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Sent by email to: Jane.Walker@beis.gov.uk; Neil.Barnes@ofgem.gov.uk;
energyretailmarketsreview@beis.gov.uk; futuresupply@ofgem.gov.uk

Dear Jane and Neil

Flexible and responsive energy retail markets: Centrica response

Over the last decade, the energy retail market in Great Britain has been subject to near-constant review and intervention: in 2008 Ofgem started the Supply Probe; in 2010 Ofgem began the Retail Market Review (RMR); in 2014 Ofgem and the Office of Fair Trading (OFT) referred the energy market to the Competition and Markets Authority (CMA); and in 2018 Parliament compelled Ofgem to introduce a price cap on default tariffs.

Yet despite this ongoing review and intervention, and despite the fact that GB's energy retail market is arguably the most competitive in the world, there is not currently a consensus about how best to protect the interests of current and future domestic energy consumers.

The challenge as we see it boils down to this: how to strike the right balance between economic efficiency and equality of outcome. Put differently, it is how to ensure that all consumers benefit from competition, and protect the most vulnerable, but without undermining the very competition that incentivises low prices, good service, and innovation. There is an added dimension: the need to decarbonise the energy system at lowest cost, in a fair yet efficient way.

In this context, we very much welcome BEIS' and Ofgem's consultation on flexible and responsive energy retail markets. We believe that it is a well-balanced consultation, which attempts to take into account different perspectives and evidence, for example regarding the effect of small supplier exemptions from policy costs and an unequal distribution of customers who have higher costs-to-serve.

In our response we have aimed to objectively consider the problems that BEIS and Ofgem describe and assess the options for reform in the same way. In doing so we have provided supporting evidence and cross-referred to that which we have already provided, for example in the context of Ofgem's consultation on the Default Tariff Cap (DTC). We have also referred to the views of independent experts such as the former GB regulators, the Centre for Competition Policy (CCP) at the University of East Anglia (UEA) and the University of Surrey.

We recognise that this consultation process is in its early stages and understand that BEIS and Ofgem plan to publish more specific, detailed proposals subsequent to digesting responses. We believe that BEIS and Ofgem should carefully consider the case for reform using a quantitative impact assessment, including consideration of potential unintended consequences of different options.

In this covering letter, we restate our established position with which BEIS and Ofgem will be familiar. We also set out a further package of measures which is designed to meet the challenge we set out on page 1 of this letter. We also summarise our initial views on other reforms that BEIS and Ofgem have included for discussion. We provide more detail and supporting material in response to the individual consultations in the Appendix.

Centrica's established position

On 20 November 2017, Centrica set out a number of [proposals to deliver a fairer and sustainable energy deal for customers](#), and published a [series of supporting papers alongside](#). We saw these proposals as an alternative to the Default Tariff Cap (DTC), which we did not (and do not) believe is in the best interests of customers in the long run.

Of our proposals, a number have already been achieved. For example, at the end of March 2018 we withdrew the Standard Variable Tariff (SVT) for new customers, and introduced a new fixed term default tariff, with the aim of increasing customer engagement. We also welcome the fact that Ofgem has reduced prescriptive rules governing energy bills and other customer communications, and that the CMA has reviewed and adjusted the prepayment price cap methodology to make it more cost reflective.

From our 20 November 2017 proposals, perhaps the most pertinent to this consultation are to:

- Fund policies such as the Energy Company Obligation (ECO) and the Warm Home Discount (WHD) through general taxation rather than energy bills, to move the burden away from those who can least afford it.
- Phase out the SVT altogether and prohibit all tariffs without an end-date, [to better promote customer engagement](#).
- Ensure more consistency for vulnerable customers, with consistent enforcement. And to the extent that ECO and WHD are funded and delivered by suppliers, there should be no exemptions for smaller suppliers.

Further package of measures

We propose a further package of measures that is designed to ensure that all consumers benefit from competition, and protect the most vulnerable, but without undermining the very competition that incentivises low prices, good service, and innovation.

We continue to believe that ECO and WHD should be funded through general taxation rather than by energy consumers. However, we recognise that there may be challenges to achieving this, at

least in the short to medium term. Our further package is therefore based on the assumption that WHD and ECO continue to be funded by energy consumers.

We believe that BEIS and Ofgem should, in the short term:

1. Reform WHD so it is fully data-matched with the Department for Work and Pensions (DWP) and remove the supplier exemption. This will protect those who are least able to pay, without reducing or removing their incentives to engage in the market. It will also spread the costs more fairly across customers and help level the playing field between suppliers.
2. Remove the small supplier exemption from ECO and enable suppliers to “buy out” their obligation. This will spread the costs more fairly across customers and help level the playing field between suppliers.
3. To the extent that BEIS, Ofgem and Citizens Advice consider it to be good value for money, expand the Energy Best Deal service through additional government funding and/or a market-share levy on all suppliers. This should help assist more customers who struggle to engage with the market.
4. Implement our proposed licence condition to deter suppliers from taking undue risks, avoiding the costs of those risks being socialised at supplier failure.
5. Undertake thorough and robust monitoring and enforcement of the supplier obligations to pay policy levies and offer customers the ability to pay by cash or cheque.

We believe that these measures would better protect consumers than the DTC and believe that the DTC should be removed.

Over the longer term, our initial view is that modular regulation and cross-sectoral regulation of TPIs would both enable innovation and ensure proportionate and consistent protections for customers. We do not believe that the Duty to Offer Terms should be removed as long as the DTC is in place because the DTC is constructed in a way that acts as a disincentive to acquire and retain customers who have higher costs-to-serve.

Summary of initial views on other reform options included for discussion

We appreciate that BEIS and Ofgem may as a matter of public policy want to provide further support to vulnerable customers, particularly those who struggle to pay their bills. If this is the case, we believe that the best way of supporting these customers would be a “deeper” WHD (i.e. bigger rebate), that is fully data-matched with the DWP, has no supplier exemption, and has a reconciliation mechanism to fairly allocate costs as the WHD Core Group does today.

We believe that a “deeper” WHD would be better than a targeted price cap for this group of customers because it will avoid reducing their incentives to engage in the market. We believe that the target group should be customers on means-tested benefits because these customers can be easily identified by suppliers through data-matching with the DWP. It is the unfortunate reality that there is no good proxy for inability to engage, hence we advocate an expansion of the Energy Best Deal service to support these customers if it is considered good value for money.

