings as there is material leakage of customers from PCWs to energy supplier websites and / or call centres where the “lead” is not tracked or compensated in any way.

Forcing PCWs to show all of market comparisons creates an extremely powerful incentive for energy suppliers to dis-intermediate PCWs from the fulfilment part of the comparison and switch process so that they can avoid paying commissions. Therefore, despite the significant benefits for energy suppliers of acquiring customers through PCWs, the free advertising incentive is so powerful that energy suppliers cannot resist the opportunity to take advantage. Any rational person would do the same. Prior to 2010 it was both the Big 6 and the smaller suppliers who launched direct to site tariffs cutting out commissions but forcing PCWs to advertise their products. At the current time it is mainly, but not exclusively, the smaller suppliers adopting a predatory / parasitic approach to accredited PCWs feeding off of the whole of market obligation. History shows, and basic economics implies, that once the partial view is banned under the new Code that the larger suppliers will also follow suit. It takes just one of the Big 6 suppliers to get the ball rolling before the others inevitably follow.

Evidence of historic supplier behaviour with respect to taking advantage of the Code to obtain free advertising and to cut out commissions is provided in Appendix A.

Evidence of current supplier behaviour with respect to taking advantage of the Code is provided in Appendix B.

Below we reproduce extracts from the 2009-2010 Consumer Focus consultation which clearly shows that:

- The Confidence Code is not voluntary where PCWs require switching agreements with energy suppliers.

- The Code imposes uniquely restrictive obligations on accredited PCWs.

- There is a significant imbalance in obligations between energy suppliers and PCWs.

- Energy suppliers have shown significant resistance to signing up to a set of even minor obligations that might work to address the imbalance.

- A default whole of market requirement is a unique and unduly onerous restriction on PCWs.

The Confidence Code proposals document

July 2010

"Under the current Code regime, service providers undergo comprehensive monitoring to ensure accuracy and consistency of results, with consumers able to obtain information not influenced by commercial considerations. Consumer Focus recognises that this degree of scrutiny, and the restrictions placed on service providers, is currently not faced by suppliers. For example, sites must base results on price and show all deals – even when they are not able to facilitate a switch or earn commission – while suppliers' doorstep sales agents are not even obligated to provide their own company's cheapest deal to a consumer, much less the cheapest deal on the market."

"Consumer Focus recognises that service providers have accepted, along with Code accreditation, some not insignificant restrictions on their business operations that internet price comparisons services in other markets do not face. We have seen clear evidence of a drive to improve the reputation of their industry, at the same time as providing a good and fair service to their users."

"The Code is unique in that it is the only accreditation scheme that requires service providers to show every offer available in the market. However, one of the findings from the consultation was that showing all tariffs is unsustainable for some service providers. As a result, Consumer Focus has concerns that energy price comparison websites may surrender their accreditation and that this will potentially have a detrimental effect on consumers"

The Confidence Code decision document

November 2010

"Consumer Focus recognises that since the Code was launched there has been a disproportionate balance in obligations between service providers and suppliers; suppliers are not signatories to the Code, therefore no obligations are placed on them. Consumer Focus's attempts to get suppliers to sign up to a set of principles in order to support the Code have been met with significant resistance. Therefore, in order to level the playing field, while ensuring that consumers' long-term

interests are not undermined, a compromise needs to be reached which helps redress the balance."

"Currently, suppliers are able to control what is shown on price comparison sites which results in consumers being unable to make a full comparison, while service providers have no such discretion. Consumer Focus has major concerns that the Code will not survive in the long term if suppliers continue to withhold tariffs and use the Code to obtain what has been described as 'free advertising' of their 'direct' tariffs. Suppliers argue that the exclusion of 'direct' tariffs would be an inappropriate extension of the Code into commercial relationships. However, Consumer Focus recognises that the Code is already 'involved' in commercial considerations as Code accreditation is a pre-condition for providers to secure a commercial arrangement with suppliers. This means that the Code is no longer truly voluntary and we therefore need to be mindful of any unduly onerous restrictions it places on the accredited sites."

"A balance needs to be struck between both parties while ensuring that consumers are provided with clear, easily accessible, accurate and impartial information. There is a real concern that continuing to make sites show all the tariffs suppliers permit them to will lead to a disintegration of the Code, as service providers report that the current model is unsustainable for the majority. This would not be in the long-term interests of consumers. We believe that there needs to be a degree of control over what is displayed across the energy price comparison sector to ensure consumers continue to be able to access robust independent price comparisons."

"Consumer Focus has taken into consideration the issues and concerns from all stakeholders regarding this matter. We have decided that in order to address the imbalance between the sites and suppliers, while continuing to fulfil the long-term interests of consumers, service providers can institute a default on the provision of results to show 'tariffs you can switch to using this service'."

