

Competition effects of saves and win-backs

Decisions and reasons

21 October 2014



Contents

1.	The Authority's decisions	1
1.1	Introduction	1
1.2	The Authority has decided to amend the Code to restrict saves, but not win-backs	1
	The Authority will monitor saves and win-backs	3
	The Authority will carry out a post-implementation review	4
	Implementation of the Code amendment	4
2.	Background	6
2.1	Switches, saves, and win-backs	6
2.2	Process followed by the Authority	7
3.	The Authority's reasons for its decisions	9
3.1	Submitters were divided on the merits of a restriction on saves	9
3.2	Primary benefits of the amendment	9
3.3	Other costs and benefits of the amendment	10
	Other effects on competition will be mixed, but are expected to be outweighed by the primary benefits	10
	Other effects on retailer behaviour can be mitigated	13
	Implementation costs are expected to be outweighed by the primary benefits	13
4.	Changes made to the proposal following consideration of submissions	14
4.1	Summary of changes	14
4.2	Win-backs are not restricted	14
4.3	There are specific purposes for which the losing retailer may communicate with the customer	16
4.4	The amendment does not apply to Type 2 retailers	17
4.5	There will be two new switch withdrawal advisory codes	19
5.	Other themes raised in submissions	21
5.1	Possible consequences of a restriction on saves on retailer behaviours	21
	'Slamming'	21

	Overly 'pushy' marketing	22
	Misinformation	23
	Fixed-term contracts with termination fees	25
	'Last look' clauses	27
	Conclusion on possible responses by retailers	28
5.2	The choice between an opt-in provision and a blanket ban on saves	29
5.3	Price discrimination	30
5.4	Consistency with the Low Fixed Charge regulations	33
5.5	Accuracy of Powerswitch and What's My Number	33
5.6	Involvement of third parties	34
5.7	Access to consumption data	34
	Glossary of abbreviations and terms	35
Appendix A	Code amendment – clean version	36
Appendix B	Summary of comments in submissions that were in support of the amendment	38
Appendix C	Responses to comments in submissions that opposed the amendment	39
Appendix D	Recorded save rates in 2013-14	49
Appendix E	Sensitivity analysis for worked example in the consultation paper	52
	Tables	
	Table 1 List of parties that provided submissions	8
	Figures	
	Figure 1 Timeframes in which saves and win-backs can occur	7
	Figure 2 The Authority's view of the direct effects and longer-term benefits of the amendment	12
	Figure 3 Save rates experienced by each gaining trader	50
	Figure 4 Effect of saves on the profitability of acquisition activity – sensitivity analysis of worked example	54

1. The Authority's decisions

1.1 Introduction

- 1.1.1 The Electricity Authority (Authority) is an independent Crown entity charged with promoting competition in, reliable supply by, and the efficient operation of the electricity industry for the long-term benefit of consumers.
- 1.1.2 In the retail electricity market, a save occurs when a losing retailer persuades a customer to cancel an incomplete switch to a gaining retailer. A win-back occurs when the customer completes the switch, but the losing retailer later persuades the customer to return.
- 1.1.3 Saves and win-backs have the potential to have a negative effect on retail competition. Therefore, the Authority has investigated whether there would be a net benefit from restricting saves and win-backs. In June 2014 the Authority consulted on a proposal to amend the Electricity Industry Participation Code 2010 (Code) to restrict saves and win-backs.
- 1.1.4 The consultation paper and further detail on the project is available on the Authority's website at <https://www.ea.govt.nz/development/work-programme/retail/winbacks-and-saves/>.
- 1.1.5 This paper sets out:
 - (a) the decisions reached by the Authority
 - (b) the Authority's reasons for its decisions
 - (c) the changes made to the version of the Code amendment that was originally consulted on
 - (d) the Authority's comments on key themes raised in submissions.
- 1.1.6 A summary of submissions is available on the Authority's website at <https://www.ea.govt.nz/development/work-programme/retail/winbacks-and-saves/>.

1.2 The Authority has decided to amend the Code to restrict saves, but not win-backs

- 1.2.1 The Authority has decided to amend Part 11 of the Code to allow a trader (retailer) to opt-in to be protected from saves initiated by the losing retailer.
- 1.2.2 The Code amendment will prohibit a losing retailer from initiating contact to offer inducements to any of its customers that are acquired by another retailer, if the gaining retailer has chosen save-protection. The prohibition

extends until the switch is complete. The losing retailer will still be able to save a customer by offering an inducement if the customer initiates contact with that retailer prior to the switch being complete.

- 1.2.3 In addition, if a retailer opts-in for save protection, it is prohibited from carrying out saves itself, unless the customer initiates the contact.
- 1.2.4 The Authority has decided not to prohibit the losing retailer from attempting to persuade a customer from returning after a switch is completed. That is, save-protection is not intended for win-backs. This is a key change from the initial proposal described in the June 2014 consultation paper.
- 1.2.5 The wording of the Code amendment is included as Appendix A and will have effect from 12 January 2015.
- 1.2.6 The Code amendment:
 - (a) allows a retailer to choose to be protected from retailer-initiated saves
 - (b) describes the circumstances in which a losing retailer may contact a customer that is switching to a save-protected retailer
 - (c) places limits on how often a retailer can change its choice
 - (d) requires the Authority to publish a list of all retailers that have chosen to be protected from saves.
- 1.2.7 The Code amendment applies when a customer switches to a gaining retailer that has chosen to be protected from saves, or from a losing retailer that has chosen to be protected from saves.
- 1.2.8 The amendment applies from the time when the losing retailer is notified of the switch until the switch is completed.¹ During this period, the amendment prohibits the losing retailer from initiating contact with the switching customer to attempt to persuade them to cancel the switch or to switch back after the switch is completed, including by making a counter-offer or offering an enticement. The amendment explicitly sets out that the losing retailer is permitted to contact the switching customer:
 - (a) in order to advise of any termination fees the customer may be required to pay
 - (b) to deal with administrative matters, such as a last meter reading or return of keys

¹ That is, until the 'event date' referred to in Schedule 11.3 of the Code

- (c) to respond to the customer's questions, including whether the losing retailer could offer a better deal
 - (d) as part of a general marketing campaign.
- 1.2.9 The amendment only applies to retailer initiated saves – the Authority has decided not to place a restriction on customer initiated saves or win-backs.

The Authority will monitor saves and win-backs

- 1.2.10 The Authority has also decided to continue, and improve, its monitoring of saves and win-backs. This decision does not require an amendment to the Code, but is described in this paper for the information of consumers and participants.
- 1.2.11 The registry uses withdrawal advisory codes to document the purpose of switch withdrawals. In order to support the monitoring of saves and win-backs, the withdrawal advisory code CR (customer requests cancellation) will be replaced with two new withdrawal advisory codes:
 - (a) CE, used when the customer requests that the switch be cancelled because the original switch request was an error
 - (b) CX, used when the customer requests that the switch be cancelled for some other reason.
- 1.2.12 The Authority will finalise the drafting of these advisory codes before they come into effect. At this stage the Authority envisages that retailers will be required to use the new codes (where applicable) from 31 July 2015.
- 1.2.13 In order to monitor compliance with the restriction on saves, the Authority will:
 - (a) make arrangements for retailers to submit reports of possible breaches of the new clauses
 - (b) liaise with the Electricity and Gas Complaints Commission (EGCC), which may be able to provide information on situations where the new clauses have been breached
 - (c) monitor switch withdrawals. If a switch is withdrawn under code CX before it is completed, then a save may have been carried out – which could potentially indicate a breach of the Code if either the losing retailer or the gaining retailer had chosen to be protected from saves.²

² It is possible that there might have been no breach of the Code even if these circumstances applied – if, for instance (a) the customer had decided to withdraw the switch without any persuasion from their retailer, or (b) the customer had been persuaded to withdraw the switch by a Type 2 retailer, or (c) the customer had been

- 1.2.14 If the Authority considers that a particular retailer may have breached the restriction on saves, then it will contact that retailer and ask it for an explanation.
- 1.2.15 The Authority may follow up in more detail with any retailer that is persistently unable to demonstrate compliance, including opening an investigation and/or seeking information relying on its powers in section 46 of the Electricity Industry Act 2010 (Act). For instance, it could require a retailer to provide materials, such as call centre phone records, that document its interactions with customers.
- 1.2.16 The Authority will also monitor withdrawals of completed switches (win-backs). It would be preferable for retailers not to withdraw a completed switch unless the original switch request was an error. If the Authority observes that switches are frequently withdrawn under code CX after they have been completed, then it may consider taking further action. This may include:
- (a) asking retailers to agree not to withdraw switches after they are completed, except where the original switch request was an error
 - (b) amending the Code to prohibit retailers from withdrawing switches after they are completed, except where the original switch request was an error.

The Authority will carry out a post-implementation review

- 1.2.17 The Authority has decided to carry out a post-implementation review of the Code amendment within two years of it coming into effect.

Implementation of the Code amendment

- 1.2.18 Implementation of the save-protection regime will occur in two stages.
- 1.2.19 The first stage of the Code amendment to enable retailers to opt-in for save-protection will be implemented by 12 January 2015. This aspect of implementation involves:
- (a) the Authority developing and publishing processes for retailers to advise of their choice for save-protection
 - (b) the Authority publishing a registry of retailers that have opted for save-protection

persuaded to withdraw the switch on the basis that if they did so then they would have to pay a termination fee to the losing retailer.

- (c) the Authority communicating with retailers the effect of the Code amendment.
- 1.2.20 The second stage will be to implement the changes to switch withdrawal codes. This is expected to take until 31 July 2015 and involves:
 - (a) changes to the registry to update registry fields to include new switch withdrawal advisory codes and a flag indicating whether a retailer is save-protected
 - (b) retailers changing their systems to accommodate the upgrade to the registry.
- 1.2.21 The Authority will provide further detail about implementation as soon as practicable.