To the extent that a targeted price cap for vulnerable customers remains an option for more detailed consideration, we strongly believe that the target group should be customers on means-tested benefits and not customers on the Priority Services Register (PSR). The PSR is a poor proxy for both customers who struggle to pay and are unable to engage. Using PSR customers as the target-group would exacerbate the unlevel playing field because of the significant differences between suppliers as to how many customers are on their respective PSRs. It could also act as a disincentive to acquire and retain these customers and add them to the PSR in the first place. On the level of any targeted cap, the DTC would be the obvious place to start as it is

in principle designed to allow suppliers to recover efficient costs and make a competitive margin, though we believe that this has not happened in practice. To the extent that a targeted price cap is set below the DTC (as some may have suggested it should be), the below-cost element would need to be funded by all suppliers proportionately to their market share of recipient and non-recipient customers.

In the consultation BEIS and Ofgem outline options for further intervening on behalf of disengaged customers who are not vulnerable, either in terms of inability to pay or inability to engage. We agree with BEIS and Ofgem that consumers will be best served by a healthy competitive market with which they can easily engage. However, we further believe healthy competition protects both consumers who engage and choose not to engage.

In their response to Ofgem's consultation on Conditions for Effective Competition¹, the former regulators set out why they believe that the GB energy retail market effectively protected disengaged consumers as well as engaged consumers before the DTC was put in place. We agree with this assessment. We also agree with Colin Robinson, Emeritus Professor of Economics at the University of Surrey, who argues in response to the same Ofgem consultation that "the "less-active"... do not need help or protection: they have voluntarily decided not to incur the expected time costs of switching supplier, the market process is working and there is no market deficiency to be remedied."²

Notwithstanding our high-level position, it is worth summarising our initial views on the options for intervening on behalf of disengaged customers who are not vulnerable:

- **Opt-out collective switching.** We believe that opt-out collective switching would have such damaging impacts on the market and consumers' interests that it should not be considered beyond this consultation. We describe the problems with opt-out collective switching in response to questions 15-17. But to name just two: (i) forced switching could lead to customers experiencing detriment and feeling confused, frustrated, disempowered and even angry; (ii) forced expropriation of suppliers' customers could lead to market exits and deter market entry to the extent that it becomes significantly less competitive, particularly in customer service and innovation.
- **Opt-in collective switching.** There are a number of challenges with opt-in collective switching, both in terms of how it might negatively impact market dynamics as well as more practical challenges. For example, it could lead consumers and suppliers to focus on price to the detriment of quality of service and innovation. It would also be costly and impractical to offer collective switching plus personal advice to all the customers that BEIS and Ofgem may consider in scope. In his recent paper Stephen Littlechild recognised and tried to address some challenges with opt-in collective switching, such as by restricting the initial scope to groups of 10k customers in the WHD Core Group. But challenges remain even with this proposal, such as the impact on market dynamics for this narrower group of customers and how to fund it. There appears to be little justification for implementing opt-in collective switching while the DTC is in place. The costs of opt-in collective switching would need to be factored into the DTC if it was implemented while the DTC is still in place.
- **A principles-based approach to pricing.** A principles-based approach to pricing for disengaged customers would appear to be the least distortive of the options for intervening on behalf of disengaged customers who are not vulnerable. The virtues of enforceable principles compared to other options include that they can: (i) cater for

¹ https://www.ofgem.gov.uk/system/files/docs/2019/07/stephen_littlechild.pdf

² https://www.ofgem.gov.uk/system/files/docs/2019/07/university_of_surrey.pdf

unequal distributions of customers who have higher costs-to-serve, and (ii) better allow suppliers to differentiate on the basis of service and innovation as well as price. We describe different variants of principles-based approaches in response to questions 15-17 below.

We expand on our views set out in this covering letter in the Appendix below. Overall, we believe that our proposed package of measures will protect current and future consumers better than the DTC. We hope that BEIS and Ofgem will consider our proposals and receive our response as positive and constructive.

Yours sincerely

Tim Dewhurst
Regulatory Affairs Director

Appendix – responses to consultation questions

1. Do you agree with our vision for the future of the energy retail market, the outcomes we are seeking to achieve and our characterisation of the key challenges we need to overcome?

Yes we agree with the outcomes that BEIS and Ofgem are seeking to achieve, being:

- Wide choice of energy services
- Consistent consumer protection
- Minimal market distortions
- Competitive prices for all
- Ensuring consumers in vulnerable situations receive services they need

We propose that “cost effective decarbonisation” should be added to this list of outcomes. Whilst decarbonisation is mentioned under the “wide choice of energy services” outcome, we believe that it should be elevated to an outcome on its own, given its importance to protecting the interests of consumers and citizens.

To ensure regulatory consistency and predictability, the outcomes need to align with Ofgem’s and BEIS’ principal objective set out in statute, which is to protect the interests of existing and future consumers, where appropriate by promoting competition. If there were a conflict between the outcomes emerging from this consultation process and Ofgem’s and BEIS’ statutory objectives and duties, the latter would prevail.

We also broadly agree with the vision and challenges described underneath the outcomes but have some specific key comments that we draw out in more detail below.

Unpacking the challenges

• Wide choice of energy services

The consultation suggests that “suppliers can find it difficult to develop specialised or innovative services because the regulatory framework is highly prescriptive in terms of how energy services can be sold”³.

We believe that there are regulatory barriers to certain propositions and explore these in response to question 2.

The consultation document asks whether the Universal Service Obligation (USO) is a barrier to specialised or innovative services. However, there are also legitimate questions about whether the USO is operative in practice today, and what would happen if it were removed. We explore these questions in response to question 4.

• Consistent consumer protection

The consultation suggests that “new products and services, such as auto-switching and brokering services are already emerging outside of the current regulatory framework, and new models will

³ Consultation, p.14

emerge in the future”⁴. We agree that the regulatory framework should cater for such developments to ensure consumers enjoy consistent protection across the market and not distort competition between different business models. We also agree that levels of protection should be proportionate to the risk posed to consumers.

Third-party intermediaries (TPIs) such as auto-switching services, brokers and price comparison websites often operate across multiple consumer markets such as energy and broadband. Therefore, our current view is that there should be cross-sectoral regulation of TPIs to avoid overlapping or conflicting regulation. The cross-sectoral regime for TPIs could work like the concurrency regime for competition law, with a single rule-making body (e.g. the CMA) with multiple enforcers (e.g. the CMA and sectoral regulators).

