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Submission on Customer Acquisition, Saves and Win-backs – Draft Issues Paper

Dear James,

1. Vocus welcomes the opportunity to engage with MDAG on the draft issues paper on Customer Acquisition, Saves and Win-Backs.

2. Vocus is concerned that although the Electricity Authority had identified why the scheme was ineffective at resolving the established regulatory failure[1] [2], the MDAG Issues Paper tends to relitigate the existence of regulatory failure and not why the current scheme failed to address the regulatory failure.

3. In the Electricity Authority review of Saves and Win-backs, the Electricity Authority correctly identified some of the problems with the scheme.

4. For example, the Electricity Authority noted *"the scheme changed retail behaviour to accelerate save protected switches; this allowed retailers to avoid the prohibition on saves and to subsequently win customers back after the switch was completed.* ***<u>This behaviour change is likely to have affected the effectiveness of the scheme</u>****"* [3]

5. The Electricity Authority further identified that *"As retailers can substitute between saves and win-backs relatively easily, we consider that* ***<u>saves and win-backs need to be considered in total</u>*** *rather than separately in any future development of this scheme"* [4]

6. The Electricity Authority also noted that small entrant retailers need input to the design, when they stated that *"Further analysis of how the scheme affected smaller entrant retailers could also help inform the regulatory design"* [5]

7. Despite our concerns about the direction of the issues paper and its questions, we still address those questions and have mapped our responses to your questions in Appendix 1.

[1] Consultation paper saves and Win-backs (24 June 2014)
[2] MDAG: Customer acquisition, saves and win-backs: issues paper (2018), Page 5;
[3] Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Executive Summary Para. 5
[4] Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Para. 13.4
[5] Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Para.13.9

The established regulatory failure

8. We believe it is important to reiterate the underlying problem the scheme sought to address, in order to understand why the scheme was unsuccessful. The original Electricity Authority consultation paper on saves and win-backs summarised the problem well as: -

> *"In most sectors, the incumbent supplier does not receive advance notice that a customer intends to change supplier. That information remains confidential to the customer and acquiring supplier until the switch is completed.*
>
> *By contrast, in the retail electricity market, **the incumbent retailer is notified that a customer intends to switch before the process is completed**. The incumbent may use this information to seek to 'save' the customer.*
>
> *The competitiveness of the retail market is driven in large part by acquisition activity and the **threat of acquisition activity**. Saves make acquisition activity less rewarding, because a proportion of customers cancel their switch before it is complete. Further, saves have a **disproportionate effect on the profitability of acquisition activity, because they reduce benefits without reducing campaign costs**. The same issue arises in relation to early win-backs.*
>
> *For small and new entrant retailers, **saves and early win-backs present a barrier to entry and expansion**. The effect on profitability is greater for such retailers as the costs of an acquisition campaign have to be spread across a smaller (or non-existent) customer base.*
>
> *In some other sectors where retailers receive advance notice of impending customer switch decisions (such as New Zealand telephone landlines), saves are disallowed."* [6]

9. Further, the Electricity Authority decisions and reasons paper set out the intended benefits of restricting saves: -

> *"(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."*[7]

and that

> *"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. "*[8]

The decisions paper further noted that restricting saves would *"increasing the incentive for retailers to **pre-emptively offer their existing customers a better deal**."*[9]

The power industry is particularly prone to not offering 'non-switchers' a better deal

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[6] Proposed Code Amendment – Saves and Early Win-Backs Consultation Paper (24 June 2014), Executive Summary
[7] Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 3.2.1
[8] Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 3.2.3
[9] Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 3.4

10. The MDAG identified in the issues paper[10] that 42% of residential ICPs have never switched over past sixteen years.

11. Combine the core 'non- switching base' with a number of factors and you have 42% of the base paying 'inflated' prices for their power. Key factors that combine to create the issue are: -

    a) The ability of incumbents to exploit the current scheme, enabling winback levels unheard of in other industries (up to 40%), and as a result removing the benefit of competitive pressure on incumbents to right rate their existing customers – *"pre-emptively offer their existing customers a better deal"*, a key objective of the saves and winbacks scheme.

    b) The rate of technology innovation - If you look at the telecommunications market, as a contrast, the rate of technology innovation means that incumbents do not collect 'inflated legacy price premiums' from existing customers. Technology innovation creates new services (such as Netflix) and in doing causes customers to service demands to change and as a result purchase a new service from their provider at the current market price or drives a customer to shop around. Examples of innovation in the telecommunications market include: -

        a. The broadband market whereby consumers have moved from dial-up to ADSL, ADSL to VDSL and VDSL to Fibre. In the case of fibre 44% of all broadband users have already switched to new fibre services, at current market prices, in the last few years.