2. Background

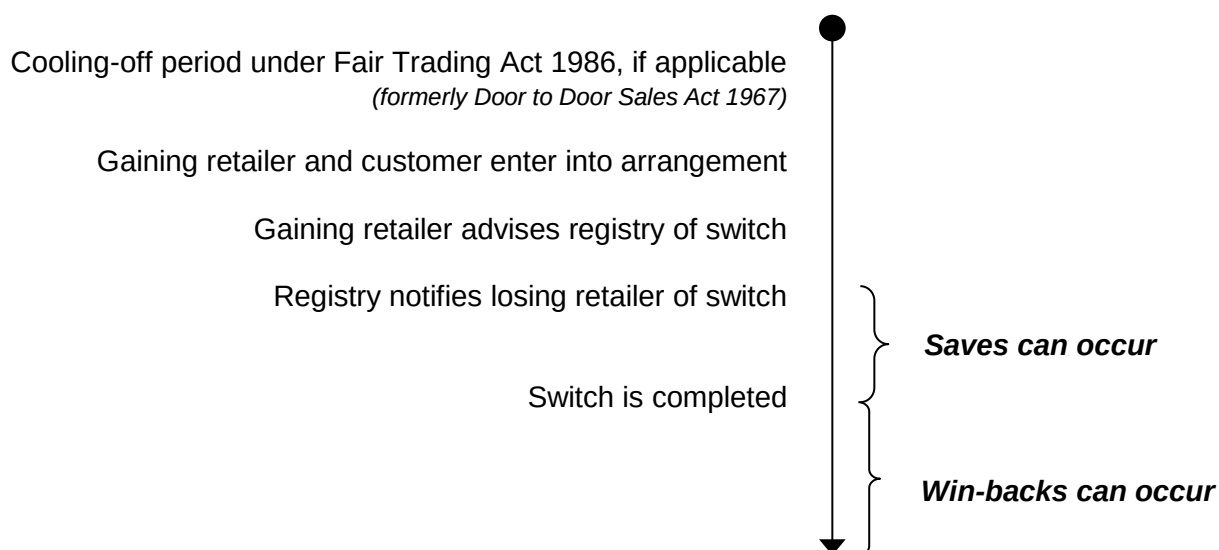
2.1 Switches, saves, and win-backs

- 2.1.1 A switch occurs when a customer ceases to purchase electricity from one retailer (the 'losing retailer') and begins to purchase electricity from another retailer (the 'gaining retailer').
- 2.1.2 For the switch to take effect, the customer must request a gaining retailer to become its supplier, and the gaining retailer notifies the registry, which in turn notifies the losing retailer.
- 2.1.3 All switches must be completed within ten business days of, and 50% of switches must be completed within five business days of, the gaining retailer notifying the registry of the switch.³ In practice, switches are usually completed within four business days.
- 2.1.4 A switch can be withdrawn, either before it is complete, or within two months of its completion. A request to withdraw a switch can be made by either the gaining retailer or the losing retailer. However the withdrawal only becomes effective if the gaining retailer and the losing retailer agree.
- 2.1.5 The switching process provides the losing retailer with information belonging to the customer and the new retailer – i.e. that the customer intends to switch. This information is provided to enable the losing trader to process the switch, but it also gives the losing retailer the ability to respond by attempting to save the customer. In most other markets this opportunity does not arise, because the losing retailer is not notified until the supply relationship with the gaining retailer is established.⁴
- 2.1.6 A save occurs when a losing retailer persuades a customer to cancel an incomplete switch to a gaining retailer. A win-back occurs when the customer completes the switch, but the losing retailer later persuades the customer to return. Retention of the customer may occur either by withdrawing the switch or by initiating a second switch.
- 2.1.7 The timeframes in which saves and win-backs can occur are shown in Figure 1.

³ Clause 4, Schedule 11.3 of the Code.

⁴ There are exceptions in sectors such as telecommunications and banking, in which switch processes sometimes make saves possible.

Figure 1 Timeframes in which saves and win-backs can occur



2.2 Process followed by the Authority

- 2.2.1 The Authority became concerned by the effects of saves and win-backs on competition, and in late 2013 added the issue to its work programme.
- 2.2.2 The Authority proceeded to investigate save and win-back practices, including through:
- (a) a series of interviews with retailers and selected past-employees of retailers, carried out by Sapere Research Group
 - (b) a survey of customers' switching experiences, carried out by UMR Research.
- 2.2.3 The Authority published a consultation paper "Proposed Code amendment – saves and early win-backs" in June 2014.⁵ The June 2014 consultation paper:
- (a) provided the findings of the interviews and survey
 - (b) explained why the Authority was concerned by the adverse effects of saves and early win-backs on retail competition
 - (c) explained that later win-backs were not a concern to the Authority
 - (d) proposed an amendment to the Code that would allow gaining retailers to choose to be protected from saves by losing retailers
 - (e) proposed to improve monitoring of the reasons for switch withdrawals, through changes to withdrawal advisory codes.

⁵ <http://www.ea.govt.nz/development/work-programme/retail/winbacks-and-saves/consultation/#c12826>

2.2.4 The Authority received 18 submissions on the June 2014 consultation paper. The list of submitters is provided in Table 1.

Table 1 List of parties that provided submissions

Generators and retailers	Consumers and their representatives	Network companies
Contact Energy (Contact)	Catherine Tudhope	Vector
Electric Kiwi	Consumer NZ	WEL Networks (WEL)
Flick Energy (Flick)	Grey Power	
Genesis Energy (Genesis)	Major Electricity Users' Group (MEUG)	
Meridian Energy (Meridian)	Molly Melhuish	
Mighty River Power (MRP)		
Nova Energy (Nova)		
Opunake Hydro		
Powershop		
Pulse Energy (Pulse)		
TrustPower		

2.2.5 The Authority has published the submissions on its website at <https://www.ea.govt.nz/development/work-programme/retail/winbacks-and-saves/consultation/#c12826>.

3. The Authority's reasons for its decisions

3.1 Submitters were divided on the merits of a restriction on saves

- 3.1.1 Submitters on the June 2014 consultation paper were divided on the merits of a restriction on saves, with:
- (a) some submitters supporting some form of restriction
 - (b) some submitters opposing a restriction
 - (c) the remaining submitter not expressing a view.
- 3.1.2 Submitters' comments in support of the restriction are summarised in Appendix B.
- 3.1.3 Submitters' comments in opposition to the restriction, and the Authority's responses, are listed in Appendix C. Some submitters expressed the view that the proposed amendment would not result in a net increase in competition, and therefore did not comply with section 32(1) of the Act and/or the Code amendment principles.
- 3.1.4 The Authority has considered each of the submissions received, and has concluded that the Code amendment:
- (a) will further the Authority's statutory objective by improving retail competition for the long-term benefit of consumers
 - (b) complies with section 32(1) of the Act
 - (c) complies with the Code amendment principles.
- 3.1.5 The remainder of this section sets out the Authority's reasons for believing that the amendment will improve retail competition, for the long-term benefit of consumers.

3.2 Primary benefits of the amendment

- 3.2.1 The Authority considers that the amendment will:
- (a) facilitate retail competition and innovation, by reducing undue barriers to the entry and expansion of independent retailers and the expansion of existing retailers
 - (b) support the durability of the competitive retail market.
- 3.2.2 The Authority considers that retailer initiated saves represent a barrier to the entry and expansion of retailers when they occur because the losing

retailer uses information provided to it in the switching process (for the purpose of processing the switch) to attempt to retain switching customers. The effects of retailer initiated saves include:

- (a) making acquisition activity less rewarding, because a proportion of customers cancel their switch before it is complete
- (b) disproportionately reducing the profitability of acquisition activity, because they can reduce benefits without a commensurate reduction in campaign costs
- (c) further reducing the profitability of acquisition activity because the losing retailer can 'cherry-pick' – that is, target save offers at the more profitable customers.

- 3.2.3 Allowing retailers to opt for protection from retailer initiated saves will reduce these barriers, and will remove the advantage conferred on the losing retailer by providing them with information in the switching process.
- 3.2.4 The Authority considers that retailer initiated saves detract from the durability of the competitive retail market in that they reduce competition and innovation, which are necessary for the sustainability of the market. Competition and innovation are driven in large part by acquisition activity and the threat of acquisition activity.

3.3 Other costs and benefits of the amendment

- 3.3.1 This section sets out the Authority's views on the other effects, and the implementation costs, of the amendment.
- 3.3.2 These views are summarised in Figure 2 , which shows how the other effects of the amendment are expected to be mixed (i.e. some increasing, and others reducing, competition) but that the overall net effect is expected to be positive.

Other effects on competition will be mixed, but are expected to be outweighed by the primary benefits

- 3.3.3 The Authority expects that the amendment will have several direct effects on retail competition – some positive and some negative.
- 3.3.4 Positive effects are likely to include:
 - (a) encouraging retailers to make win-back offers to consumers that have switched away
 - (b) increasing the incentive for retailers to pre-emptively offer their existing customers a better deal.

3.3.5 Negative effects are likely to include:

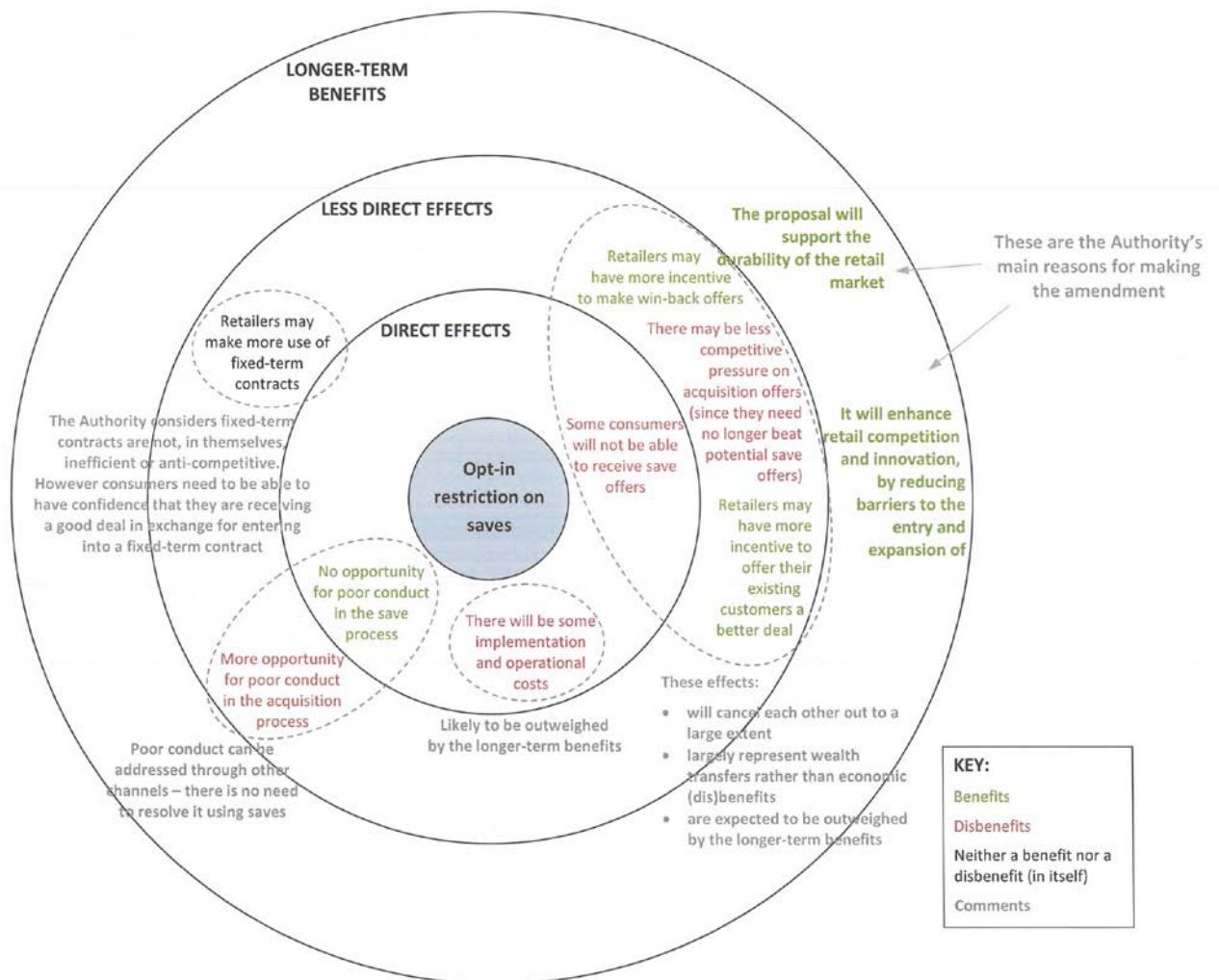
- (a) preventing some customers from receiving save offers⁶
- (b) reducing the competitive pressure on acquisition offers (i.e. because a save-protected gaining retailer will no longer need to pre-emptively beat the losing retailer's save offer).

3.3.6 The Authority expects that these direct effects on retail competition:

- (a) will cancel each other out to some extent
- (b) largely represent wealth transfers rather than economic (dis)benefits
- (c) will, in any case, be outweighed by the longer-term benefits of the amendment that are set out in Section 3.2.

⁶ The Authority notes that a save offer does not necessarily result in the consumer getting a substantially better deal. Pulse Energy commented that *"the benefits to the consumer of the save offer are often negligible relative to the acquiring retailer's offer... incumbents have learned that merely 'matching an offer' has a high success rate"*.