- **Minimal market distortions**

The consultation suggests that social and environmental obligations such as the Warm Home Discount (WHD) and Energy Company Obligation (ECO) have “been designed in a way that may lead to an uneven playing field between suppliers”⁵. We strongly agree, as set out in this paper on [levelling the playing field](#) we published on 20 November 2017.

As we say in our covering letter to this response, assuming that WHD and ECO continue to be funded via energy bills rather than general taxation, small supplier exemptions from both of these policies should be removed. WHD should be fully data-matched with the Department for Work and Pensions, and suppliers should be able to “buy out” their ECO obligation. We provide more detail on the buyout mechanism in response to question 8.

The consultation also suggests that, beyond WHD and ECO, “the uneven way that higher cost-to-serve customers are distributed across the market could contribute to market distortions”⁶.

It is correct that some customers have higher costs-to-serve than others, and that such customers are unevenly distributed across suppliers. In setting the DTC Ofgem has recognised that customers who pay by Standard Credit (SC) have higher costs to serve than customers who pay by Direct Debit (DD), and it is a fact that suppliers have varying numbers and proportions of each of these customer groups. We submitted detailed evidence to Ofgem during the DTC consultation process that other groups of customers have higher costs-to-serve, such as customers on the PSR.

In principle, an uneven distribution of higher costs-to-serve customers should not contribute to market distortions if suppliers are allowed to set their prices on a cost reflective basis. However, if suppliers are not permitted to recoup higher costs-to-serve where they arise, suppliers with a higher proportion of these customers will be at a competitive disadvantage. We believe that the default price cap has created this problem; suppliers with higher proportions of higher cost-to-serve customers than the benchmark cannot recover their efficiently incurred costs and make a competitive margin, and suppliers with lower proportions than the benchmark can price lower to win customers and/or make a higher margin.

We discuss potential solutions to the issue of uneven distribution of higher cost-to-serve customers, beyond WHD and ECO, in response to questions 13, and 15-17 below. The issue is also relevant to the question 4 about the USO, specifically some suppliers’ strategies of avoiding

⁴ Ibid, p.14

⁵ Ibid, p.15

⁶ Ibid, p.15

acquiring customers with higher costs-to-serve, specifically customers who pay by cash or cheque.

Still on the outcome of minimal market distortions, we believe that there is a key challenge missing from BEIS and Ofgem's discussion on pages 14 and 15 of the consultation. The missing challenge is that some suppliers have operated unsustainable and unduly risky business models which have failed, with the costs of failure being mutualised across customers of non-failed suppliers. This is a key challenge that needs to be addressed. We have proposed a solution to Ofgem in the context of its supplier licensing review. We attach to this response relevant documents from NERA Economic Consulting and Cornwall Insight that we commissioned.

- **Competitive prices for all**

We believe that BEIS and Ofgem's description of the challenges in relation to this outcome gets right to the very heart of the challenge which has dominated energy retail market policy for the last decade or more. This is the same challenge that has led to the near-constant review and intervention in the GB energy retail market since the Ofgem Probe in 2008 that we describe in the covering letter.

We characterise the challenge differently to BEIS and Ofgem. We characterise it as:

How to strike the right balance between economic efficiency and equality of outcome. Put differently, it is how to ensure that all consumers benefit from competition, and protect the most vulnerable, but without undermining the very competition that incentivises low prices, good service, and innovation.

There is an added dimension: the need to decarbonise the energy system at lowest cost, in a fair yet efficient way.

We believe that a key problem with BEIS and Ofgem's description of the challenges in relation to this outcome is that it does not draw out the tensions within and between those challenges.

The consultation states that:

"We recognise that consumers will be best served by a healthy competitive market with which they can easily engage. Nevertheless, appropriate safeguards should be in place where necessary for all consumers, including those that don't engage in the market."⁷

The first issue with this description is that the second proposition does not, in our view, follow from the first (for clarity we assume that the second proposition is referring to price-oriented safeguards, since there are a large number of non-price safeguards in place in the supply licence such as the Standards of Conduct, as well as general consumer protection law).

As stated in the covering letter above, we believe that a healthy competitive market protects both consumers who engage and choose not to engage. We agree with the former regulators' assessment⁸ that the GB energy retail market effectively protected disengaged consumers as well as engaged consumers before the DTC was put in place. In a healthy competitive market such as this one, there should be no need for price-oriented "safeguards...for all consumers,

⁷ Ibid, p.15

⁸ https://www.ofgem.gov.uk/system/files/docs/2019/07/stephen_littlechild.pdf

including those that don't engage in the market". We strongly support the view offered by Ofgem in 2016 that "consumers' interests are best protected by effective competition rather than price regulation"⁹.

The second issue with BEIS and Ofgem's description is that it does not acknowledge that "safeguards" for those who "don't engage in the market", depending on how they are designed, can undermine the very competition that BEIS and Ofgem agree best serves consumers. We believe that this is well-understood by the UK Government and competition authorities. In 2011 the UK Government replaced social tariffs with the Warm Home Discount, because the latter as a flat rebate of £140 would help low income households without undermining incentives to engage in the market. In 2016 the Competition and Markets Authority (CMA) said that a price cap on default tariffs would be a bad idea because it would "run excessive risks of undermining the competitive process, likely resulting in worse outcomes for customers in the long run". Ofgem recognised the "risk that a regulated tariff becomes a permanent feature as it may be very difficult to exit from" which "highlights the importance of a clear exit strategy from the start"¹⁰.

There is a third issue. BEIS and Ofgem describe concerns about disengaged consumers paying higher prices than engaged consumers. However, the description does not explicitly recognise that price differences between these groups of consumers are a common feature of highly competitive markets, and they drive competition by incentivising consumers to engage. The mutualistic relationship between price differentials and competition is well-established and supported by expert witness evidence cited in Ofgem's own consultation on conditions for effective competition¹¹.

We do not agree that any of our customers pay or paid "excessive" or "uncompetitive" prices, either now or prior to the implementation of the DTC. We agree with the former regulators' assessment that claims of "a "two-tier" market, excessive price differentials, excessive profit margins, inefficiency and slow-adjustment" are not convincing¹². Colin Robinson, Emeritus Professor of Economics at the University of Surrey, has described the "concept of a two tier market" as used in Ofgem's paper on Conditions for Effective Competition as "unhelpful and... misleading"¹³.