A clarification should be made here. Clearly if the Code is not voluntary, as Consumer Focus acknowledges, then it follows that PCWs have not accepted "***some not insignificant restrictions on their business operations"*** but that these restrictions have been imposed upon them.

4. The Issues

That people respond to incentives is one of the fundamental principles of economics.

"There is one basic law of economics that is the foundation for all the others: People respond to incentives."

"People do more of something when the reward increases. When you subsidize something, you get more of it."

Glen Whitman

Associate Professor of Economics

California State University, Northridge

Incentives don't get much bigger than free. What Ofgem has done with the amended "whole of market" requirement is to further increase the incentive for energy suppliers to dis-intermediate PCWs from the "fulfilment" part of the compare and switch process on which commissions are earned.

However, issues with the Confidence Code relate not just to recent changes, but also other elements that have been in existence for some time. These are;

- The involuntary nature of the Code.
- Imbalanced obligations between PCWs and energy suppliers.
- The whole of market comparison obligation.
- Micro-management by Ofgem to support flawed concepts, such as the Personal Projection methodology, which are mis-leading and run the risk of causing considerable harm and damage to consumers.

These issues act to restrict innovation, distort competition, and mis-lead consumers and have adverse impacts for consumers both in the short-term and the long-term.

The issue and the implications of each are summarised in the Table below.

Issue	Implications / Incentives
Involuntary nature of the Code (PCWs must comply with stringent requirements in order to secure direct switching agreements with energy suppliers).	Taken together with the whole of market obligations this creates a situation where PCWs are forced to provide a cross-subsidy to energy suppliers. Energy suppliers have all the bargaining power in negotiation of commercial terms. Energy suppliers have no incentive to work efficiently with PCWs (they dictate terms and processes). Creates loss of efficiency and increases costs for consumers.
Imbalanced obligations (no obligations on suppliers)	A lack on obligations on energy suppliers breeds complacency, arrogance and inefficiency. PCWs are required to adapt to the working processes of the energy suppliers (irrespective of whether there is a commercial agreement in place or not). Suppliers have no incentive to invest in efficient mechanisms for transfer of product or customer data. Efficiency and innovation are significantly hindered and impaired. This results in inefficient and costly data transfer processes leading to higher costs for consumers and poor levels of customer service. This in turn discourages consumers from switching and stifles competition. **Examples include:** A grossly inefficient 5-7 week switching window which has prevailed in the industry for over 10 years. Batch processing of applications (rather than real-time data transfer). Poor quality of data records (for example meter numbers records). Monopoly provision of certain data records which drives up costs and stifles innovation (MPAN/MPRN numbers)

	The development of switching of prepay tariffs has been unbelievably slow. This has had a disproportionately adverse impact on vulnerable customers.
Whole of market comparisons	Creates a hugely powerful incentive for energy suppliers to act in a predatory and / or parasitic manner “freeloading” off of the requirements of the Code to obtain free advertising. Creates and implicit and unlawful cross-subsidy between PCWs and energy suppliers. Damages profitability and undermine the ability to earn a normal return from energy switching. Puts energy suppliers that pay commissions at a commercial disadvantage to those that don’t. Hinders development and innovation of services by PCWs. Undermines investment in advertising and promotion of services which in turn removes a powerful switching message from the market. Competition is stifled. Dis-engaged and vulnerable customers are disproportionately affected. Creates a barrier to effective switching. Non fulfillable tariffs on PCWs need to be be fulfilled at the supplier end. Certain suppliers don’t even offer online quotes let alone online fulfilment. Switching and competition are hindered.
Micro-management of the Code	Imposes a significant hurdle to product innovation. Forces Ofgem’s often flawed policy goals unnecessarily onto PCWs. Some, such as the Personal Projection methodology, are grossly mis-leading and run the risk of causing considerable harm and damage to consumers.

Each of the issues and the evidence supporting them is discussed in below.

5. The Issues in detail

5.1 The Code is not voluntary

5.1.1 Consumer Focus

The evidence from Consumer Focus is very clear in this regard. Consumer Focus gathered extensive evidence during its consultation process of 2009-2010 and some of its conclusions are summarised in Section 1 - Background.

A few relevant points are copied below.

"Currently, suppliers are able to control what is shown on price comparison sites which results in consumers being unable to make a full comparison, while service providers have no such discretion. Consumer Focus has major concerns that the Code will not survive in the long term if suppliers continue to withhold tariffs and use the Code to obtain what has been described as 'free advertising' of their 'direct' tariffs. Suppliers argue that the exclusion of 'direct' tariffs would be an inappropriate extension of the Code into commercial relationships. However, Consumer Focus recognises that the Code is already 'involved' in commercial considerations as Code accreditation is a pre-condition for providers to secure a commercial arrangement with suppliers. This means that the Code is no longer truly voluntary and we therefore need to be mindful of any unduly onerous restrictions it places on the accredited sites."