Figure 2 The Authority's view of the direct effects and longer-term benefits of the amendment



Other effects on retailer behaviour can be mitigated

- 3.3.7 Some submitters have commented that the amendment could also lead to a net increase in the use of some retailer behaviours that are not in the interest of consumers. One example is the (accidental or deliberate) provision of misinformation to customers.
- 3.3.8 However, as set out in Section 5.1, the Authority considers that there are effective ways of preventing or mitigating these behaviours. Any harm they may cause is likely to be outweighed by the primary benefits of the amendment that are set out in Section 3.2.

Implementation costs are expected to be outweighed by the primary benefits

- 3.3.9 The Code amendment may cause retailers to incur some implementation and operational costs. These might include the costs of policy and procedure changes, training, and computer system changes. Most submitters did not provide material or specific information about the costs that they may incur as a result of the restriction on saves. The cost of computer system changes should be modest, assuming well-designed systems.
- 3.3.10 The Registry provider will incur some implementation costs. The Authority expects that the implementation costs are likely to be outweighed by the primary benefits of the amendment that are set out in Section 3.2.
- 3.3.11 The Authority does not anticipate that any incremental costs will be incurred in the process of monitoring saves and win-backs, as it is already carrying out these activities.

4. Changes made to the proposal following consideration of submissions

4.1 Summary of changes

4.1.1 Following consideration of submissions, the Authority has made a number of changes to the proposal in the June 2014 consultation paper.

4.1.2 The main changes are that:

- (a) there is no restriction on win-backs (as opposed to the proposal, under which there would have been an opt-in restriction on 'early win-backs' occurring within 10 business days of the completion of the switch)
- (b) there is no restriction on customer initiated saves
- (c) the list of purposes for which the losing retailer is explicitly permitted to communicate with the customer has been extended
- (d) there is a clearer provision stating that Type 2 retailers cannot elect switch saving protection.

4.1.3 In addition, the Authority will introduce two new switch withdrawal codes rather than the seven that were proposed in the consultation paper.

4.2 Win-backs are not restricted

4.2.1 The consultation paper proposed that the opt-in restriction should cover both saves and early win-backs – where 'early' win-backs are those that occur in the ten business days following the completion of the switch.

4.2.2 Submitters were divided on this point, with:

- (a) some opposing a restriction on either saves or win-backs
- (b) some supporting a restriction on saves and early win-backs
- (c) some considering that not only saves and early win-backs, but also later win-backs, should be restricted.

4.2.3 The Authority has considered submissions and formed the view that a restriction on win-backs is not necessary at this point, because:

- (a) win-backs, unlike saves, do not rely on information provided to the losing retailer through the switch process
- (b) the Authority has not seen evidence to demonstrate that win-backs are having a material negative impact on retail competition

- (c) gaining retailers can mitigate the risk of win-backs through contractual means, for example by signing new customers up to fixed-term contracts.⁷
- 4.2.4 Therefore, the Authority has decided only to restrict retailer initiated saves at this point.
- 4.2.5 Save-protection is not required for the period following the switch completion (i.e. protection against early win-backs). Regulatory intervention is not required because the gaining retailer has several contractual options for protecting itself against retention activity by the losing retailer after the switch has completed. For example, the gaining retailer could enter a fixed term contract with the customer, requiring a termination fee if the customer leaves early, or could require the customer to give notice.
- 4.2.6 Although the Authority has decided not to restrict win-backs at this point, it has also decided to monitor the way in which win-backs are carried out.
- 4.2.7 At present, win-backs within two months of the switch completion date can potentially be carried out using the switch withdrawal process. The Authority considers that this is inconsistent with the original purpose of allowing switches to be withdrawn after they are complete (which was to correct switches that were carried out in error) and is undesirable.
- 4.2.8 The Authority takes the view that retailers should not withdraw a completed switch unless the original switch request was an error. If the customer wishes to switch back to the original losing retailer after a completed switch– either because the original losing retailer persuaded them to do so (a win-back) or for some other reason – then the original losing retailer should initiate a second switch.
- 4.2.9 The Authority will monitor withdrawals of completed switches and may consider taking further action if win-backs are frequently carried out using the switch withdrawal process. This may include:
 - (a) asking retailers to collectively agree not to withdraw switches after they are completed, except where the original switch request was an error; or
 - (b) amending the Code to prohibit retailers from withdrawing switches after they are completed, except where the original switch request was an error.

⁷ See Section 5.1 for the Authority's comments on fixed-term contracts.

4.3 There are specific purposes for which the losing retailer may communicate with the customer

- 4.3.1 Under both the version of the amendment that was consulted on in June 2014 and the final version, the losing retailer would still be allowed to communicate with the customer during the restricted period – so long as they did not by any means, attempt to persuade the customer to terminate the arrangement with the gaining retailer.
- 4.3.2 The draft amendment proposed in the June 2014 consultation paper specifically provided that the losing retailer could:
- (a) contact the customer to advise of any termination fees that they would be required to pay
 - (b) offer an enticement to the customer as part of a general marketing campaign.
- 4.3.3 Submitters suggested various other purposes for which the losing retailer should be able to communicate with the customer during the restricted period.
- 4.3.4 The Authority does not agree that some of the purposes suggested by submitters should be specifically permitted in the amendment. These include:
- (a) confirming that the customer has chosen to switch – rather than the switch being accidental or ‘slamming’
 - (b) determining whether the customer felt pressurised into switching by the gaining retailer
 - (c) correcting false information provided by the gaining retailer
 - (d) directing the customer to an independent source of information such as Powerswitch
 - (e) obtaining information on the customer’s reasons for switching
 - (f) dealing with an unresolved customer service issue
 - (g) providing information about the loyalty scheme offered by the losing retailer.
- 4.3.5 The Authority considers that explicitly permitting communications for the above purposes before the switch was complete:
- (a) would undermine the effectiveness of the amendment – because the losing retailer could use these types of communications to segue into a save attempt, and might be particularly inclined to do so for high-value customers

- (b) would make it difficult to enforce the amendment – because determining whether the retailer had breached the provision would be a subjective decision and would need to be informed by detailed analysis of recorded communications.
- 4.3.6 The Authority notes that the amendment still permits the losing retailer to communicate with the customer for any of the purposes above, after the switch is complete.
- 4.3.7 On the other hand, the Authority agrees that it is worth setting out explicitly that the losing retailer may communicate with the customer before the switch is complete for administrative reasons, including (but not limited to):
 - (a) obtaining a final meter reading
 - (b) transfer of keys
 - (c) dealing with outstanding debt
 - (d) advising the customer if the switch will affect other contracts between the customer and the losing retailer. For instance, if they were a dual fuel customer, ending their contract for electricity supply might also invalidate their contract for gas supply.
- 4.3.8 Although the issue was not raised by submitters, the Authority has also decided that it is worth setting out explicitly that the losing retailer may answer any factual questions asked by the customer.
- 4.3.9 The Authority has therefore revised the Code amendment to extend the list of purposes for which the losing retailer may contact the customer before the switch is complete.

4.4 The amendment does not apply to Type 2 retailers

- 4.4.1 As set out in the June 2014 consultation paper, the amendment only applies to 'Type 1 retailers' – i.e. those that buy electricity from the clearing manager and sell it to consumers and/or Type 2 retailers. It does not apply to 'Type 2 retailers' – i.e. those that buy electricity from Type 1 retailers and on-sell it to consumers. Type 2 retailers do not directly interface with the market systems.
- 4.4.2 However, while a Type 2 retailer cannot elect switch saving protection, a Type 2 retailer may receive the benefit of switch saving protection. This would arise if the Type 1 retailer from which the Type 2 retailer buys electricity elected switch saving protection. This is because:
 - (a) if a Type 2 retailer is not a "trader" under the definition in Part 1 of the Code, the Type 1 retailer (from which the Type 2 retailer bought

electricity) would notify the registry if the Type 2 retailer gained a customer

- (b) in this situation, the losing trader is likely to assume that the Type 1 retailer (that had elected switch saving protection), rather than the Type 2 retailer, had entered into the arrangement with the customer
- (c) the losing trader would therefore assume that it had to comply with the restriction on switch saving that the Type 1 retailer had elected, even though it was the Type 2 retailer that had entered into the arrangement with the customer.

4.4.3 This means that:

- (a) although a Type 2 retailer cannot elect switch saving protection, it may receive the benefit of switch saving protection if the Type 1 retailer from which it buys electricity elected switch saving protection
- (b) a Type 2 retailer is allowed to save a customer from a save-protected Type 1 retailer
- (c) a save-protected Type 1 retailer is allowed to save a customer from a Type 2 retailer.

4.4.4 Submitters did not comment on the exclusion of Type 2 retailers. However, the Authority has further considered the matter and has decided that the original wording of the amendment did not make it sufficiently clear that the amendment did not apply to Type 2 retailers. The Authority has changed the drafting of the amendment to clarify this point.

4.4.5 It is not practicable for Type 2 retailers to be able to elect switch saving protection because:

- (a) participants would not be able to determine whether Type 2 retailers were carrying out saves, since a switch withdrawal advisory code is always associated with a Type 1 retailer (which may or may not be acting as the 'parent' of a losing Type 2 retailer)
- (b) other retailers would be at risk of accidentally saving a customer from a save-protected Type 2 retailer, since a switch request is always associated with a Type 1 retailer (which may or may not be acting as the 'parent' of a gaining Type 2 retailer).

4.4.6 The Authority acknowledges that allowing Type 2 retailers to save customers from save-protected Type 1 retailers reduces the effectiveness of the amendment. However, the Authority believes that the reduction in effectiveness is small, because the great majority of customers currently purchase their electricity from a Type 1 retailer.

- 4.4.7 If the Authority becomes aware that the exclusion of Type 2 retailers is materially reducing the effectiveness of the amendment, either because Type 2 retailing is becoming substantially more common or for some other reason, it will consider taking further action.

4.5 There will be two new switch withdrawal advisory codes

- 4.5.1 When a gaining or losing retailer requests the withdrawal of a switch, it must provide the registry with a withdrawal advisory code. The Authority must determine and publish the list of valid withdrawal advisory codes.
- 4.5.2 The consultation paper proposed to improve transparency about switch withdrawals by removing the CR (customer requests cancellation) withdrawal advisory code and introducing seven new withdrawal advisory codes:
- (a) C0: Other reason / reason not known
 - (b) C1: Customer uses cooling off period under Fair Trading Act
 - (c) C2: Customer changed mind
 - (d) C3: Customer declines to agree gaining retailer terms and conditions
 - (e) C4: Customer cancels switch due to exit fee from fixed term contract
 - (f) C5: Customer accepts counter-offer from losing retailer
 - (g) C6: Customer alleges misleading sales information or inappropriate tactics.
- 4.5.3 Some submitters agreed that new withdrawal advisory codes should be introduced, in order to improve transparency about switch withdrawals. Powershop disagreed, and provided information to the effect that the new codes will be costly for participants to implement.
- 4.5.4 Some submitters commented on the drafting of the new codes. The Authority has considered these comments and agrees that:
- (a) C1 should never be used – a gaining trader should not begin a switch until the cooling-off period under the Fair Trading Act 1986 (FTA) is complete
 - (b) C3 should never be used – a switch should not begin until the customer has agreed to the gaining retailer's terms and conditions
 - (c) several of the codes are just special cases of C2 ("customer changed mind").

- 4.5.5 The Authority has therefore decided to introduce only two new withdrawal advisory codes –CE and CX.
- 4.5.6 In the context of withdrawal advisory codes, Powershop pointed out that “the Code references to the Door to Door Sales Act 1967 are out of date and need to change to reflect the cooling off period for uninvited direct sales in 36M of the Fair Trading Act 1986, as effected by the Fair Trading Amendment Act 2013”. The references to the Door to Door Sales Act 1967 have already been amended by the Electricity Industry Participation Code Amendment (ICP Switching) 2014, the relevant parts of which come into force on 6 November 2014.