        b. Similarly, in the mobile market the level of consumer handset innovation means consumers replace existing handsets each year and the need to acquire a new handset naturally leads to shopping around for a better price plan at today's prices.

    c) Power billing is hard to understand and current prices are not marketed above the line. The electricity market is made up of numerous distribution companies and price categories for different consumer types. Electricity billing is not intuitive to the average person. This makes it difficult for a consumer to compare their bill to that of another person.

    d) Switching back to your previous retailer is easy in the electricity market as compared to other markets. In the broadband market by the time the losing service provider is aware of a switch the gaining service provider will already have arranged for modems to be set out and for physical work to be undertaken at the exchange for example.

12. Given these factors the rational behaviour of large incumbent is to focus marketing effort on retaining customers who are switching (and readily identified) through immediate retention activity rather than proactively right-rating their existing customer base.

13. The inevitable result is that the scheme has not achieved its original goals and incumbents continue to monopolise the market despite almost 40 new competitors trying to gain market share. The Electricity Authority's market statistics show that the market share of incumbent retailers over the 8 years from 2010 to 2018 has not materially changed.

[10] MDAG: Customer acquisition, saves and win-backs: issues paper (2018), Para. 4.3.3

RETAILER	MARKET SHARE MAY 2010	MARKET SHARE MAY 2018
Contact Energy	24.71%	19.82%
Genesis Energy	26.36%	23.98%
Mercury Energy	22.11%	18.58%
Meridian Energy	12.3%	13.78%
Trustpower	11.33%	12.10%
Overall Share	**96.81%**	**88.26%**

Source: **Market Share Trends - emi.ea.govt.nz**

14. It appears that non-switching customers retained by these incumbents are on "inflated legacy price premiums" and that incumbents are using this to cross-subsidise offers to switching customers. For example, Powershop, a wholly owned subsidiary of Meridian Energy (a large incumbent retailer) noted that

> *"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"*[11]

Early notification of switching remains a regulatory failure under the current scheme

15. The current scheme was built on the presumption that win-backs (other than those almost immediately after a switch) would be harder than saves[12]. We have outlined the problems with this assumption in the following table.

PROBLEM	DESCRIPTION
The switching process is invisible to the customer	The switching process is invisible to the customer, and a relationship with a new retailer is not bedded in until the first bill which usually arrives at least a month later. So an early winback is easy to undertake

[11] Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Powershop submission to Authority, Page 31.
[12] Proposed Code Amendment – Saves and Early Win-Backs Consultation Paper (24 June 2014), Para 3.6.2

Switch completion is meaningless to a customer until the first bill is sent	The presumption of the original Electricity Authority paper was that a customer may be more willing to cancel an in-progress switch than to reverse a completed switch. However, in practice it's the first bill that 'cements' the new relationship. Given there is nothing in the code which prohibits early win-backs prior to the first bill being sent a withdrawal post-switch is just as easy as a withdrawal pre-switch.
Regulated saves are easily converted into unregulated win-backs	It is worth noting that in general the losing trader controls the timing for the completion of the switch as they must send the relevant completion file. This gives a losing trader enormous power to subvert the regulated period by simply completing switches faster, only to withdraw it immediately after a successful save. Unsurprisingly, this is exactly what the MDAG has noted has happened[13].

16. In the final decisions paper, the Electricity Authority also decided not to restrict early life win-backs. The Authority acknowledged that withdrawals could be used in win-backs within two months of the switch completion date in an undesirable manner but noted that retailers should not do this, stating that:

> *"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.***
>
> *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**."* [14]

17. Despite this, the post implementation review shows that withdrawals are being used in this manner to effect win-backs. This has resulted in the situation that the Electricity Authority itself noted where *"saves are substituted for win-backs relatively easily"*[15] and that the *"advantage conferred on the losing retailer remains"*[16].

18. Because of these issues, the results of the scheme cannot be used to assess if the regulatory failure itself existed, or continued to exist.

Information won't address the issue - Incumbents will always win the perfect auction

[13] MDAG: Customer acquisition, saves and win-backs: issues paper (2018), Page 2 (Background)
[14] Electricity Authority, Competition effects of saves and win-backs, Decisions and reasons paper (2014), Para. 4.2.7 and 4.2.8
[15] Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Para. 13.4
[16] Electricity Authority, Post implementation review of saves and win-backs Final Report (2017), Para. 13.6

19. The MDAG issues paper discusses information asymmetry. We consider it worth noting that greater information symmetry would do nothing to address the issue that 42% of residential ICPs who are paying higher prices and have never switched.