We agree with the former regulators' conclusion that "the competitive market process seems to be working well over time"¹⁴. We also agree with their conclusion that:

*"Competition could be made more effective, not only by removing the tariff cap, but also by removing two present distortions in the regulatory framework. These are associated with exemptions for small suppliers and with compliance procedures for environmental obligations."*¹⁵

⁹ Ofgem Response to the CMA's addendum to its provisional findings report and second supplemental notice of possible remedies, 13 January 2016, p.2

¹⁰ Ofgem Response to the CMA's Provisional Findings and Notice of Possible Remedies, 5 Aug 2015, p.88

¹¹ https://www.ofgem.gov.uk/system/files/docs/2019/05/cfec_discussion_paper_280519_finalversion.pdf Appendix 2 page 30 – see quotations from the Centre for Competition Policy from its evidence to the BEIS Select Committee

¹² Ibid, p.16

¹³ https://www.ofgem.gov.uk/system/files/docs/2019/07/university_of_surrey.pdf Paragraph 2

¹⁴ Former GB regulators' response to Ofgem consultation on Conditions for Effective Competition, p.16

¹⁵ Ibid

In line with this, we agree with BEIS and Ofgem that “reforms that minimise market” distortions - such as removing exemptions for WHD and ECO and introducing a new licence condition to prevent suppliers taking undue risks with customers’ money - will help address the issue of unsustainably low acquisition pricing which may have knock-on effects on non-acquisition pricing. We agree with the former GB regulators where they say that “the low tariffs offered by exempt suppliers give a misleading impression of what competitive prices are”¹⁶.

BEIS and Ofgem claim that before the price cap, customers who did not engage typically “paid £75-100 more than the average efficient costs of serving them”¹⁷. The £75-100 figure comes from a chart which compares the average SVT of the six larger suppliers to a hypothetical backdating of the price cap methodology. This is not an accurate comparison because suppliers’ costs have changed over time and a different methodology may have been used in the past (e.g. at an earlier stage of smart meter rollout or during implementation of Retail Market Review reforms).

The same Ofgem source document for the £75-100 states that the Default Tariff Cap “scrapped excess charges of around £76 on average per year for customers using a typical amount of energy when it came into effect on 1 January 2019”. In our response to Ofgem’s statutory consultation on the DTC, we itemised a minimum £58 shortfall in the efficient costs allowed in the cap in Q1 2019. The £58 shortfall was for a supplier with a greater proportion of customers who have higher efficient cost-to-serve than the benchmark supplier.

- **Ensuring consumers in vulnerable situations receive services they need**

We agree that consumers in vulnerable situations should receive the support and services they need no matter who their supplier is.

The challenge that BEIS and Ofgem describe in relation to this outcome is that it “does not always happen consistently across the market”. BEIS and Ofgem emphasise in particular, “consumers who struggle to afford their energy bills and get into debt do not receive consistent levels of support”¹⁸.

The meaning of the word “consistency” in this context is unclear. For example, does it mean that not all suppliers *support* vulnerable customers? Or does it mean that not all suppliers support vulnerable customers *in the same way*?

The meaning is important. We believe that all suppliers should support vulnerable customers. But whether suppliers should provide identical services will vary between circumstances. While there can be good reasons for common protections (e.g. ease of understanding, level playing field), policymakers may also want to allow room for innovation.

Consistency of support for vulnerable customers is also pertinent to the question about the Universal Service Obligation (USO) below. It appears that some suppliers are not meeting their obligations. Suppliers’ obligations to their customers, especially vulnerable customers, should be monitored and enforced.

We believe that there is a key challenge missing from BEIS and Ofgem’s description under this outcome. The missing challenge, in our view, is:

¹⁶ Ibid, p.11

¹⁷ Ibid, p.15

¹⁸ Ibid, p.15

How to reach the right vulnerable customers with help that is appropriate to their need(s)

When the UK Government designed the WHD, we believe that it appreciated these challenges and delivered an effective policy. We describe the WHD in simple terms below:

- The need was that customers struggled to pay their bills because of having a low income, and were consequently at risk of fuel poverty
- Customers who experienced the need could be identified through the proxy of being on state means-tested benefits
- The remedy (a flat £140 rebate) was applied to customers in receipt of means-tested benefits
- A flat £140 rebate was chosen because it would retain customers' incentives to engage in the market better than social tariffs which were phased out

The WHD is an effective policy instrument for helping customers who struggle to pay. We consequently advocate an expansion of WHD so all suppliers have to offer it, and for customers to be targeted solely through data-matching with the DWP.

The real challenge in the debate about protection of vulnerable customers is those who are least able, or unable, to engage in the market. The unfortunate reality is that there are no good proxies for this group of customers that suppliers could use to target assistance. Therefore, the best way of addressing the problem is through education and outreach, and ensuring that customers who are unable to engage can delegate authority to manage their energy bills to their family or friends. It is for this reason that we advocate an expansion of the Energy Best Deal service, to the extent that BEIS, Ofgem and Citizens Advice believe it is good value for money.

2. Are there examples of new products, services and business models that would benefit current and future consumers, but are blocked by the current regulatory framework?

We describe below some potential barriers to potential new products, services and business models.

i. Self-certification of licence exempt status as a barrier to a local peer-to-peer (P2P) energy market platform

We believe that there is potential for significant customer participation in P2P platforms. For example, P2P platforms could enable customers to sell their excess generation to their friends and neighbours and incentivise installation of renewable generation and batteries. P2P platforms could help keep prices low, maintain security of supply, decarbonise the energy system and empower and engage local communities.

Currently, for a P2P platform to operate, customer “sellers” on the platform have to self-certify as licence-exempt generators and suppliers. Licence-exemption is the means of these customers selling electricity without becoming a licensed generator and supplier, with associated requirements. We believe that self-certification is a potential barrier to P2P platforms because of the administrative requirement on licence-exempt customers.

Another similar barrier for licence-exempt customers could be what Ofgem describes in its Innovation Link Information Note as “legislative requirements which are based on key customer-facing requirements from the conditions of the electricity supply licence (eg, giving customers contractual information, regular bills and notice of price increases).”

One solution could be to enable the platform to certify on behalf of customers who sell electricity on that platform and for the platform to undertake the other requirements that Ofgem describes. A better, long-term, solution may be modular licensing.

ii. Upper-limits of licence exempt generation as a barrier to a local peer-to-peer energy market platform

Currently, for a customer to participate (i.e. sell electricity) in a P2P platform, they need to operate as a licence exempt generator and supplier (see above). But there is a limit on the amount of electricity that participants can sell and remain in this category.