5. Other themes raised in submissions

5.1 Possible consequences of a restriction on saves on retailer behaviours

- 5.1.1 Some submitters commented on potential responses from retailers to a restriction on saves – for instance, an increase in the use of fixed-term contracts with termination fees.
- 5.1.2 This subsection comments on potential retailer actions that may:
- (a) become more or less frequent as a result of the amendment; and/or
 - (b) become easier or harder to mitigate as a result of the Code amendment.
- 5.1.3 Each potential action identified by submitters or the Authority is listed under a separate subheading below.

‘Slamming’

- 5.1.4 In its submission, Consumer NZ referred to the potential consumer detriment caused by ‘slamming’ (where consumers are switched to another provider without their consent). There is anecdotal evidence slamming may already be happening in the electricity market. Consumer NZ expressed concern that the proposed amendment would increase the problem of slamming, by preventing the losing retailer from carrying out a save on a ‘slammed’ customer.
- 5.1.5 Some other submitters also seemed to allude to the practice of slamming.
- 5.1.6 The EGCC has advised the Authority that some customer complaints about marketing activities relate to customers being switched without consent. In some cases the incorrect switch appears to have been accidental; in other cases, apparently deliberate. The EGCC can and does investigate complaints of this nature, and encourages the customer and retailer to reach a settlement.
- 5.1.7 Slamming is prohibited under the FTA, which is administered and enforced by the Commerce Commission. Telecommunications companies (Slingshot and Power Marketing Ltd) have been prosecuted by the Commerce Commission for slamming customers, found guilty, and fined sums in the hundreds of thousands of dollars.⁸

⁸ <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2013/slingshot-fined-for-slamming-customers> , <http://www.comcom.govt.nz/the-commission/media-centre/media->

5.1.8 The Authority therefore considers that:

- (a) any customer that is switched without consent should ask the losing and/or gaining retailer to cancel the switch, and can also consider complaining to the EGCC
- (b) any party that has evidence that a retailer or their agent is deliberately slamming customers should provide that evidence to the Commerce Commission
- (c) there is no need to rely on saves as a means to deal with slamming, because the practice can be dealt with through a combination of win-backs, the EGCC, and the Commerce Commission's enforcement of the FTA.

Overly 'pushy' marketing

- 5.1.9 In its submission, Contact Energy pointed out that the save process "provides [the consumer] with an out if they felt pressured to switch". Contact's point was that the proposed amendment would reduce the opportunity to deal with overly pushy marketing through the save process – which, in turn, might encourage more widespread use of overly pushy sales tactics. Contact cited "very aggressive sales activities" used by some new entrant retailers in the UK, which might also occur in New Zealand.
- 5.1.10 Some other submitters also noted the role of saves in mitigating overly pushy marketing by the gaining retailer.
- 5.1.11 However, other submitters noted that the save process can be an opportunity for overly pushy marketing by the losing retailer. Pulse complained about "coercive" or "predatory" tactics; Grey Power about "misleading or fear tactics".
- 5.1.12 The EGCC has advised the Authority that some customer complaints about marketing activities relate to overly pushy marketing. These cover unpleasant door-to-door or telemarketing sales experiences (such as when a retailer or its agent calls the customer many times and presses them to switch). The EGCC can and does investigate complaints of this nature. The outcome may be (among other possibilities) that the customer receives a payment and/or that the retailer concerned becomes aware of the problem and takes steps to prevent it from happening again.
- 5.1.13 Overly pushy marketing is not, in itself, illegal. However, door-to-door and telemarketing sales are regulated under the uninvited direct sales

[releases/detail/2014/telemarketing-company-fined-almost-170k-for-misleading-claims-and-slamming-customers](#)

provisions of the FTA. Businesses who sell electricity in these ways must comply with rules around negotiating a sale, disclosure, cancellation, and enforcement of an agreement.⁹

5.1.14 The Authority therefore considers that:

- (a) any consumer that is troubled by overly pushy marketing should consider complaining to the retailer concerned and/or to the EGCC
- (b) any party that has evidence of possible breaches of the uninvited direct sales provisions of the FTA should provide that evidence to the Commerce Commission
- (c) there is no need to rely on saves as a means to deal with overly pushy marketing, because the practice can be dealt with through a combination of win-backs, retailer efforts to improve the conduct of their staff and agents, the EGCC, and the Commerce Commission's enforcement of the FTA
- (d) restricting saves may actually reduce the scope for overly pushy marketing by losing retailers.

Misinformation

5.1.15 In its submission, Trustpower complained that “we have found marketers from other retailers to be very creative when it comes to reasons why our customers should switch away from us. Many of the claims made, particularly around pricing, have not been correct.” Trustpower cited various misinformation provided by other retailers' sales staff – e.g.:

- (a) “other retailers claimed customers will still receive their TECT cheque even if they are not with Trustpower – this is not true”
- (b) “comparisons of competitors' GST-exclusive prices made with Trustpower's GST-inclusive prices”.

5.1.16 Trustpower's point was that the proposed amendment would reduce the opportunity to deal with misinformation through the save process – which, in turn, might encourage more widespread use of misinformation.

5.1.17 Some other submitters also noted the role of saves in mitigating the use of misinformation by the gaining retailer.

5.1.18 On the other hand, Flick's submission complained about the use of misinformation by the losing retailer – “a number of save calls... contain information that could be interpreted to misinform the customer and/or to discredit Flick”. Similarly, Pulse complained about “save calls that seek to

⁹ <http://www.comcom.govt.nz/fair-trading/fair-trading-act-fact-sheets/door-to-door-and-telemarketing-sales/>

cast [aspersions] on [Pulse's] reputation, financial stability and sustainability".

- 5.1.19 The EGCC has advised the Authority that some customer complaints about marketing activities relate to misinformation. Complaints can refer to both losing and gaining retailers. Often the problem relates to information about rates – e.g.:
- (a) the gaining retailer has not clearly indicated the rate it proposes to charge
 - (b) the losing or gaining retailer has provided a misleading comparison between rates (perhaps handling prompt payment discounts or GST on an inconsistent basis).
- 5.1.20 The EGCC can and does investigate complaints of this nature. The outcome may be (among other possibilities) that the customer receives a payment and/or that the retailer concerned becomes aware of the problem and takes steps to prevent it from happening again.
- 5.1.21 Using misinformation to sell a product is prohibited under the FTA as 'misleading or deceptive conduct'. Electricity companies have been investigated by the Commerce Commission for misleading or deceptive conduct, resulting in a prosecution and payment of fines and compensation in excess of \$1M,¹⁰ or a settlement for a lesser sum,¹¹ or a warning.
- 5.1.22 The Authority therefore considers that:
- (a) any consumer that is concerned about alleged misinformation should complain to the retailer concerned and/or to the EGCC
 - (b) any party that has evidence of possible breaches of the 'misleading or deceptive conduct' provisions of the FTA should provide that evidence to the Commerce Commission
 - (c) there is no need to rely on saves as a means to deal with misinformation, because the practice can be dealt with through a combination of win-backs, retailer efforts to improve the conduct of their staff and agents, the EGCC, and the Commerce Commission's enforcement of the FTA
 - (d) restricting saves may actually reduce the scope for losing retailers to provide misinformation.

¹⁰ <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/detail/2006/energyonlinepays1millionformislead>

¹¹ See e.g. <http://www.comcom.govt.nz/the-commission/media-centre/media-releases/2003/meridianenergytorei>, <http://www.comcom.govt.nz/fair-trading/fair-trading-media-releases/detail/2004/contactenergyadmits1>

- 5.1.23 Retailers that are affected by misinformation spread by their competitors via advertising may also be able to obtain redress through the Advertising Standards Authority.¹²

Fixed-term contracts with termination fees

- 5.1.24 Some submitters commented that the proposal was likely to result in an increase in the use of fixed-term contracts with termination fees – because retailers would no longer be able to rely on the save process as a means of retaining their customers.
- 5.1.25 Some of these submitters regarded fixed-term contracts with termination fees as harmful to competition. For instance, Consumer NZ commented that “fixed-term contracts with high termination fees have a ‘deadening’ effect on competition, limiting the ability of consumers to exercise choice and reducing the market pressures on suppliers to deliver quality goods and services. The complexity of some fixed-term offers also means that it can be difficult for consumers to assess whether accepting a fixed-term offer will be beneficial.”
- 5.1.26 Grey Power also strongly opposed termination fees, describing them as “outrageous” and “over the top”.
- 5.1.27 The EGCC has advised the Authority that some customer complaints about marketing activities relate to termination fees – often because:
- (a) the customer considered that they had not been properly informed about the contract
 - (b) the customer found the termination fee to be unreasonably large
 - (c) the termination fee was charged after the fixed term of a contract had ended (possibly because the fixed term had been rolled over without notification).
- 5.1.28 The Authority acknowledges that restricting saves means that it is likely that fixed-term contracts with termination fees will be used more frequently in future – both by incumbent and independent retailers.
- 5.1.29 The Authority has previously expressed, and continues to hold, the view that fixed-term retail electricity contracts are not in themselves detrimental to competition. The availability of fixed-term contracts can provide benefits for consumers, because it can allow them to choose an option that better suits their individual needs. For example, fixed term contracts can provide

¹² See e.g. <http://www.stuff.co.nz/the-press/business/9890570/ASA-rules-Powershop-ad-berating-Trustpower-misled>

a greater degree of insulation for the consumer against price rises during the contract term (at least for non-network components of the bill).

5.1.30 Consumers can therefore decide between:

- (a) entering into a fixed-term contract, if the retailer's offer is good enough to justify 'locking themselves into' an arrangement; or
- (b) choosing a contract without a fixed term, if they would prefer to maintain the flexibility to 'shop around', and accept the possibility of price increases.

5.1.31 Further, the Authority considers that termination fees are not undesirable per se. Termination fees may be required to make it viable for retailers to offer competitive fixed-term deals to customers. Without termination fees, fixed term contracts may be unattractive to retailers – because customers could cancel contracts when it was to their advantage to do so. There is support for this view in the economic literature.¹³

5.1.32 However, the Authority acknowledges that problems may arise if customers enter into a fixed-term contract without being clearly informed about what they are signing up to. The EGCC can assist in these cases. There are also potential remedies under the FTA.¹⁴

5.1.33 The Authority also acknowledges that problems may arise when termination fees are not communicated clearly, or are unreasonably high (i.e. do not reflect the true costs incurred by the retailer). The EGCC can assist in these cases.¹⁵ For domestic consumers, there are potential remedies under the 'unfair contract terms' provisions of the FTA that will be in force from 17 March 2015.¹⁶ Commercial consumers will not be covered by these provisions, but can pursue any grievances relating to termination under the common law.

5.1.34 Therefore:

- (a) retailers that use fixed-term contracts and/or termination fees should ensure that their customers understand what they are entering into – for instance, they should clearly explain the fees that may apply, and the rate that will apply to the customer at the end of any fixed term

¹³ See e.g. http://www.gcbpp.org/files/EPV/EPV_Mayo_RegEarlyTerm_012010.pdf, <http://eraa.com.au/wp-content/uploads/ERAA-submission-IPART-early-termination-fees-Issues-Paper.pdf>

¹⁴ <http://www.comcom.govt.nz/fair-trading/fair-trading-act-fact-sheets/fine-print/>

¹⁵ See e.g. p20 of http://www.egccomplaints.co.nz/media/68257/2014_EGCC_Annual_Report.pdf

¹⁶ <http://www.comcom.govt.nz/dmsdocument/12163>

- (b) retailers that use termination fees should ensure that these are reasonable, and should have regard to the 'unfair contract terms' provisions of the FTA.