5.1.2 Ofgem

During the consultation process Ofgem chose to ignore this issue and the evidence from the Consumer Focus 2009-2010 consultation supporting it. This is despite representations from many PCWs, as well as Ofgem being in possession of the Consumer Focus 2009-2010 consultation documents.

During a workshop of accredited PCWs on 28 May 2015 there was an extensive debate of the issue, with the significant majority of PCWs present confirming that they could not get commercial agreements with energy suppliers unless they were accredited. It took 287 days to get the minutes of that meeting from Ofgem and only after repeatedly chasing. To our surprise, the discussion about the nature of the Code was omitted from the minutes in its entirety. It appears to us that Ofgem maybe improperly ignoring and / or suppressing evidence that conflicts with its policy goals.

5.1.3 CMA

In its working papers the CMA notes...

"10. Ofgem manages a voluntary Confidence Code the aim of which is to give domestic customers the confidence that accredited PCWs are independent and that the information provided will be accurate and reliable. It is a voluntary code although we note that the Six Large Energy Firms normally require PCWs with whom they have a commercial relationship to sign up to the terms of the Confidence Code."

We would ask the CMA to investigate whether the Code is voluntary for accredited PCWs and, if so, whether the obligations in the Code impose an unlawful cross-subsidy from PCWs to energy suppliers.

5.2 Imbalanced Obligations

5.2.1 Consumer Focus

Consumer Focus found a clear imbalance in obligations between PCWs and energy suppliers yet significant resistance from energy suppliers to signing up even some very minor obligations.

The Confidence Code decision document

November 2010

"Consumer Focus recognises that since the Code was launched there has been a disproportionate balance in obligations between service providers and suppliers; suppliers are not signatories to the Code, therefore no obligations are placed on them. <u>Consumer Focus's attempts to get suppliers to sign up to a set of principles in order to support the Code have been met with significant resistance.</u> Therefore, in order to level the playing field, while ensuring that consumers' long-term interests are not undermined, a compromise needs to be reached which helps redress the balance."

"2.2 Supplier conduct and the Code

Consumer Focus recommended that suppliers adhere to a set of guiding principles which incorporate 'best practice' when interacting with service providers. These include:

- ***ensuring that price comparison websites receive tariff information at the same time and in consistent format ie tariff guidance should include target price indicators and explanation of the discount structure***
- ***ensuring that Consumer Focus receives tariff changes or updates at the same time as service providers***
- ***ensuring that post implementation quality checks are carried out***
- ***adhering to the spirit of the Code, which is to ensure consumers have access to accurate and comprehensive information to give them the confidence to engage in the competitive market and obtain the best deal for them***

We acknowledge that service providers are disappointed <u>that suppliers did not show support for the Code by signing up to the proposed code of conduct."</u>

5.2.2 Ofgem

Ofgem does not appear to have any intention of addressing these imbalances. Ofgem's review of the Code specifically excluded energy suppliers.

5.3 Whole of market

5.3.1 Consumer Focus

Consumer Focus found Code provisions on PCWs to be uniquely and unduly restrictive and potentially unsustainable.

The Confidence Code proposals document

July 2010

"Consumer Focus recognises that service providers have accepted, along with Code accreditation, some not insignificant restrictions on their business operations that internet price comparisons services in other markets do not face."

"The Code is unique in that it is the only accreditation scheme that requires service providers to show every offer available in the market. However, one of the findings from the consultation was that showing all tariffs is unsustainable for some service providers. As a result, Consumer Focus has concerns that energy price comparison websites may surrender their accreditation and that this will potentially have a detrimental effect on consumers"

5.3.2.1 Ofgem Confidence Code

Ofgem's rationale is inconsistent with the evidence and changes significantly in a short space of time. It suggests a lack of rigour and consistency in their approach and their thinking.

Ofgem Consultation

Domestic third party intermediaries: Confidence Code and wider issues

7 August 2014

"4.10. We consider that sites should make consumers aware that a whole of market view is available to them. We propose to allow sites to continue to display only those tariffs to which a consumer can switch through their site as a default. However, we propose to strengthen existing requirements to ensure that this messaging is prominent and informative. The message should be clear and transparent, so that consumers understand the choice available to them."

Ofgem hearing in front of the CMA

10 November 2014

"57. <u>Ofgem believed that the level of confidence in accredited PCWs was very high</u>. The standards set by the confidence code were more exacting than comparable codes in industries such as housing and car insurance. Energy PCWs were required to be independent of the suppliers, ensuring that there was no cross-ownership. The prices that were offered to consumers could also not be influenced by any commission arrangements."

"58. Ofgem would like it made much clearer to consumers that the deals they saw under the option 'the deals you can switch to today' were effectively only those that the PCWs earned a commission from. It had consulted on proposals to make this clearer, but it was currently not minded to require a default where consumers would see a whole-market view of available deals. It also did not see a role for itself in creating and owning an industry-wide website."