One solution could be increasing the limit for licence-exemption. However, simply increasing the limit could have knock-on effects on other market participants (e.g. imbalance position of primary supplier). A better, long-term, solution may be modular licensing. The knock-on effects on the imbalance position of the primary supplier could also be mitigated by P379 which is discussed below.

iii. Single supplier per meter point as a potential barrier to multiple suppliers (e.g. one electricity supplier to charge electric vehicle, another for all other consumption)

Currently, there can only be one supplier at any given meter point. This means that a customer cannot enter into multiple contractual relationships for energy supply to any given meter point, at least not without the consent and involvement of their “primary” supplier. The same applies to a customer who wants to buy some of their energy from a P2P platform discussed above, even from an exempt supplier.

Customer demand for multiple energy contracts at a single meter point is yet to be proven. It may be that customers prefer a single supplier relationship because of the relative simplicity.

One solution may be the P379 modification¹⁹. P379 is at an early stage, is very complex and would be challenging to implement.

On the potential for reforms to the supplier hub such as P379, it is important for BEIS and Ofgem to consider the interaction between these and supplier obligations such as WHD, ECO and the Duty to Offer Terms. For example, if there were to be more than one supplier per meter point and WHD and ECO are not funded through general taxation, the question arises about how to maintain a level playing field between all suppliers. It might be that our current proposal for there to be no exemptions from WHD and ECO and a reconciliation mechanism to fairly distribute costs might be transferrable to a world where there is more than one supplier per meter point. But this is just an initial view and it would require further investigation.

iv. Metering rules as a barrier to virtual metering solutions ✕

European metering rules²⁰ specify, amongst other things, that all meters must have a display. However, this is not required on the meter when the display is available elsewhere, such as on a smartphone app.

¹⁹ <https://www.elexon.co.uk/mod-proposal/p379/>

²⁰ https://ec.europa.eu/growth/single-market/european-standards/harmonised-standards/measuring-instruments_en



v. Supplier consent as a potential barrier to aggregators

Some aggregators have suggested that a potential barrier to demand-side response is suppliers having the ability to constrain customers via T&Cs from contracting with third parties (e.g. a contract with a third party to turn their demand up or down).

Project TERRE²¹ will allow aggregators to manage their own imbalance and should remove this issue for them.

vi. Barriers to domestic and non-domestic flexibility

Whilst not explicitly a subject of the consultation, we would like to take this opportunity to repeat points that we have made in other contexts regarding barriers to domestic storage propositions and data release that could help enable flexibility services.

We have sent a paper to BEIS outlining how the removal of fixed consumption levies from larger batteries should also apply to smaller batteries to make the case for domestic flexibility more economic.

We support the swift implementation of the recommendations from the Government's Energy Data Taskforce that will enable flexibility markets and services.

There are a range of other developments in this area in which we are engaged, for example concerning procurement of electricity flexibility services by transmission and distribution network operators. We consider that flexibility markets generally should be a high priority for BEIS and Ofgem.

vii. The Ofgem Innovation Link and beyond

Ofgem has established its Innovation Link²², which it describes as “a ‘one stop shop’ offering support on energy regulation to businesses looking to launch new products, services or business models”. In partnership with Verv, Centrica has engaged with Ofgem's Innovation Link and secured a Regulatory Sandbox for this²³ blockchain peer-to-peer electricity trial. We understand that Ofgem's Innovation Link and Sandbox have enabled a number of innovative products and services, at least on a trial basis. The Sandbox could be improved we believe if Ofgem committed to considering longer-term solutions that might be needed in light of applications and results, so that trial business models had a chance of wider deployment after the trial, if the benefits to consumers outweigh the costs.

3. Are there current or emerging harms to energy consumers which are currently out of scope of the regulatory framework? Do these differ for domestic and non-domestic consumers?

²¹ <https://www.elexon.co.uk/mod-proposal/p344/>

²² <https://www.ofgem.gov.uk/about-us/how-we-engage/innovation-link>

²³ <https://verv.energy/centrica-joins-the-verv-community-energy-blockchain-trial/>

Yes, there are current and emerging *risks* to energy consumers which are currently out of scope of the regulatory framework. We agree with BEIS and Ofgem that levels of protection should be proportionate to the risk posed to consumers. The magnitude of the risks to consumers therefore needs to be understood.

Looking at the risks to domestic consumers first, Price Comparison Websites (PCWs) have been operating in the market for some time under a voluntary regulatory framework called the Confidence Code administered by Ofgem.

We understand that PCWs are increasingly speaking directly to consumers over the phone and face-to-face. We believe that there are greater risks to consumers of selling over the phone and face-to-face compared with on a website or app. PCW behaviours can be less easily monitored and controlled when they interact with customers over the phone or face-to-face, and consumers do not always see the details of what they are being sold in this scenario.

For similar reasons, we consider that brokers in the non-domestic market pose greater risks to consumers than website-only PCWs. Brokers in theory conduct similar activities to PCWs (i.e. compare different offers and take a commission) but operate almost exclusively over the phone.

Auto-switching services are emerging in the domestic market. We believe that auto-switching services pose greater risks to consumers than PCWs. With PCWs, the consumer still compares the options and chooses which if any supplier to switch to. With auto-switching services, the consumer delegates the task of comparison and choice, so there is a greater risk of the auto-switching site making a choice that the consumer does not agree with.

Third-party intermediaries (TPIs) such as auto-switching services, brokers and PCWs often operate across multiple consumer markets such as energy and broadband. Therefore, our current view is that there should be cross-sectoral regulation of TPIs to avoid overlapping or conflicting regulation. The cross-sectoral regime for TPIs could work like the concurrency regime for competition law, with a single rule-making body with multiple enforcers including the sectoral regulators. Careful consideration would need to be given to the question of which body should be the rule-maker; rules could be set out in legislation and/or by a regulator, pre-existing or new. Care would also need to be taken to ensure that all interested parties have clarity in how any new powers are exercised, and on what basis, by the rule-making body and respective enforcers, and how such new powers interact with existing powers and duties.

4. Would it be beneficial to allow suppliers to specialise and provide products and services to targeted groups of customers? If so, how can this be delivered while balancing the need for universal service?

As set out in the covering letter, we do not believe that the Duty to Offer Terms should be removed as long as the DTC is in place because the DTC is constructed in a way that acts as a disincentive to acquire and retain customers who have higher costs-to-serve.

In theory, in a healthy competitive energy retail market all customers should be able to access a variety of offers because suppliers would be able to recover their costs of supply and make a competitive margin from each and every customer.