'Last look' clauses

5.1.35 'Last look' clauses¹⁷ require a customer to advise their existing retailer of any competing offers they receive. If the existing retailer agrees to match the competing offer, then the customer must stay with the existing retailer.

5.1.36 An example from outside the electricity industry can be seen in Nova Energy's standard terms for commercial LPG supply, which include the following clause:¹⁸

24. Opportunity to match: The Customer will, by written notice, give Nova Energy an opportunity to match within ten working days of that written notice any bona fide improved price and/or terms offered in writing (a copy of which is to be supplied to Nova Energy) by another supplier (to apply following the termination of the Agreement) before agreeing to take any LPG supply services from that other supplier in relation to all Sites referred to on the Term Sheet and any other site of the Customer's. If Nova Energy is willing to match that price and those terms, then the Agreement, as amended by any variations necessary to reflect the price and terms matched by Nova Energy, shall continue in force. This clause shall survive the termination of this Agreement for a period of 2 years.

5.1.37 'Last look' clauses have been used in the NZ retail electricity market in the past,¹⁹ but, to the best of the Authority's knowledge, are not presently being used in new retail electricity contracts.

5.1.38 None of the submissions on the June 2014 paper mentioned 'last look' clauses. However, the Authority considers it is possible that some electricity retailers might consider employing 'last look' clauses to retain customers. The introduction of a restriction on saves might make this more likely.

5.1.39 'Last look' clauses are considered anticompetitive by some competition authorities. They are generally frowned on in European competition law.²⁰

¹⁷ Also known as 'right of refusal', 'meet or release', or 'English' clauses. Not to be confused with the price matching guarantees offered by some retailers such as Bunnings, which bind the retailer rather than the customer.

¹⁸ <http://www.novaenergy.co.nz/standard-terms-commercial-lpg-supply>

¹⁹ By Nova Energy – see <http://www.stuff.co.nz/business/money/8773399/How-to-avoid-power-switch-shock>

²⁰ Under the name 'English clause' – see e.g. <http://www.inhouselawyer.co.uk/index.php/eu-a-competition/10011-a-fresh-look-at-price-promises-the-impact-of-competition-law>, http://www.learlab.com/pdf/oft1438_1347291420.pdf

They make it harder for retailers to acquire customers, because any acquisition offer can be matched by a retention offer. In consequence, they can discourage new retailers from entering the market, and existing retailers from growing their customer base.

5.1.40 Retailers considering the use of 'last look' clauses in the retail electricity market should have regard to:

- (a) the 'misleading and deceptive conduct' terms of the FTA – in particular, they should ensure that they have clearly explained the 'last look' clause to their customers and have correctly represented the effective duration of the contract
- (b) the new 'unfair contract terms' provisions of the FTA²¹
- (c) section 27 of the Commerce Act 1986 which relates to restrictive trade practices.

Conclusion on possible responses by retailers

5.1.41 Some submitters have suggested that the opt-in restriction on saves could potentially lead to an increase in the use of some retailer behaviours that are not in the long-term interest of consumers.

5.1.42 The Authority is not persuaded that this concern will outweigh the expected benefits from the Code amendment, because:

- (a) some of the behaviours are not directly related to the saves issue
- (b) some of the behaviours are not undesirable per se – but rather depend on particular circumstances
- (c) there are effective ways of dealing with undesirable behaviours, if they arise, through:
 - (i) win-backs
 - (ii) retailers' efforts to improve the practices of their staff and agents
 - (iii) the EGCC
 - (iv) the Commerce Commission's enforcement of the FTA.

5.1.43 Contact Energy commented that if the Authority proceeds with its proposal, it would need to "ensure an active monitoring regime" to deal with "very aggressive sales activities". The Authority is certainly willing to hear any information that participants can provide about activities that may

²¹ See e.g. <http://www.comcom.govt.nz/dmsdocument/12163>

hinder competition, efficiency or reliability. However, the Authority recommends that in the first instance:

- (a) consumers should direct any complaints about their electricity retailer to the EGCC
- (b) participants should direct any information about possible breaches of the FTA to the Commerce Commission
- (c) participants should direct any information about breaches of the Code provisions to the Authority.

5.2 The choice between an opt-in provision and a blanket ban on saves

5.2.1 The consultation paper proposed an opt-in provision, on the basis that it would be preferable to allow each individual retailer to assess the impact of saves on its own business. It put forward several alternative options, including:

- (a) a one-way opt-in provision – i.e. allowing retailers to opt-in to save protection, while still being able to carry out saves themselves
- (b) an opt-out provision, under which retailers would be save protected by default, but could choose to forgo the protection if they wished
- (c) a blanket ban on saves.

5.2.2 Of these options, the only one that attracted any support from submitters was the blanket ban on saves.

5.2.3 Submitters were divided on the relative merits of the proposed opt-in provision and an alternative blanket ban on saves, with:

- (a) some recommending that an opt-in provision would be preferable to a blanket ban
- (b) some recommending that a blanket ban would be preferable to an opt-in provision
- (c) the remainder not expressing a view.

5.2.4 The reasons given for preferring an opt-in provision were that:

- (a) an opt-in provision would reduce the risk of unintended consequences
- (b) allowing for different approaches helps deliver choice to consumers
- (c) there is inadequate evidence to justify banning saves entirely.

- 5.2.5 The reasons given for preferring a blanket ban were that:
- (a) if save activity reduces retail competition then it should not be allowed under any circumstances
 - (b) an opt-in provision would create confusion and complexity
 - (c) an opt-in provision would result in additional administrative and system costs
 - (d) the Authority should not put retailers in the position of making a decision that will create costs for their customers
 - (e) if an opt-in provision is enacted, all retailers will eventually opt-in
 - (f) retailers might ‘flip-flop’ in and out of save protection
 - (g) retailers could circumvent the intention of the opt-in provision by opting for save protection but using a Type 2 retailer to carry out saves. (See Section 4.4 for an explanation of Type 2 retailers and how they are affected by the amendment.)
- 5.2.6 The Authority is not persuaded by the arguments in favour of a blanket ban over an opt-in provision. In particular, it considers that:
- (a) submitters have not provided evidence to demonstrate that an opt-in provision would cause ‘confusion and complexity’ or would materially increase transactional costs
 - (b) problematic consequences such as ‘flip-flopping’ in and out of save protection, or the use of Type 2 retailers to carry out saves, could be detected by market monitoring and, if they arose, could be addressed by further amendments to the Code.
- 5.2.7 The Authority considers that an opt-in provision is more consistent with the Code amendment tie-breaker principles, which set out a preference for non-prescriptive options.
- 5.2.8 Therefore, the Authority has decided to include an opt-in provision.

5.3 Price discrimination

- 5.3.1 The June 2014 consultation paper set out the Authority’s view that “saves are not primarily a problem of market segmentation”.
- 5.3.2 The Authority commented that “it might be thought that saves are a problem because they make it too easy to segment the market – a retailer could offer its customers an uncompetitive price, wait for price-sensitive customers to switch, and then save those customers by offering them a better deal... this would have an adverse effect on the level of competition

experienced by the 'rump' of non-price-sensitive customers". However, the Authority went on to explain "that is unlikely to be a viable strategy for a retailer, because the save rate is too low (at about 10%)... therefore the Authority is not concerned about saves from a price discrimination perspective per se."

- 5.3.3 Some submitters countered that retailers can and do use saves to segment the market. This practice is referred to as 'cherry-picking'. Powershop, for instance, commented that "contrary to the Authority's view... existing retailers can and do [have different tiers of pricing for sticky and price-sensitive customers], because a negative pricing movement among the whole of a relevant segment of its customer base is significantly more expensive than just making [save offers] available to a few hundred customers." Powershop concluded that "retailers should put their best offer in front of all their customers who fit the criteria for the offer, not just ones that threaten to leave".
- 5.3.4 To some extent this is a moot point. If the Authority was persuaded that saves were a problem of market segmentation, then this would only strengthen its view that it is important to enact a restriction on saves.
- 5.3.5 However, the Authority does want to take this opportunity to set out its views on the merits of price discrimination.
- 5.3.6 Price discrimination is defined as the situation where different customers, or different sets of customers, pay different prices for essentially the same goods or services. In this context, it refers to the situation where a 'switchy' customer is able to secure a better deal than an equivalent but more 'sticky' customer of the same retailer.²²
- 5.3.7 This situation can arise in various ways – for instance:
- (a) as a result of the 'switchy' customer informing their retailer that they are considering leaving, and receiving a better deal in exchange for staying
 - (b) as a result of the 'switchy' customer receiving a save or win-back offer
 - (c) as a result of a retailer pro-actively making retention offers to their existing customer base
 - (d) as a result of a retailer making acquisition offers to its new customers that are better than the terms it provides to some of its existing customers.

²² 'Switchy' and 'sticky' are colloquial terms indicating high and low propensity to switch, respectively. Generally a 'sticky' customer is one that is less price-sensitive.

- 5.3.8 It is straightforward for an electricity retailer to apply a simple form of price discrimination if it so wishes – such as by providing save offers to high-volume customers only.
- 5.3.9 Some submitters appeared to view price discrimination as generally undesirable. As well as Powershop’s comments above:
- (a) Grey Power complained about “offers that are of the under-the-table type, not generally available to that retailer’s customer base”
 - (b) Pulse commented that “allowing undocumented, customised offers is potentially discriminatory” and that it is better for retailers to use “transparent published offers” – that is, to make the same deals available to all their customers.
- 5.3.10 The Authority considers that price discrimination is not necessarily anti-competitive (though in some circumstances it can be a sign of other problems). The Authority observes that:
- (a) price discrimination is ubiquitous, occurring in many types of markets²³
 - (b) a substantial body of economic literature generally supports the view that price discrimination is not inherently anti-competitive – though it may have anti-competitive effects in particular instances²⁴
 - (c) in some circumstances, price discrimination can actively support efficiency – for instance, Ramsey pricing²⁵ is a form of price discrimination, and has good theoretical properties in terms of maximising allocative efficiency
 - (d) attempts to prevent price discrimination can arguably do more harm than good. A good case in point is the critique by Littlechild et al of the efforts of Ofgem²⁶ to “prevent unfair price differentials” in the UK retail electricity market.²⁷ Littlechild et al argue that Ofgem’s interventions have actually acted to reduce competition and innovation.

²³ A long list of examples is provided at http://en.wikipedia.org/wiki/Price_discrimination

²⁴ See e.g. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=470146, <http://else.econ.ucl.ac.uk/papers/uploaded/222.pdf>, https://www.coleurope.eu/system/files_force/research-paper/gclc_wp_07-05.pdf?download=1, <http://www.australiancompetitionlaw.org/law/pricediscrimination.html>, http://lawreview.law.ucdavis.edu/issues/43/4/articles/43-4_Gifford-Kudrle.pdf

²⁵ See e.g. http://en.wikipedia.org/wiki/Ramsey_problem

²⁶ Ofgem regulates the electricity and gas markets of Great Britain.

²⁷ <http://www.eprg.group.cam.ac.uk/wp-content/uploads/2014/08/Submission-to-CMA-7-Aug-2014.pdf>

- 5.3.11 The Code amendment described in this paper will reduce the scope for price discrimination in the save process. However, the Authority does not intend to place a more general restriction on price discrimination – e.g. by requiring retailers to offer the same tariffs to all their customers. The Authority considers that doing so would stifle innovation. Rather, the Authority prefers to:
- (a) allow consumers and retailers to negotiate whatever tariffs they wish – subject to the restrictions set out in the Code and in other instruments such as the FTA
 - (b) support consumers to enter the negotiation in a well-informed manner, through the retail data project and other initiatives such as Powerswitch, What’s My Number and the publication of fact sheets.