Confidence Code Review – Decision

30 January 2015

"1.3. Consumers' interaction with comparison sites is generally positive, with 94% considering them to be 'reliable'."

"2.3. Survey evidence suggests consumers generally trust comparison sites across different sectors (94% feel they are reliable).[19] Nevertheless our research has shown some scepticism around sites' independence, particularly where sites receive commission from suppliers."

A 94% reliability rating is hardly just **"generally positive"** by any standards. Only the very top brands such as Apple will score a rating of this order of magnitude. Despite this Ofgem decided even more needed to be done because of "***some scepticism"***, although we don't see any supporting evidence for their decision.

Confidence Code Review – Decision

30 January 2015

Our decision

"3.14. We have decided to change the Code to require that consumers see a whole of market comparison unless they make an active and informed choice to see a smaller number of tariffs. Noting the importance of clarity in this area in maintaining confidence and trust in sites, our decision strengthens our August proposal to amend existing Code requirements."

An interesting comment but presented without any supporting evidence.

We know that The Gas and Electricity Markets Authority (GEMA) made its decision on the changes it wanted to see to the Code at its meeting on 11 December 2014. This means that there was a fundamental shift in Ofgem's thinking between 10 November 2014 and 11 December 2014.

The Ofgem consultation process ended on 1 October 2014 so it seems highly unlikely that this change of position would have arisen from evidence in the consultation itself. It seems unlikely that Ofgem would provide evidence to the CMA without itself first having considered the consultation responses, and its position on the evidence in those responses. [Nevertheless we look at some of the responses to the consultation below.] So if it wasn't the consultation responses, what made Ofgem change its position at the last minute?

We are aware that during this period, a switching outfit called The Big Deal (TBD) partnered with The Sun newspaper to run an orchestrated campaign against the energy PCWs. The campaign was used primarily to build a consumer group to take part in collective switching schemes. It was in effect a “dirty tricks” campaign designed for purely commercial purposes.

TBD published on its website details of research that it had undertaken on the larger price comparison websites between July and September 2014. The research can be found at the following link. https://thisisthebigdeal.com/blog/research-into-price-comparison-websites

We have reviewed in detail the screen shots and the result provided by TBD.

Our analysis of the TBD research shows the following;

- Number of use cases analysed - 296.
- Total aggregate "potential" consumer detriment identified (all cases) - £473.
- Average level of “potential" consumer detriment identified - £1.60 per use case.
- Average level of “potential" consumer detriment identified (excluding the consistently worst performer) - £1.06
- Use cases with no potential loss - 76%
- Use cases with potential loss of £1 or less - 81%

We have also analysed the performance of TDB’s first collective switch which ran in June-July 2014. It paints a very different and very worrying picture.

Our analysis shows that:

- The Big Deal didn’t tell consumers that there were at least 6 cheaper tariffs available to consumers at the time of the switch. These deals didn't pay The Big Deal a commission and were therefore "hidden" from consumers.
- The Big Deal didn’t tell consumers that there was even a cheaper tariff available from the same supplier that won their auction.
- The Big Deal used mis-leading comparisons and saving messages that were grossly exaggerated and unachievable for the average user. The Big Deal claimed the average user would save **more than twice** what was actually achievable.
- The level of consumer detriment from the The Big Deal’s lack of proper disclosure cost consumers £62 a year in lost savings (£124 per customer over the 2 year term of the deal they switched users to). Over the first year, hat is almost **40 times greater** than the average level of detriment that, according to The Big Deal’s own research, has arisen from comparison sites "hiding deals" behind a "switch today" button.

The Big Deal’s first auction has created a level of consumer detriment on an altogether different and much greater scale than anything they uncovered on PCWs. These are the comparable statistics.

- Number of use cases - 1,000+.
- Total maximum "potential" consumer detriment (all cases) = £60,000+ per year (£120,000 + over the 2 year term of the deal offered).
- Average level of potential" consumer detriment = £62 per year.
- Use cases with no potential loss - 0%
- Use cases with potential loss of £1 or less 0%

We have concerns that Ofgem's policy decisions are being too easily influenced by press commentary and are not supported by fundamental evidence and analysis. We would therefore ask the CMA to review the evidence behind Ofgem's decision to impose "whole of market" obligations. We would also ask the CMA to audit Ofgem's consultation processes to see if they are fit for purpose and that they are being followed consistently and correctly.

5.3.2.2 Ofgem – Non-domestic Energy

Ofgem's conditions for domestic price comparison websites is in sharp contrast to its lax and apparently indifferent approach to business energy consumers and in particular micro-business customers.

Third Party Intermediaries: exploration of market issues and options

28 June 2013

"3.2. A significant proportion of consumers interacting with TPIs are subject to instances of misselling, pressurised conversations to secure energy contracts, nuisance calls and a lack of transparency around energy offers and how TPI costs are recovered. This can lead to consumer harm and a lack of trust in TPIs and the energy industry among consumers. Further, this may negatively impact competition within the retail energy markets as such behaviour may discourage consumers from engaging with the market, or result in consumers making poor choices."