However, to the extent that suppliers are unable to recover their costs of supply and make a competitive margin for any group of customers, then that group of customers might not be able to access a variety of offers (absent intervention such as the Duty to Offer Terms).

The DTC has reinforced the need for the Duty to Offer Terms because it has been set at a level that does not allow some suppliers to recover their efficient costs and a competitive margin from some customers. For example –

- The extra costs of serving customers who pay by Standard Credit (SC) are partly socialised across customers who pay by Direct Debit (DD).
- Customers in receipt of WHD who pay by SC are charged the DTC at DD levels.
- The operational costs element of the cap is only set to capture the efficient costs of a supplier which has the same proportion of PSR customers as the benchmark supplier.

These choices in setting the DTC penalise suppliers who have above average proportions of SC and PSR customers and penalise *any supplier* who has *any* WHD SC customers. These choices correspondingly reduce incentives on suppliers to serve these groups of customers, hence bolstering the case for the Duty to Offer Terms.

As with the DTC, the case for the Duty to Offer Terms is linked to some options in the consultation for protecting vulnerable customers. For example, if BEIS and Ofgem decided to target an enduring price cap at vulnerable customers using the DTC methodology, then the same methodology would impose an enduring disincentive to serve those customers. This would bolster the case for the Duty to Offer terms, unless Ofgem adjusted the DTC methodology to make it more cost reflective, or the costs were redistributed across all suppliers via a mechanism like that used for the WHD Core Group.

If the DTC was removed entirely and suppliers were able to recoup costs of supply and make a competitive margin from each and every customer, then the case for the Duty to Offer Terms may not be as strong. The question then focuses almost entirely on whether and the extent to which BEIS and Ofgem believe that all suppliers should provide an offering for all customers.

5. Are incremental changes to regulation sufficient to support the energy transition and protect consumers? Or does this require a more fundamental reform, such as moving to modular regulation?

On our reading of the consultation, BEIS and Ofgem put forward three options for regulation to support the energy transition and protect consumers. These are: licensing, general authorisation, and modular regulation.

Fundamentally, these three options do not appear to be *that* different. Under all three options, market participants would have to notify the regulator prior to undertaking any regulated activity. Also, under all three options, regulated parties would have to follow enforceable rules that are relevant to the activity that they undertake.

The main differences between the options appear to be:

- i. Whether there are any ex ante controls on who can operate in the market and the conditions on which they can do so (there are with licensing and modular regulation, and not with general authorisation); and
- ii. The extent to which the enforceable rules are specific to the activity undertaken (more so with general authorisation and modular regulation, and less so with licensing).

If our understanding is correct, then we believe the best option of the three is modular regulation, followed by licensing, followed by general authorisation. We believe that licensing is a better option than general authorisation because it is needed to maintain the market entry requirements

that Ofgem has recently introduced as part of its supplier licensing review. We also believe that licensing better lends itself to “positive” (i.e. must) obligations that energy suppliers have (e.g. to roll out smart meters) and general authorisation better lends itself to “negative” (i.e. must not) obligations that tend to be a feature of general consumer law.

6. Are there any other potential market distortions we should be considering as part of our review?

We believe that it is very important that, as part of its supplier licensing review, Ofgem implements reforms that will make a real difference to consumers by preventing suppliers from operating unduly risky business strategies using customers’ money. We encourage BEIS to feed into the review and encourage Ofgem to implement reforms that make a real difference to consumers.

We attach to this response reports from NERA Economic Consulting and Cornwall Insight that we commissioned as inputs to Ofgem’s supply licensing review. The NERA report considers the merits of different solutions to address moral hazard and adverse selection that exists in today’s retail energy market.

7. Would removing the thresholds for the Energy Company Obligation and Warm Home Discount help remove imbalances in the retail market, and could this be done without significantly increasing barriers to supplier entry or expansion in the retail market?

Yes.

As to how to achieve this, ECO is covered in question 8 below.

WHD should be straightforward. WHD should be provided by all suppliers, with no exceptions, entirely through data matching with the DWP. As with the WHD Core Group today, there should be a reconciliation mechanism to ensure that suppliers pay proportionately to their market share.

In the event that data-matching is delayed, the WHD Industry Initiatives mechanism has been successfully running for many years and would enable small companies to financially contribute to industry programmes that provide energy advice, energy efficiency measures and debt relief for vulnerable and fuel poor households. Furthermore, Ofgem initiated an Industry Initiatives scheme to enable park home residents to receive a £140 payment in the same manner as eligible on-grid households. A solution for small suppliers could be an equivalent programme, funded by and purely for, customers of these organisations.

8. How could the delivery burden on suppliers from the Energy Company Obligation be reduced, for example through the introduction of a buyout mechanism?

There are multiple mechanisms that could be deployed in ECO to remove the delivery burden from small suppliers. The three the options below remove delivery risk from the supplier.

- Trading

Trading was introduced to ECO in April 2017 and used by at least six suppliers in ECO2t, including the three newly obligated suppliers. The active participation of so many suggests that trading can be a competitive market, which ensures competitive prices. We know from our own experience that it is a straightforward price negotiation and legal contract. Such activity should not be complex

or time-consuming, for even for companies unfamiliar with ECO. This solution requires no additional delivery mechanism.

- Buy-out option

A buy-out option would enable small suppliers to make a fair contribution if they chose not to deliver the obligation. From an administrative point of view, this could be as simple as a variant on WHD Industry Initiatives, where small suppliers contribute to existing energy efficiency programmes. The price is fixed in the regulations and the burden on the supplier is an application form and a legal contract.

Beyond a certain funding level, it may be more cost effective to consolidate funds for a complimentary programme that runs alongside ECO. Solid wall insulation or off-grid solutions are two options and could be tendered through auction. This development could test mechanisms to transition away from the current ECO delivery model which we discuss in our response to BEIS' consultation on the Fuel Poverty Strategy.

- Small supplier levy

In the event of new delivery programme(s), the disadvantage of a buy-out is that it provides no certainty on funding. A small supplier levy overcomes this issue.

9. What effect does the range of Energy and Climate Change Policy Levies have on the retail market?

From our perspective, it is the policies that have exemptions for small suppliers that have a material distortive effect on the retail market. These include WHD and ECO, but also include and are not limited to Green Deal, aspects of the smart meter rollout and now the Smart Energy Guarantee (SEG).

For the levies that apply to all suppliers equally, these are less concerning in terms of their impact on competitive dynamics. In some cases they were challenging to initially implement (e.g. EMR supplier obligations) but now they are established they have become part of our Business as Usual (BaU) operations.