5.4 Consistency with the Low Fixed Charge regulations

- 5.4.1 Pulse Energy questioned whether the practice of ‘cherry-picking’ customers is consistent with the spirit of the Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004 (LFC Regulations).
- 5.4.2 The Authority responds that:
- (a) ‘cherry-picking’ customers is not inconsistent with the letter of the LFC Regulations
 - (b) ‘cherry-picking’ customers is not inconsistent with the spirit of the LFC Regulations, as expressed in their objective, which is “to ensure that electricity retailers offer a low fixed charge tariff option or options for delivered electricity to domestic consumers at their principal place of residence that will assist low-use consumers and encourage energy conservation”²⁸
 - (c) in any case, the Authority is guided by its statutory objective and Code amendment principles, rather than by ‘the spirit of the LFC Regulations’.

5.5 Accuracy of Powerswitch and What’s My Number

- 5.5.1 Some submitters commented that the existence of special offers, which are available to some customers but not others, may cast doubt on the accuracy of the information shown by the Powerswitch and/or What’s My Number services. These services may be perceived as showing

²⁸ Regulation 3 of the LFC Regulations.

consumers the best deal they can get, but in fact may only show the best advertised deal.

- 5.5.2 The purpose of the What's My Number campaign and website is to encourage consumers to check they are on the best deal. Powerswitch, which is administered by Consumer NZ, provides tariff information supplied by retailers. Therefore, the accuracy of the data used by Powerswitch, including about special offers, reflects the price information provided to it by retailers.
- 5.5.3 The Authority agrees that it is important for these services to accurately reflect the deals that are available to consumers. The Authority is considering options for access to retail data.²⁹

5.6 Involvement of third parties

- 5.6.1 Nova Energy recommended that the Code amendment should be drafted in a way that prevents a save-protected losing retailer ("retailer A") from notifying its non-save-protected ally or subsidiary ("retailer B") that one of retailer A's customers is switching to another retailer ("retailer C"), in order to encourage retailer B to attempt to save the customer from retailer C.
- 5.6.2 The Authority acknowledges there is a potential issue here, and notes that it relates to the issues around Type 2 retailers that are discussed in Section 4.4 of this paper. At this stage the Authority will not extend the amendment as suggested, but may consider taking further action if the behaviour described above becomes an issue.

5.7 Access to consumption data

- 5.7.1 Opunake Hydro recommended that the scope of the Code amendment should be extended to cover the situation where a retailer "obtains approval from [another retailer's] customer to obtain its consumption information for the purpose of building an optimal tariff for [that] customer", and proceeds to contact the customer's current retailer to ask for that consumption information.
- 5.7.2 The Authority plans to address this issue through the retail data project,³⁰ rather than by extending the restriction on saves.

²⁹ See e.g. <http://www.ea.govt.nz/development/work-programme/retail/retail-data/consultations/#c8203>

³⁰ See e.g. <http://www.ea.govt.nz/development/work-programme/retail/retail-data/consultations/#c12844>

Glossary of abbreviations and terms

Act	Electricity Industry Act 2010 (as opposed to the Fair Trading Act 1986, which is referred to as the FTA)
Authority	Electricity Authority
Code	Electricity Industry Participation Code 2010
EGCC	Electricity and Gas Complaints Commission
FTA	Fair Trading Act 1986
gaining retailer	The retailer that a customer is switching to
LFC Regulations	Electricity (Low Fixed Charge Tariff Option for Domestic Consumers) Regulations 2004
losing retailer	The retailer that a customer is switching from
save	A save occurs when a losing retailer persuades a customer to cancel an incomplete switch
save protection	Under the Code amendment described in this paper, a Type 1 retailer may opt for save protection – in which case other Type 1 retailers are prohibited from saving customers that it acquired
save rate	The proportion of a gaining retailer's acquisitions that are saved by the losing retailer
switch	A switch occurs when a customer ceases to purchase electricity from one retailer (the 'losing retailer') and begins to purchase electricity from another retailer (the 'gaining retailer')
Type 1 retailer	Retailer that buys electricity from the clearing manager and sells it to consumers and/or Type 2 retailers
Type 2 retailer	Retailer that buys electricity from a Type 1 retailer and on-sells it to consumers
win-back	A win-back occurs when the customer completes a switch, but the losing retailer later persuades the customer to return. Retention of the customer may be implemented either by withdrawing the switch or by initiating a second switch
withdrawal advisory code	A withdrawal advisory code records the reason for the cancellation of a switch

Appendix A Code amendment – clean version

11.15AA Trader may elect to have switch saving protection

- (1) A **trader** that buys **electricity** from the **clearing manager** may elect to have switch saving protection by giving written notice to the **Authority**.
- (2) The **Authority** must **publicise** the name of each **trader** that has elected to have switch saving protection as soon as practicable after receiving the written notice from the **trader**.
- (3) A **trader's** switch saving protection comes into effect on the day after the day on which the **Authority** **publicises** the **trader's** election.

11.15AB Switch saving protection

- (1) This clause applies if a **trader** (the "protected **trader**") has switch saving protection.
- (2) If the protected **trader** enters into an arrangement with a **customer** of another **trader** (the "losing **trader**") to commence trading **electricity** with the **customer**, the losing **trader** must comply with subclause (4).
- (3) If a **trader** enters into an arrangement with a **customer** of a protected **trader** to commence trading **electricity** with the **customer**, the protected **trader** must comply with subclause (4).
- (4) A losing **trader** referred to in subclause (2) or a protected **trader** referred to in subclause (3) must not, by any means, initiate contact with the **customer** to attempt to persuade the **customer** to terminate the arrangement referred to in subclause (2) or subclause (3) (as the case may be) during the period specified in subclause (5), including by—
 - (a) making a counter-offer to the **customer**; or
 - (b) offering an enticement to the **customer**.
- (5) The period starts on the day on which the **trader** receives notice of the switch request under clause 22(a) of Schedule 11.3, and ends on the **event date** for the switch.

11.15AC Trader may communicate with customers for certain purposes

Clause 11.15AB(4) does not prohibit a **trader** from—

- (a) contacting a **customer** to advise the **customer** of any termination fees that the **customer** is required to pay as a result of the **customer** ceasing to trade with the **trader**; or
- (b) contacting a **customer** regarding administrative matters, including—
 - (i) any fees the **customer** owes the **trader**;
 - (ii) the **customer's** final meter reading;
 - (iii) how the **trader** will return any keys it holds on the **customer's** behalf;
 - (iv) the effect of the **customer** ceasing to buy **electricity** from the **trader** on other contracts between the **customer** and the **trader**, for example, for the supply of gas; or
- (c) providing a factual response to a question asked by a **customer**; or

- (d) making a counter-offer or offering an enticement to a **customer** who has invited the **trader** to attempt to persuade the **customer** to terminate the arrangement referred to in clause 11.15AB(2) or (3); or
- (e) offering an enticement to a **customer** as part of a general marketing campaign.

11.15AD Cancellation of switch saving protection

- (1) A **trader** that has elected to have switch saving protection may cancel its switch saving protection by giving written notice to the **Authority**.
- (2) However,—
 - (a) a **trader** may not cancel its switch saving protection earlier than 12 months after the date on which the switch saving protection came into effect; and
 - (b) a **trader** that has cancelled its switch saving protection may not elect to have switch saving protection earlier than 12 months after the date on which the **trader** cancelled its switch saving protection.

Appendix B Summary of comments in submissions that were in support of the amendment

- B.1.1 Some submitters agreed that saves are a significant problem. Specific comments included that:
- (a) “any positive effects of the save process on retail competition are significantly outweighed by its broader negative effects”
 - (b) “it is imperative that saves and win-backs are contained to allow new entrants to recoup acquisition costs and stay in business”
 - (c) “in the extreme, [saves] could lead to retailers dropping out of the market as the disadvantage becomes the difference between financial success and failure”.
- B.1.2 Some submitters commented that small and new entrant retailers are disadvantaged by the save process. For instance:
- (a) one independent retailer commented that it has been “subjected to a disproportionate share of save and win-back activity”, and that large retailers disproportionately direct their save efforts against ‘disruptive’ smaller retailers
 - (b) another retailer commented that “saves impact disproportionately on new retailers, who will be in acquisition mode. New retailers who are seeking to grow are likely to be expending considerably more effort and proportionately more spend in marketing than large companies whose efforts are largely geared at staying steady. There are of course exceptions e.g. asset rebalancing”
 - (c) a consumer advocate commented that “saves discourage competition from retailers other than the four dominant gentailers” – particularly from small innovative retailers.
- B.1.3 Some submitters commented that the save process does not provide transparency, because consumers that do not begin the switch process do not find out about the opportunity to receive save offers. One expressed the view that “a consistent lack of transparency will, over time, lead to low levels of consumer trust in the industry”.
- B.1.4 Some submitters supported a restriction on saves. The majority of these explicitly agreed that the Authority’s proposed amendment would:
- (a) support the Authority’s objectives
 - (b) provide a net economic benefit
 - (c) comply with section 32(1) of the Act
 - (d) comply with the Code amendment principles.

Appendix C Responses to comments in submissions that opposed the amendment

Submitter view	Examples of submitters that expressed this view	Response
Whether restrictions on saves are required		
Restrictions on saves are not required, because there is already a high level of competition in the retail market	Contact, Genesis, Meridian, Vector	The relevant test is whether a proposed Code amendment is consistent with the Authority's statutory objective. In that context, while the Authority is pleased with the recent improvements in retail competition, it considers that the Code amendment will further promote the statutory objective.
Restrictions on saves to benefit small and new entrant retailers are not necessary, because small and new entrant retailers are already succeeding	Contact, Genesis, Trustpower	
Small and new entrant retailers are not the only source of innovation; in fact, the vast majority of innovation is driven by larger competitors	MRP	The Authority acknowledges the valuable innovations introduced by MRP and other established retailers, but remains of the view that independent retailers are an important source of competition and innovation. This includes the spur that such parties provide for innovation and competition by larger and more established participants.
The telecommunications examples provided in the consultation paper were not relevant to the NZ electricity industry, which is more competitive than telecommunications markets	Contact, Genesis, Meridian, Trustpower, Vector	The Authority acknowledges that electricity is different from telecommunications. The examples provided were merely intended to illustrate that there is some precedent for a restriction on saves. In deciding whether to amend the Code, the Authority is guided by the Act and Code amendment principles, rather than by what has been done in other sectors.

Submitter view	Examples of submitters that expressed this view	Response
The Authority should also consider examples from the retail banking sector	Genesis	The Authority has looked into switching arrangements in the NZ retail banking sector. The Authority understands that saves are possible in theory, but are infrequent in practice. Possibly in consequence, there is currently no restriction on saves.
Only a small (and declining) percentage of consumers appear to be targeted by save campaigns, and therefore dealing with saves need not be a priority	Consumer NZ, Trustpower	As set out in Section 3.3 of the consultation paper, saves can have a disproportionately large effect on the profitability of acquisition campaigns. Furthermore, the perceived threat of saves may deter retailers from mounting aggressive acquisition campaigns. Therefore, even if the percentage of consumers that are currently being successfully saved is small, in the Authority's view it is still worth taking action to restrict saves. Also, see Appendix D for updated information on save rates.
The illustrative example in Section 3.3 of the consultation paper, showing that saves can significantly affect the profitability of acquisition campaigns, used incorrect assumptions	Genesis, Trustpower	The example was meant to illustrate the point that a low rate of saves can still have a disproportionately high effect on the profitability of acquisition campaigns, rather than to accurately model the economics of a specific participant's acquisition campaigns. As set out in Appendix E, the Authority has carried out sensitivity analysis to test how the assumptions used affect the results. Under all assumptions tested, the example still shows that acquisition activity can be significantly less profitable if saves are allowed.