Ofgem does not mention which TPIs it is referring to in this passage but it can reasonably be inferred that it cannot possibly be accredited online domestic PCWs as domestic PCWs have, according to Ofgem, a 94% reliability rating with customers, they do not make nuisance calls* (they are by definition online services) and they clearly do not lack transparency around energy offers (real time offers are visible online 24/7). By implication it suggests that there are major issues with the non-domestic TPI market that Ofgem is aware of, and has been aware of for a long time.

* We note that some accredited PCWs operate both inbound and outbound telesales activities and might be captured within this statement. However as the Code only covers online PCWs, unregulated telesales activities are excluded from our report.

Ofgem goes onto say...

"5.5. We have been aware of increasing issues in the non domestic market over the last 5 years and in our RMR we considered a number of options including accrediting a TPI Code. Similarly we

had strong calls from stakeholders that we needed to progress work in this area as soon as possible."

CMA

In respect of SMEs the CMAs Updated Issues Statement found that....

"17. ....EBIT margins in the SME segment were on average 8.6% over the period – significantly higher than those on sales to domestic customers."

"18. We also have found considerable variation in the prices paid by microbusinesses. A comparison of the average annual electricity (gas) bill for a typical microbusiness on different contract types showed that as of 1 April 2013: a rollover contract was 33% (28%) higher than a retention contract; and a deemed contract was 75% (58%) higher than a retention contract."

The evidence for SMEs points to a TPI market that lacks transparency and is riddled with bad practises that create harm for consumers and allow energy suppliers to earn supernormal profits in what would normally be expected to be a fully contestable market. We also expect, but cannot show as we have not done the analysis, that the lack of transparency also allows certain TPIs to earn very high levels of return in what should also be a fully contestable market. We therefore ask that the CMA investigate whether energy suppliers and non-domestic TPIs, whether individually, collectively or jointly, are restricting the development of transparent online price comparisons in order to earn excessive returns.

Ofgem's very belated response to addressing issues in the non-domestic TPI market has been to develop a "TPI Code of Practice" (although this will not go fully live until end 2015). In the circumstances if Ofgem believes that the principals of good intermediation necessitated whole of market comparisons one might have reasonably expected that Ofgem would include mandatory whole of market comparisons within this non-domestic TPI Code. There is no mention whatsoever of whole of market comparisons in the non-domestic TPI Code of Practice. In fact there is no mention of what part of the market, if any, is to be compared the non-domestic TPIs. Ofgem actions clearly imply that whole of market comparisons are not an essential requirement of good quality intermediation.

Imposing whole of market comparisons just on domestic TPIs is therefore inconsistent and grossly unfair. It is also discriminatory and prejudicial against the interests of domestic energy PCWs.

We would ask that the CMA investigate whether Ofgem's inconsistent policies with respect to TPIs in similar and related markets amounts to prejudicial and unfair discrimination against domestic PCWs.

5.3.2.3 Ofgem's Consultation responses

In respect of responses to the question on **"consumer awareness of the availability of whole of market comparisons"** in the Ofgem August 2014 consultation document, we note that Ofgem writes...

"3.7. Those in favour varied in the extent to which they thought whole of market comparisons should be promoted. <u>Some stakeholders felt that our proposals did not go far enough</u> to ensure that a whole of market comparison is available, suggesting that sites should show whole of market comparisons as a default. This would require consumers to actively choose to see a partial market comparison."

We have reviewed all the published consultation responses to this question. It is crucial to note that while there are many opinions on the subject, none of the respondents provides any evidence in support of their opinions.

We also note that many energy suppliers were in the camp which "***<u>felt that our proposals did not go far enough"</u>***

Asking an energy supplier whether they would like to have their products advertised for free is like asking an alcoholic whether they want a free drink. Aside from those who would try to pretend that they don't have a drink problem, the answer is surely a given.

These are the same energy suppliers which do not have any obligations under the Code and, when requested to sign up to a set of relatively mild of obligations, showed ***<u>"significant resistance."</u>***

We have to question whether it is correct and appropriate that Ofgem should be swayed by the opinions of a group that has a massive incentive to influence a policy decision from which it would benefit greatly. Is it appropriate that these opinions are weighted, if at all? These are questions we believe the CMA should consider in its review of the consultation evidence.

We also note that one energy supplier writes;

"We do not believe that Ofgem's proposals on the availability of whole of market comparisons are adequate.... It would be more transparent for switching sites to provide a whole of market comparison as a default,... <u>It is unlikely that this change of default would significantly influence a supplier's decision to pay commission."</u>

This response comes from the exact same supplier that cut off commissions from PCWs at the height of the switching cycle in the second half of 2008, when this offered the cheapest tariff in the market for a period of over 6 months straight. The impact on PCWs was a dramatic loss of conversions and revenues as customers leaked direct to the supplier's website. Responses such as this should clearly be struck out on the evidence.