20. The incumbent retailers have deep pockets and the advantage of their non-switching customer bases to subsidise offers to switchers. This means that even with a perfect auction the incumbents will always have the upper hand.

21. The benefits of greater information symmetry are marginal and changes to increase the availability of information may only drive more cost into the industry.

Contracts – the 'Elephant in the Room'

22. We are concerned that the MDAG[17] and the Electricity Authority[18] have proposed fixed-term consumer contracts as a solution to a regulatory and market failure.

23. We strongly believe that driving the market to contracts an undesirable solution to the problem both for new entrant retailers and consumers. Because this is so frequently identified as a solution, we thought it important to address exactly why it is a rabbit-hole that should be avoided.

ISSUE	COMMENTARY
Contracts make switching harder for consumers and drive costs and risk reputational damage into the industry	The industry has spent a great deal of time, money and resources on improving the switching process by making switching quick and simple for customers. More widespread use of contracts would mean that customers who are considering switching must now time their switching to occur only at the end of their contract – making switching harder.
Contracts discourage switching & drive acquisition costs creating a barrier to entry	Incumbents have a significant advantage in brand recognition over most new entrant retailers. This means that until a new entrant becomes established and recognized in the market, a customer often perceives they are taking a risk when switching to a new entrant retailer. Having fixed term contracts as a necessity for a new entrant retailer means that fewer customers may be willing to take that risk, thereby lowering take-up and increasing acquisition costs, and creating a barrier to entry new entrants.
The perception of handcuffing consumers damages brands	Handcuffing customers to a retailer inevitably drives brand damage and consumer issues. New entrants who are trying to establish a brand are more impacted than better known established brands.
Contracting customers increases search costs	Small and new-entrant retailers will find that their search costs only increase as it becomes harder and harder to find uncontracted customers - creating a barrier to entry
Contracts make customers the loser in a	Fixed term contracts for the primary purpose of preventing early-life win-backs simply shifts the cost of the problem from the market to the customer

17 MDAG: Customer acquisition, saves and win-backs: issues paper, Para. 2.3.6
18 Electricity Authority, Post implementation review of saves and winbacks Final Report (2017), Para. 2.4(c) and Para. 7.10 is one example among others.

battle for market share	who will ultimately be penalized by early termination fees. We already see situations where a customer switches without realising they are already on a contract, end up on a contract with their new retailer as well, and are stuck in a situation where they must decide which contract they will break and to whom they will pay a now unavoidable termination fee.
Encouraging contracts does not achieve the Electricity Authority's statutory objectives	The Electricity Authority has a statutory objective of promoting competition for the long-term benefit of consumers. Encouraging fixed term contracts as a solution doesn't achieve these objectives for the reasons we have noted above.

Recommendations for further action

24. In summary as the EA identified the previously established regulatory failure still exists, the problem simply morphing from saves to early winbacks. A large non-switching segment of residential customers are not benefitting from the competitive pressure and new entrants face significantly high acquisition costs due to 40% winback levels.

    To address these concerns, we make the following recommendations to the Electricity Authority and MDAG on how to proceed

    Recommendation 1: We recommend that the Authority regulate withdrawal activity

25. As outlined in paragraphs 14 to 17, the industry is using the withdrawal process in a manner which the Electricity Authority already noted is undesirable. We recommend that the Authority regulate withdrawals so that withdrawals are only used to address genuine errors and not to enable win-backs.

    Recommendation 2: We recommend the Authority investigate pricing behaviour

26. In paragraphs 10 to 13 we outlined that it appears that the 42% of residential ICPs which have never switched are likely to be on higher pricing than customers who switch. We believe that it is likely there is a high spread of pricing between switchers and non-switchers, and many customers would be paying a legacy incumbent premium.

27. We strongly recommend that MDAG ask the Electricity Authority to undertake a review of consumer pricing, using its market monitoring powers, to investigate the price spread between switching and non-switching customers.

28. The end-goal of this investigation should be understanding the extent to which incumbents are keeping non-switching customers on high pricing and using this financial advantage to cross-subsidise retention activities on switchers.

    Recommendation 3: We recommend the Authority regulate early life win-backs

29. We addressed the fact that use of contracts would be undesirable for both consumers and retailers in paragraphs 22 and 22. There appears to be no other meaningful strategies that small and new entrant retailers can use to counter early-life incumbent retailer win-backs.

30. This being the case, we recommend that the Electricity Authority extend the current scheme in the interim, in the form of a moratorium on win-backs for the first 45 days after a switch for retailers who elect to be save and win-back protected.