Submitter view	Examples of submitters that expressed this view	Response
A level playing field already exists, in that the Code treats all retailers equally with respect to save activity	MRP	The Authority acknowledges that the Code does not explicitly discriminate against small, new entrant, or independent retailers with respect to save activity. Nonetheless, the Authority considers that saves can present more of a problem for small, new entrant or independent retailers than for incumbents. Incumbent retailers have been advantaged by the ability to use information gained in the save process to retain customers. Small, new entrant and independent retailers have gained relatively little benefit from this ability because they have not had a large customer base to defend.

Whether the proposal will deliver benefits		
The proposal will reduce consumer choice, by preventing some customers from receiving save offers	Contact, Genesis	As set out in Section 2.2.5, the Authority considers that the amendment will result in a net increase in competition, to the long-term benefit of consumers. The Authority expects that the direct effects of the amendment on retail competition are likely to include: - encouraging retailers to make win-back offers to consumers that have switched away - increasing the incentive for retailers to pre-emptively offer their
The proposal will not have a net positive effect on retail the proposal will prevent consumers from receiving and accepting save offers	Contact, Genesis, Vector, Catherine Tudhope	

Submitter view		Examples of submitters that expressed this view	Response
competition, to the benefit of consumers, because:	the proposal will lessen the competitive pressure on acquisition offers, since the gaining retailer will have less need to beat retention offers	Contact, Genesis, Meridian, Nova, Trustpower	existing customers a better deal • preventing some customers from receiving save offers • reducing the competitive pressure on acquisition offers. However, the Authority expects that these direct effects on retail competition: • will cancel each other out to some extent • will, in any case, be outweighed by the longer-term benefits of the amendment – i.e.: – to facilitate retail competition and innovation, by reducing barriers to the entry and expansion of independent retailers and the expansion of existing retailers – to support the durability of the competitive retail market.
	the proposal will not increase innovation	Contact	
The proposal will not material reduce or may increase barriers to entry for independent retailers because:	there are more important barriers to entry for independents, i.e. “the dominance of the five main incumbents, which are backed by significant generation assets”	Consumer NZ	The Authority acknowledges that independent retailers without significant generation assets are dependent on a well-functioning electricity hedge market. Hedge market arrangements are a high priority for the Authority, and are currently being reviewed by the Wholesale Advisory Group.
	independent retailers might lose more from being unable to carry out saves than they gained from save protection	Trustpower	The proposed opt-in provision would allow independent retailers to forego save protection if they wanted to be able to carry out saves themselves. However, submissions from independent retailers seem to indicate that their preference would be to opt for save protection.

Submitter view		Examples of submitters that expressed this view	Response
	the proposal may lead to an increase in fixed-term contracts, which make it harder for independent retailers to establish a customer base	Contact	The Authority acknowledges that some retailers (both incumbent and independent) may seek to increase their use of fixed-term retail contracts. As set out in Section 5.1, the Authority considers that fixed-term contracts are not in themselves detrimental to competition. Indeed, they can result in customers receiving more attractive offers than they would otherwise have.

Submitter view		Examples of submitters that expressed this view	Response
Whether the proposal has the potential for unintended and undesirable consequences			
The proposal may have unintended and undesirable consequences, including:	preventing losing retailers from contacting switching customers for purposes they consider to be legitimate, such as correcting false information provided by the gaining retailer, or dealing with administrative matters	Contact, Meridian, Powershop, Trustpower	As set out in Section 4.3, the Authority has reviewed the purposes for which a losing retailer could communicate with a switching customer, and has made some changes to the amendment as a result. It therefore considers that this concern is addressed in the revised Code amendment.
The proposal may have unintended and undesirable consequences, including:	an increase in poor marketing conduct by gaining retailers	Contact, Meridian, Trustpower	As set out in Section 5.1, the Authority agrees that there could potentially be an increase in the use of some retailer behaviours that are not in the interest of consumers. However, the Authority is not dissuaded from proceeding with the amendment, because it considers (following discussions with the EGCC and Commerce Commission) that there are effective safeguards in place to prevent or mitigate the use of such behaviours. As set out in Section 5.1, the Authority agrees that some retailers may seek to increase their use of fixed-term retail contracts and/or termination fees, but considers that fixed-term contracts with reasonable, clearly explained termination fees are not in themselves detrimental to competition.
	an increase in the use of fixed-term retail contracts and/or termination fees	Consumer NZ, Contact, Genesis, Meridian, Nova	

Submitter view		Examples of submitters that expressed this view	Response
	increasing the complexity of the market	Contact, Trustpower	The Authority is concerned to avoid complexity where it imposes transactional costs that exceed benefits, or form a barrier to competition. In this instance, submissions have not indicated that there will be material additional costs that will arise through increased market complexity, or that the increase in complexity will hinder retail competition.
	creating costs	Trustpower	Participants have not provided concrete information about the costs they may incur as a result of the restriction on saves. Trustpower mentioned costs arising from “the increased need for monitoring due to the decrease in internal industry monitoring against fraudulent claims” and from “the complexity added by the opt-in system”, but did not quantify these costs.
The overall case for the proposal			
The proposal does not comply with section 32(1) of the Act, for reasons including that:	it has not been proven to be in the long-term interest of consumers	Consumer NZ, Trustpower	For the reasons set out in Section 2.2.5, the Authority considers that the amendment is in the long-term interest of consumers.
	it will not increase competition	Contact, Meridian	For the reasons set out in Section 2.2.5, the Authority considers that the amendment will result in a net increase in retail competition.
	it is inefficient	Contact	This issue is covered in the discussion of the net benefits of the amendment in a later row of this table. The Authority expects the amendment to result in a net economic benefit.

Submitter view		Examples of submitters that expressed this view	Response
The proposal does not comply with the Code amendment principles, for reasons including that:	there is no market or regulatory failure	Powershop, Trustpower	The Authority considers that the amendment addresses a flaw in current regulatory arrangements that act as an undue barrier to competition.
	the proposal is not consistent with the Authority's statutory objective	Contact	For the reasons set out in Section 2.2.5, the Authority expects that the amendment will result in a net increase in retail market <u>competition</u> . Section 5.7 of the consultation paper set out that the Authority expected the proposed amendment would not undermine <u>reliability</u> of supply or the <u>efficiency</u> of the electricity industry. The submissions received have not led the Authority to change its views on the reliability or efficiency effects of the amendment.
	there is no clear evidence of the competition or innovation benefits	Contact, Meridian, Trustpower, Vector	For the reasons set out in Section 2.2.5, the Authority considers that the amendment will support competition and innovation.

Submitter view		Examples of submitters that expressed this view	Response
	the net benefits have not been quantified	Contact, Meridian, Powershop, Trustpower	The Authority acknowledges that the net benefits of the proposal have not been quantified. While the Authority agrees that quantification of net benefits is desirable, the Code amendment principles note that “quantitative analysis will not always be possible” and the Authority considers that this is a case in which benefits cannot be quantified. Nevertheless, the Authority is of the view that the net benefit of the amendment will be positive, based on the qualitative reasoning set out in the following row of this table. Further, Section 5.7 of the consultation paper set out that the Authority considered that the proposal satisfied the ‘tie-breaker’ Code amendment principles four to eight. (These are preferences for: small-scale ‘trial and error’ options, greater competition, market solutions, flexibility to allow innovation, and non-prescriptive options.) The submissions received have not led the Authority to change its views on the extent to which the amendment satisfies these principles.

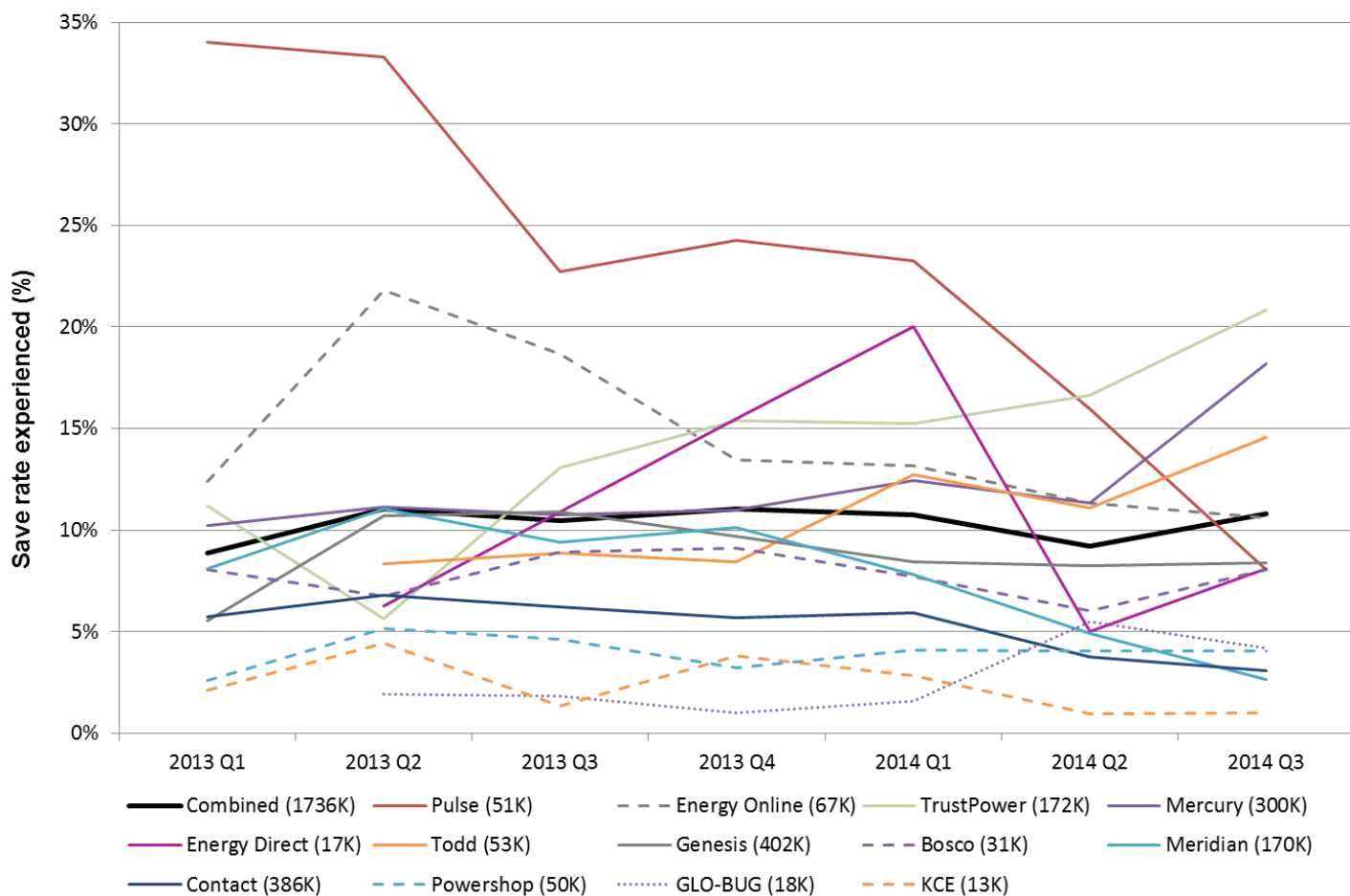
Submitter view		Examples of submitters that expressed this view	Response
	the net benefits are likely to be small or negative	Contact, Genesis, Meridian, Trustpower	Section 5.4 of the consultation paper set out that the Authority expected the net benefit of the proposal to be positive, and explained the reasons for this view. The submissions received have not led the Authority to change its view on the net benefit of the amendment. In particular, submitters have not provided evidence to show that the economic cost of the proposal is likely to be greater than the Authority had assumed. Some submitters commented that the economic benefit of the proposal was likely to be less than the Authority had assumed. However, for the reasons set out above, the Authority is not persuaded by these comments and considers that the amendment is likely to produce a worthwhile economic benefit.