6. Cashback

In its 26 February 2015 working paper on Price comparison websites the CMA noted that...

"38 Of the ten major PCWs for which we received switching data, two PCWs – uSwitch and MoneySuperMarket – accounted for around 75% of energy supplier switches facilitated by a PCW in 2013."

and...

"19. The commission paid by energy suppliers to PCWs for each switch generated by a PCW varies but is most commonly between £15 and £35 per fuel. This may vary depending on a number of factors such as the volume of switches a PCW generates and whether the customer used the PCW's website or call centre."

In oral evidence given to the Energy and Climate Change Committee on 3 February 2015, both uSwitch and MoneySupermarket explained where they spend their marketing dollars.

Moneysupermarket
"Peter Plumb: I can only give you 2013, because our financial year closes now. Our revenue was £226 million. We spent roughly £100 million on marketing. That includes money spent with Google, which is by far the largest marketing tool for us to market on, which is a paperclip (should read pay per click) ***model"***

uSwitch
"Steve Weller: In the accounts that we have for 2013, because we have not finalised 2014, the revenue was £34 million and our marketing costs were £14 million. Again, this is across multiple products and not just related to energy. What we would typically spend on TV advertising, for instance, would only be a few hundred thousand, less than a million. A lot of the money that we spend is around digital marketing, whether it is Google or display advertising."

Moneysupermarket also owns the moneysavingexpert website which, in its own right, is now one of the largest energy switching sites in the UK. Moneysavingexpert operates a cashback model rebating a share of its commission to consumers. The cashback model only applies in respect of those tariffs that are fulfillable by Moneysupermarket / moneysavingexpert.

In its RMR proposals Ofgem decided to ban cashbacks and other incentives.

"Behavioural economics suggests that consumers make inconsistent decisions depending on when monetary rewards are received which has led us to limit the type of discounts allowed."

Ofgem
The Retail Market Review -Implementation of Simpler Tariff Choices and Clearer Information Decision - 27 August 2013

Then in a spectacular last minute u-turn, less than 2 weeks before implementation, Ofgem decided that it hadn't meant to ban cashbacks for TPIs after all. We believe that this arose due to pressure on Ofgem from Moneysavingexpert and we are aware that conversations took place between the parties.

It is clear from the CMA evidence that, with a 2 firm concentration ratio of 75% the energy PCW market exhibits oligolopolistic if not monopolistic characteristics. The buying power of uSwitch and Moneysupermarket / moneysavingexpert drives up commission rates for energy suppliers. The significantly higher commission rates paid to these firms create significant barriers to entry. New players (and even existing smaller players) are unable to compete for customers as they are always outbid either with higher cashback rates (in the case of moneysavingexpert) or are unable to bid on the high volume keywords on Google (pay per click advertising on Google Adwords). As such, the positions of uSwitch and Moneysupermarket / moneysavingexpert are now entrenched and their combined market shares are probably growing.

In our view cashbacks have an overall detrimental effect on consumers.

- They are largely rewarded to repeat switchers and churners who are already actively involved in the energy market in any case. In many cases they create excess churn purely for the purpose of obtaining the cashback. Excess churn increases energy supplier costs and increases average energy prices.

- They increase overall commission rates and drive up the overall cost of energy prices overall, the burden of which falls primarily on inactive and dis-engaged consumers including disproportionately vulnerable customers.

- They commoditise the market so that marketing dollars are spent on churning the already engaged market. In the process they create dis-incentives for investment in above the line advertising. The overall market is consequently starved of above the line marketing spend promoting switching leading to adverse effects on switching and competition. Inactive, dis-engaged and vulnerable customers are disproportionately affected.

- They erect significant barriers to competition for the larger established players (in this case Moneysupermarket / moneysavingexpert) and stifle market entry and innovation.

- Much the same can be said for non-financial inducements such as "meerkat" toys although these at least are promoted to a much broader audience through television advertising.

We would ask the CMA to:

Investigate whether a monopoly / oligopoly situation exists with respect to energy PCWs and whether this has adverse effects on competition and consumers.

Investigate whether current commissions arrangements for uswitch / moneysupermarket / moneysavingexpert lock out competition and create adverse long term effects for consumers.

Investigate whether cashbacks distort the market, erect entry barriers, stifle competition, and drive up energy prices for consumers generally and for Inactive, dis-engaged and vulnerable customers particularly.

7. Empirical questions

In their Submission on the Updated Issues Statement dated 24 February 2015, Professor Steven Littlechild and others note that...