More generally, we consider that it is important that all policy levies, to the extent that they are not paid by taxpayers, are as low as possible because of their impacts on energy consumers' bills. Ways of doing this include through harnessing competitive pressures, such as technology-neutral auctions for Contracts for Difference agreements (CfDs).

10. What actions could government take to reduce any negative impact of Energy and Climate Change Policy Levies?

As a starting point, there should be no exemptions for smaller suppliers for any supplier obligation. All supplier obligations should be designed so no exemptions are needed.

There has been some discussion in the context of the Ofgem supply licensing review about some suppliers defaulting on the Renewables Obligation (RO) and those costs being mutualised across suppliers who have not defaulted. We agree that this is an issue. We believe that there are three parts to the solution:

- Ofgem should be faster and firmer in its response to RO default

- Ofgem should implement a new licence condition that requires suppliers to prevent mutualisation of their debts were they to fail. In practice this means that they would need to make provision for their debts such as credit balances (i.e. debts to customers) and RO. The licence condition would provide a list of options that suppliers could use to make provision, such as ringfencing credit balances, Parent Company Guarantees (PCGs) and insurance.
- Ofgem should adjust the price cap methodology to automatically factor in mutualisation costs of the RO and any other obligation where costs can be mutualised. We do not accept the argument that RO mutualisation costs are factored into the headroom component of the cap. As we said in response to Ofgem's September consultation on the default tariff cap²⁴, we consider that the uncertainty component of headroom is already at least £18 per customer too low to meet the requirements of the Tariff Cap Act. This was before taking into account other material unforeseen costs such as the £58.6m industry RO mutualisation costs²⁵.

We understand that one or two suppliers may have suggested that RO payments should be made quarterly rather than annually. We would strongly oppose quarterly RO payments being compulsory for suppliers. Compulsory quarterly payments are not necessary to achieve the objective of avoiding mutualisation; this could be achieved with our proposed licence condition which does not make quarterly payments compulsory. Compulsory quarterly payments would also have a negative cash impact on suppliers that would be unnecessary and disproportionate.

11. Do you agree that now is not the time to make further changes on system and network cost recovery, metering and access to data as part of this retail market review?

Yes

12. What total costs do suppliers face with regards to bad debt and supporting consumers who struggle to pay for their energy?

It is welcome that the consultation cites Ofgem's finding that "the average cost to suppliers of bad debt and the additional administration cost of serving standard credit customers (much of which relates to the costs of handling debt-related issues, phonelines and similar) was equivalent to around £96 for a standard credit customer with typical dual fuel consumption levels in 2017/18"²⁶.

✂

We responded to Ofgem's Request for Information (RFI) used to calculate the average and set the uplift for standard credit as part of the DTC consultation process. We have sent relevant parts of our RFI responses that we sent to Ofgem during consultation on the DTC on to BEIS prior to this consultation.

What the present consultation does *not* say is that some of the extra costs of serving standard credit (SC) customers are incorporated into the Direct Debit (DD) cap. This decision to socialise SC (and therefore bad debt) costs across DD customers penalises those suppliers with higher than average proportions of SC customers, and acts as a disincentive to serve SC customers. As set out in our response to Ofgem's statutory consultation on the DTC and in our email to BEIS on

²⁴ https://www.ofgem.gov.uk/system/files/docs/2018/10/centrica_-_response_2_-_appendices_2-10.pdf

²⁵ <https://www.ofgem.gov.uk/publications-and-updates/ofgem-takes-action-over-payment-shortfall>

²⁶ Ibid, p.32/33

21 May 2019, we estimated that this led to a shortfall in the cap of ₤ to account for suppliers with more SC customers than the benchmark.

BEIS and Ofgem have said that they “are interested in hearing from as many suppliers as possible about whether there is a consistent issue across the market, or whether some suppliers are able to deal with these challenges more efficiently.”²⁷ We believe that it is instructive that some suppliers appear to refuse to serve SC customers altogether, as evidenced in the table immediately below.

| Supplier | Evidence |
|----------------|--|
| Avro Energy | https://www.avroenergy.co.uk/Terms - see definition of “Payment Method” and Section 9 Payment Method, both of which specify that Avro Energy only accepts payment by Direct Debit or PPM |
| Bulb Energy | https://bulb.co.uk/terms/ - paragraphs 3.7, 3.8 and 3.9 of the T&Cs state that customers can only pay by Direct Debit or PPM, even for deemed contracts. Additionally: Paragraph 3.16 states “You must keep your account in credit by paying for the supply in advance by automatic payment, or if you're in debt with us, you agree to not be in debt by more than half of what we've calculated as being your expected annual bill.” Paragraph 3.20.2 states “If you do not make a payment to us on the date it is due we can charge you £15 for each missed payment to cover the administrative costs of recovering outstanding payment.” |
| Octopus Energy | https://octopus.energy/policies/terms-and-conditions/ - Section 9 of the T&Cs states that the requirement is to pay by Direct Debit or PPM only. There is no provision for cash/cheque. Furthermore, Octopus charges £15 for the first missed DD payment and £20 for each missed payment after that. |

13. How could any potential distortions related to high cost-to-serve customers be addressed, for example by the provision of additional support services for customers struggling to afford their energy?

As stated in response to question 1, in principle, an uneven distribution of higher costs-to-serve customers should not contribute to market distortions if suppliers are allowed to set their prices on a cost reflective basis. However, if suppliers are not permitted to recoup higher costs-to-serve where they arise, suppliers with a higher proportion of these customers will be at a competitive disadvantage. As stated in response to questions 4 and 12, we believe that the DTC has created this problem. Suppliers with higher proportions of higher cost-to-serve customers than the benchmark cannot recover their efficiently incurred costs and make a competitive margin, and suppliers with lower proportions than the benchmark can price lower to win customers and/or make a higher margin.

The question asks specifically about “the provision of additional support services for customers struggling to afford their energy”. In principle, we support these services. Many are in existence that help customers today. For example, Citizens Advice Bureau and other charities help clients maximise their income and provide debt advice.

²⁷ Ibid, p.

As to whether there should be *additional* support services, questions include:

- How would they be funded (e.g. taxpayers or energy consumers)? It is worth noting that customers in energy debt are commonly in debt to suppliers of other services.
- How much funding would be provided?
- Could this money be better spent?

We believe that the WHD has been a successful policy tool for helping those who struggle to afford their bills. We advocate a fully data-matched obligation with no exemptions. However, we also believe that there should be help on offer for customers who struggle to engage, so would support an expansion of the Energy Best Deal service if Ofgem and Citizens Advice consider it to be value for money.