Appendix D Recorded save rates in 2013-14

- D.1 Figure 3 shows save rates experienced by each gaining trader³¹ in each quarter since the beginning of 2013.
- D.2 The number of customer-initiated switch withdrawals has been used as a proxy for the number of saves. In fact, not all customer-initiated switch withdrawals are saves. The changes to withdrawal advisory codes described in this paper will allow saves to be distinguished more effectively from other types of switch withdrawals in future.
- D.3 If a trader is shown as having a high save rate, this means that its acquisitions are relatively often saved by the losing retailer. The Authority notes that the overall save rate (**heavy black line**) has not changed substantially since the beginning of 2013, but that some individual gaining traders have experienced changes in save rates.

³¹ This Appendix provides statistics for 'traders' as distinct from 'retailers' or 'brands'. Some retailers (i.e. Type 2 retailers) may not be traders. Some traders have more than one brand.

Figure 3 Save rates experienced by each gaining trader



Note: Traders are sorted in descending order of mean save rate over the period.

Number in brackets is current number of ICPs.

Some minor brands are excluded.

- D.4 The **figure** shows that Pulse's save rate (i.e. the proportion of Pulse's acquisitions that have been saved by the losing retailer) has declined substantially since early 2013. It is possible that this change is partly or wholly due to changes in Pulse's marketing practices. Another possible explanation is that other retailers have reduced their save efforts due to increased scrutiny of save practices by the Authority, which began in late 2013.
- D.5 The Authority considers that the decline in save rates experienced by some retailers does not mean that 'the problem has gone away'. The Authority expects that, without the Code amendment described in this paper, the ability of losing retailers to use information gained through the switching process for retention purposes would continue to discourage new entry and expansion.

Appendix E Sensitivity analysis for worked example in the consultation paper

- E.1 The Authority's June 2014 consultation paper included a section titled "Effect of saves on the profitability of acquisition activity: a worked example".
- E.2 This worked example (reproduced overleaf) was used to illustrate the point that "saves have a disproportionate effect on the profitability of acquisition activity, because they reduce benefits without reducing campaign costs". It showed that a 20% save rate can change a hypothetical campaign from profitable to unprofitable.
- E.3 Genesis and Trustpower each disagreed with some of the input assumptions used in the worked example. Points of difference were that:
- (a) the Authority assumed a fixed campaign cost of \$100K, while Genesis assumed a variable campaign cost of \$250 per customer successfully acquired – with a nil cost for saved customers
 - (b) the Authority assumed a 5% acquisition success rate, while Trustpower considered 7-12% was more reasonable.
- E.4 Under either Genesis or Trustpower's assumptions, the hypothetical campaign would still be profitable even with a 20% save rate, and even with selective cherry-picking of the best customers.
- E.5 Genesis and Trustpower also questioned the use of a 20% save rate – "such a significant save rate is not guaranteed across all retailers and across all campaigns".
- E.6 The Authority emphasises that the worked example was only meant to be illustrative. It was not intended to accurately model the economics of any particular participant's acquisition campaigns.
- E.7 Nonetheless, the Authority has carried out sensitivity analysis to show how the results of the worked example depend on the input assumptions used.

Effect of saves on the profitability of acquisition activity: a worked example

(Reproduced from the June 2014 consultation paper)

Suppose a retailer carries out an acquisition campaign. In previous campaigns, 20% of the customers it has won have been saved by the losing retailer. Consider three scenarios:

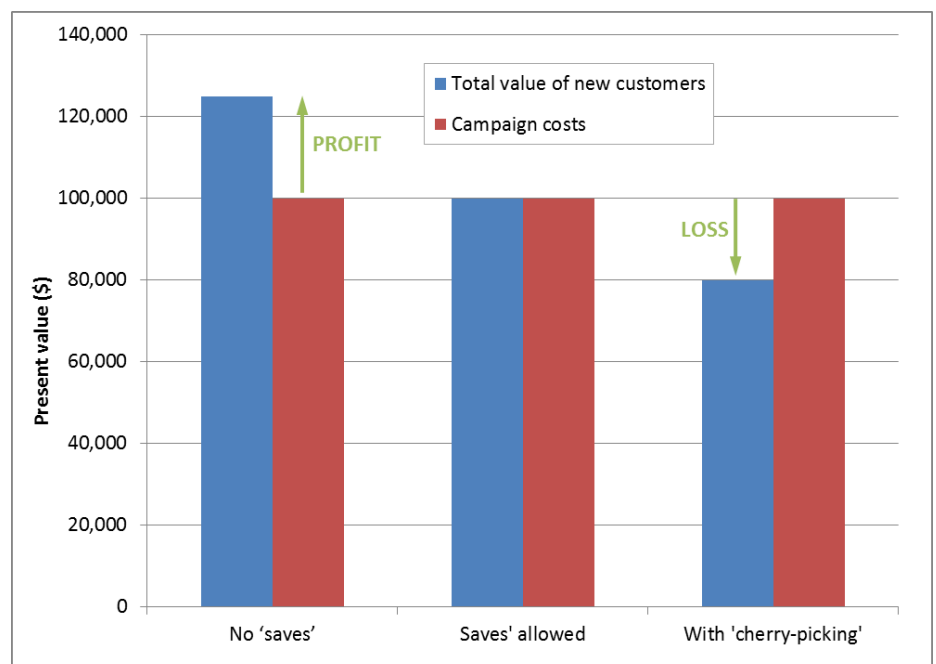
- in which the gaining retailer is somehow protected from saves
- in which it loses 20% of its acquisitions to saves
- a worst case in which it loses its 20% most profitable acquisitions to saves (as a result of 'cherry-picking' by the losing retailer).

The profitability of the campaign under each of these scenarios is shown below. (Assumptions are made about the size and success rate of the campaign, and the value of the customers acquired. All calculations are pre-tax. A 10% WACC is assumed, though the results are not particularly sensitive to the choice of WACC.)

	No saves	Saves allowed	With 'cherry-picking'
Customers approached	5000	5000	5000
Cost per customer approached (\$)	20	20	20
Success rate (% - net of switch cancellations unprompted by the losing retailer, which can occur under all three scenarios)	5%	5%	5%
Save rate (%)	0%	20%	20%
Number of customers acquired	250	200	200
Average time for which new customers are retained (yrs)	4	4	4
Average margin (\$/yr)	150	150	120
Total value of new customers (\$ PV)	125,000	100,000	80,000
Campaign costs (\$)	100,000	100,000	100,000
Profitability of campaign (\$ PV)	25,000	0	-20,000

It can be seen that a 20% save rate does not merely reduce the profitability of the campaign by 20%. Rather, it makes the campaign completely unprofitable.

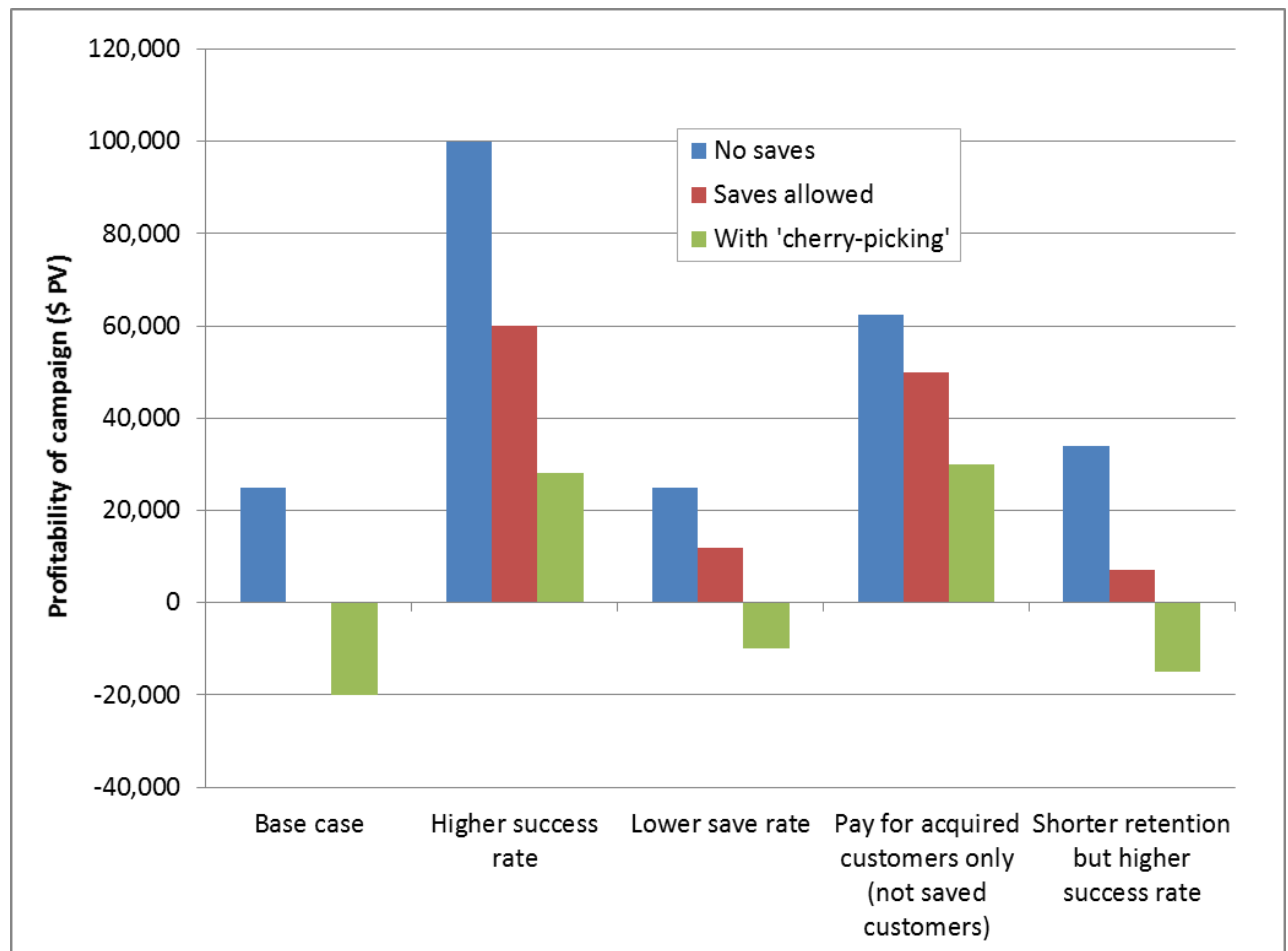
In the worse case, where the losing retailer is able to 'cherry-pick' the best customers to save, the campaign makes a substantial loss.



- E.8 The Authority tested the following changes to the input assumptions:
- (a) acquisition success rate of 8% (base case was 5%)
 - (b) save rate of 10% (base case was 20%)
 - (c) in which the retailer pays \$250 for each customer that is successfully acquired and not saved (in the base case, the retailer instead paid \$20 for each customer that was approached)
 - (d) in which each customer is only retained for two years (base case was four years), but the acquisition rate is 10% (base case was 5%).

E.9 The effect on the results of the worked example is shown in Figure 4.

Figure 4 Effect of saves on the profitability of acquisition activity – sensitivity analysis of worked example



E.10 Under all the input assumptions tested, the example still shows that acquisition activity can be significantly less profitable if saves are allowed – and that cherry-picking further weakens the profitability of acquisition activity.