"23. It is an empirical question whether PCWs are able to remain in the market and invest in ever-improving methods of making and presenting comparisons that customers find understandable, informative and attractive, while providing details of all tariffs in the market, including of those suppliers that do not pay commission for switching. <u>At present, it seems that many PCWs can do this, and have chosen to provide details of all tariffs."</u>

We would agree that it is indeed be an empirical question but Professor Littlechild provides no supporting evidence for his comment that *"**At present, it seems that many PCWs can do this, and have chosen to provide details of all tariffs."***

In assessing the extent to which PCWs and can and choose to do this the following needs to be taken into consideration.

The requirement to list all tariffs without the option of filtering out "fulfillable "deals that did not pay commission prevailed until November 2010. Over the 2009-2010 period the evidence pointed to the unsustainability of this "all of market" approach which is why PCWs were allowed to adopt filters.

Since November 2010 there is no empirical evidence that the default all of market approach is sustainable because it has been followed by nobody. There are those who have recently claimed to have followed an all of market approach but such claims that can never be proven (and indeed some evidence appears to show that has not been the case by those making such claims).

The entry and exit of players in the energy PCW market suggests empirically that the all of market approach is not sustainable. The number of accredited sites has fallen from a peak of 13 to the current 11. More importantly large branded operators have been replaced only partially and by much smaller unbranded players. The level of competition has weakened materially leading to a 2 firm concentration ratio of 75% with the position of the 2 leading players entrenched through the excessive commission rates they command which in turn allows them to outbid competitors on Google keywords and / or consumer cashbacks. It should be noted that even when accredited PCWs had the option to filter out deals that do not pay commission all the following pulled out of the market. This strongly points to the Code being unsustainable even before the latest particularly stringent were introduced.

- Confused.com, a previously accredited site withdrew from the Confidence Code in August 2012. At that time Confused.com had, and used, the option of filtering out deals that did not pay commission.

- Google acquired Beat that Quote.com in March 2011. Beat That Quote operated an accredited energy price comparison website which Google promptly shut down. At the time Beat That Quote had, and used, the option of filtering out deals that did not pay commission.

- Which?, the self proclaimed consumer champion, operated an accredited energy comparison and switching site. It withdrew from the Confidence Code in early 2014. At the time Which? had, and used, the option of filtering out deals that did not pay commission.

- GoCompare, one of the largest PCWs in the UK, has never been accredited opting instead to partner with accredited sites. This has always given it much greater flexibility in terms of the results it shows and the monetisation of those results.

- CompareTheMarket, one of the largest PCWs in the UK, has never been accredited opting instead to partner with accredited sites. This has always given it much greater flexibility in terms of the results it shows and the monetisation of those results.

- MoneySavingExpert now operates one of the largest energy comparison and switching sites in the UK. It has never been accredited opting instead to partner with its parent MoneySuperMarket.com

8. Personal Projections and other issues

8.1 Personal Projections

In our view Ofgem is inappropriately using the Confidence Code to push through poorly thought through market interventions which are having harmful effects on consumers.

We have published research on the implications of Ofgem's Personal Projection methodology. We consider it gives rise to mis-leading savings messages and is potentially mis-selling. Our research is published on our website starting at https://www.theenergyshop.com/HomeEnergy/advice-articles-inflated-savings-1 and will be updated as new evidence and developments arise. We note that a growing number of influential commentators now support our views on this important matter.

We note that the CMA writes...

"68. We note that the proposed changes to the Confidence Code outlined above (see paragraph 32) aim to address such concerns. In this context we consider that Ofgem's Confidence Code and some of the proposed changes to it strike a reasonable balance between fostering trust in the use of PCWs in the energy sector and allowing PCWs the commercial freedom to innovate and promote their services."

We would like to point out that the use of the Personal Projection methodology will make absolutely no difference whatsoever to the quotes for the customer's **new tariff** (nor will it make any difference to the results of Ofgem's audits of price comparison websites which are based on the total annualised cost of the new tariff). What the Personal Projection methodology does is this. Where a customer is currently on a tariff that has less than 12 months to expiry, it inflates the assumed cost that the customer actually pays and results in a directly proportional increase in the savings claimed. The savings figures quoted in this respect are pure fiction and never translate into hard cash savings for consumers. Consumers can be harmed by these exaggerated savings in many ways (switching too early, paying exit fees unnecessarily and so forth). In our research we found savings to be inflated by between £100 and £200. They are a source of potentially material consumer harm and should be stopped and banned. Consumers that have been duped by these savings messages should be compensated.

We would ask the CMA to suspend implementation of mis-leading, confusing and harmful approach to calculating savings.

Appendix B

To follow

Appendix B – Current Supplier Behaviour

Ofgem

Confidence Code – code of practice for online domestic price comparison services

25 March 2013

"Availability of whole of market comparisons

As with responses to the August 2014 consultation, stakeholders were varied in their response to the new requirements about the availability of whole of market comparisons and messaging. Some suggested our requirements could have gone further. Others expressed concerns that these requirements may lead to negative unintended consequences for accredited sites by limiting the incentives for suppliers to enter into commercial arrangements with accredited sites.