31. We have outlined how we believe this would meet the Electricity Authority code amendment principles in Appendix 2.

Regards,

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Vocus Group

Appendix 1: MDAG Issues Paper Questions

QUESTION		RESPONSE
1.	Do some retailers have a distinct win-back advantage which others do not have and cannot ever have	
i.	What sorts of strategies do acquiring retailers have to defend against win backs and how cost-effective are they?	Acquiring retailers have very few strategies which can be used to defend against win-backs, and the only strategy of a meaningful nature is that the acquiring retailer can attempt to contract the customer. We believe that this is an ineffective and undesirable strategy, which we have elaborated on in some detail in paragraph 22/23 of this response.
ii.	Is there a market or regulatory failure preventing acquiring retailers using contractual terms to counter win-backs, given that some retailers are prepared to enforce contracts when customers leave them before the completion of the contract term?	We address this in paragraph 22/23 of this response.
iii.	Does early switch notification give an undue advantage to retailers seeking to win-back customers.	Yes – see paragraph 15 - 18 of this response.
2.	Are consumers frequently prompted into making decisions when they switch or switch back that are not in their best interests?	
i.	If consumers make mistakes in the 'heat of the moment', is there a way to tell which was intended and which was the error – the switch or the win-back?	Nothing within the current switching process or publicly available datasets would allow for this to be effectively analysed. It is however worth noting that, at least for domestic consumers, the Fair Trading Act cooldown period applies on any unsolicited sale which at face value does not seem to apply on a re-sign.
ii.	Is there any evidence that retailers have engaged systematically in proscribed marketing behaviours?	Given we do not actively call customers who have withdrawn our switch, and that we are not aware of what is discussed with a customer during the retention call, it is difficult for us to collect evidence of this. We are anecdotally aware of questionable behaviour of certain sales agents during win-backs, including the provision of potentially misleading information, however when this has occurred we have raised this directly with the relevant retailers.

		We suspect that, in general, retailers do not intentionally engage in illegal behaviour, but their agents may make statements which would be undesirable and would sit in a grey area.
iii.	Are there regulatory provisions that treat saves and win-backs in a different manner from other acquisition activity in such a way as to constitute a regulatory failure?	We address this in Paragraph 15 - 18 of this response.
iv.	What are the implications (if any) for consumers of saves and win-backs?	We address this in Paragraph 15 - 18 of this response.
3.	Are there any further issues related to saves and win-backs that we have not considered	Additional points that we believe the MDAG should consider are set out in the remainder of this response.

Appendix 2: Assessment of proposed protection extension against code amendment principles

PRINCIPLE	COMMENTARY
1. Lawful - The Electricity Authority and its advisory groups will only consider amendments to the Code that are lawful and that are consistent with the Act (and therefore consistent with the Electricity Authority's statutory objective and its obligations under the Act).	The Electricity Authority has already determined that intervening in retention activity is consistent with its objectives under the Act. Given that the original scheme differs only from this proposal in the presumption that the switching process influences customer behaviour, we believe that this proposal is consistent with the statutory objectives for all of the same reasons as supported the implementation of the current scheme.
2. Provides Clearly Identified Efficiency Gain or Market or Regulatory Failure	We believe that this proposal will meet the requirements of the principle for all of the reasons that the Electricity Authority set out in its original consultation and decision papers supporting the implementation of the current scheme.
3. Net Benefits are Quantified	We anticipate that the net benefits would align that the Electricity Authority had anticipated in its original consultation and decision papers supporting the implementation of the current scheme.
4. Preference for small scale 'trial and error options'	The proposal meets this requirement because: a. The proposal is that the Electricity Authority implement this on a trial-basis for a fixed (but extendible) period to determine the difference between the effects of the current scheme and the effects of what we believe is a more effective scheme. b. The scheme can easily be reversed if there are detrimental impacts by code amendment.
5. Preference for greater competition	The proposed amendment would be likely to encourage competition by: 1. Allowing new-entrant retailers to become better established in the market and reduce the barriers to entry 2. Encourages incumbent retailers to actively right-rate their customer base, as they would be at greater risk of losing customers on uncompetitive prices without the ability to rely on retention behaviour to reverse losses.
6. Preference for market solutions	The proposed solution is a market solution.

7.	Preference for opt-out features	The proposed amendment should still allow a retailer to opt-out of save and win-back protection and if they do so they will continue to be able to apply save and win-back strategies on other retailers who are also unprotected.
8.	Preference for non-prescriptive options	Each retailer will be able to choose whether the value of save and win-back protection is sufficient to justify forgoing the ability to carry out saves and win-backs themselves.