A number of stakeholders noted the potential for suppliers to 'free ride' by using the whole of market comparison as a platform to gain free advertising. One stakeholder suggested that Ofgem introduce a regulatory counterweight to prevent the 'gaming' of whole of market results tables from suppliers in this way.

We will monitor developments in this area to see whether these new requirements are having unintended consequences. To inform this, we welcome engagement from sites where they consider there may be gaming of the new requirements."

We are not sure what Ofgem means by unintended consequences.

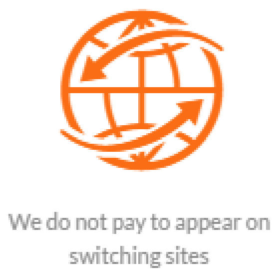
The logic of creating an incentive, which Ofgem then expects firms NOT to respond to, is both perverse and intellectually challenged. It is also conflicts directly with the empirical evidence about how suppliers have behaved, and continue to behave, in this kind of environment.

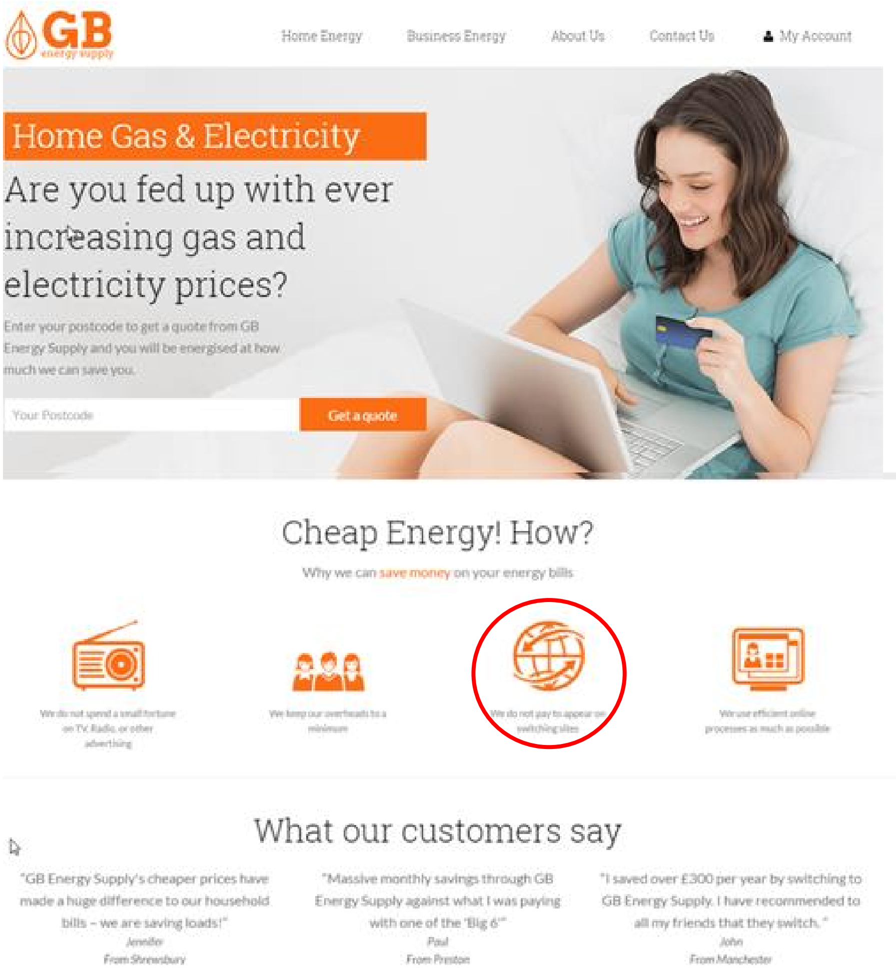
Nevertheless we present here evidence of the implications of this policy, whether an unintended consequence or not. All the examples are drawn or implied from the public domain.

It is a certainty that more will follow.

GB Energy

GB Energy, on its website, proudly boasts that “We do not pay to appear on price comparison websites”.





Zog Energy

MailOnline

February 3, 2015

Director at Zog Energy Tony Chester said The Big Deal's claims were not good news for them.

'Obviously we would like all customers to be given the best deal for them,' he said.

He added that around 20 customers a day are currently switching to Zog Energy every day - up from around five before sites began adopting new Ofgem's changes to price comparisons.

Not paying commission to switching websites helps Zog Energy to keep its costs down, which in turn allows it to offer very competitive deals to customers.

****

Flow energy

Various communications

“We will not be paying commissions to directly switch via your site for new acquisitions on this occasion.”

“Please note that Flow will not be paying commissions.”

****

iSupplyenergy

In addition to this Fixed tariff we have now launched our iFix 201605 Direct rates. **This is now available exclusively via isupply energy’s website.**