The consultation states that BEIS and Ofgem “could also work with industry to explore tools which would facilitate a more equitable distribution of the costs of dealing with the most extreme cases of debt across the market.”²⁸ We consider one such tool in our response to questions 15-17 below.

14. Would addressing market distortions (for example size-based obligation thresholds for some policy schemes, supporting those who are struggling to afford their energy bills) help reduce incentives for suppliers to adopt pricing strategies that lead to excessive prices for loyal consumers? If so, to what extent (providing quantitative evidence, where possible)?

As stated in response to question 1, we do not agree that any of our customers pay or paid “excessive” or “uncompetitive” prices, either now or prior to the implementation of the default price cap.

However, we agree with BEIS and Ofgem that “reforms that minimise market” distortions - such as removing exemptions for WHD and ECO and introducing a new licence condition to prevent suppliers taking undue risks with customers’ money - will help address the issue of unsustainably low acquisition pricing which may have knock-on effects on non-acquisition pricing. We agree with the former GB regulators where they say that “the low tariffs offered by exempt suppliers give a misleading impression of what competitive prices are”²⁹.

We believe that BEIS and Ofgem should already know the quantitative advantage that exempt suppliers have over non-exempt suppliers. BEIS produces cost estimates for ECO and WHD as part of its Impact Assessments (IAs). Ofgem has factored the scheme costs into the DTC.

We published [this paper](#) on 20 November 2017 to set out in simple terms the advantages for exempt suppliers and regressive effects of exemptions. However, the £40 figure in that paper may be out of date because ECO has been reformed since then, new IA(s) produced by BEIS and the updated costs factored into the DTC by Ofgem.

15. What are your views on the measures being considered to address loyalty penalties in different markets? What approach or – combination of approaches – would be most effective in the energy retail market?

²⁸ Ibid, p.33

²⁹ Ibid, p.11

- 16. What other approaches could be adopted to ensure loyalty penalties do not re-emerge?**
- 17. What protections or support may be required to engage consumers in vulnerable situations in the future market?**

From our perspective there is significant overlap between these questions 15-17, so we answer them together.

Our starting point is the challenge that we outline in the covering letter and in response to question 1, which is:

How to strike the right balance between economic efficiency and equality of outcome. Put differently, it is how to ensure that all consumers benefit from competition, and protect the most vulnerable, but without undermining the very competition that incentivises low prices, good service, and innovation. There is an added dimension: the need to decarbonise the energy system at lowest cost, in a fair yet efficient way.

Through this lens we discuss some different versions of the reform options set out on page 38 of the consultation, which we set out - based on BEIS and Ofgem's initial list - as:

- Targeted price interventions, including relative or absolute price caps or rebates (such as the WHD), for example targeted at vulnerable customers
- Principle-based approaches, for example principles set by the regulator "which describe unfair pricing approaches – with compliance demonstrated by ex post monitoring and reporting"
- Collective switching – opt-in and opt-out, including focussed collective switching put forward by Professor Stephen Littlechild

We do not discuss the "use of smart data" or "enforcement of consumer law and sector specific rules" options from page 38 of the consultation. We believe that in these cases there is either insufficient detail to evaluate them properly and/or it is unclear how they would be different to the status quo.

- **Targeted price interventions, including relative or absolute price caps or rebates (such as the WHD), for example targeted at vulnerable customers**

This option only refers to targeted interventions, which implies that BEIS and Ofgem are not seeking views on the DTC, which applies to all customers on default tariffs and is therefore not targeted. We would be happy to reiterate our views on the DTC if BEIS and Ofgem would like us to do so. Our response³⁰ to Ofgem's consultation on Conditions for Effective competition may be relevant to any such inquiries.

Given that a relative price cap: (a) has been actively opposed by Ofgem and Citizens Advice, (b) was criticised by the CMA during the Energy Market Investigation (EMI), and (c) was not adopted by the Government in the Tariff Cap Bill, we do not consider it to be a credible option and do not consider it further in this response.

Which leaves us with "targeted" absolute price caps, or rebates like WHD.

The first question is: "who should be the target group"?

³⁰ https://www.ofgem.gov.uk/system/files/docs/2019/07/centrica_0.pdf

As stated in response to question 1, we believe that a healthy competitive market protects both consumers who engage and choose not to engage. We do not believe that there is a good case for targeting absolute price caps or rebates at consumers who are able to pay and able to engage, but choose not to engage. To do so would reduce or remove their incentives to engage in the market, and in the long run lead to worse outcomes for consumers (as the CMA said the DTC would).

We *do* believe that there is a case for targeting support at customers who struggle to afford their bills or who are unable to engage in the market. However, it is an unfortunate reality that there are no good proxies for customers who are unable to engage. This is why we are advocating an expansion of the Energy Best Deal service, to the extent that BEIS, Ofgem and Citizens Advice consider it to be good value for money.

So we are therefore left with customers who struggle to afford their bills. We believe that the best proxy for this group is those who are on means-tested benefits, in part because they can be targeted by suppliers through data-matching with the DWP.

To reiterate what we said in response to Ofgem's consultation on further extending price protection to vulnerable customers³¹, the Priority Services Register (PSR) is a poor proxy for both customers who struggle to pay and are unable to engage. By definition, customers on the PSR are capable of engagement or have nominees who are able to engage on their behalf. There are also customers on the PSR who have special needs but are well-off. Using PSR customers as the target-group would exacerbate the unlevel playing field because of the significant differences between suppliers as to how many customers are on their respective PSRs. It could also act as a disincentive to acquire and retain these customers and add them to the PSR in the first place. It could also undermine the initial purpose of the PSR.

For further assessment of the potential use of the PSR as proxy, please we refer Ofgem and BEIS to our response to Ofgem's consultation on "Providing financial protection to more vulnerable customers". We responded to that consultation on 31 January 2018. At the time we estimated that British Gas had \times PSR customers that would fall within scope of Ofgem's proposals. Ofgem had estimated that the overall coverage of its proposals would be 2.6 million customers. These two figures show the extent to which using the PSR as proxy would exacerbate the unlevel playing field.

The second question is: "what is better for this target group, an absolute price-cap or a fixed rebate like WHD"?

We believe that the UK Government's rationale in 2010-11 for replacing social tariffs with the Warm Home Discount is as valid today as it was then. Among other things, the Government rightly appreciated that the WHD, as a flat rebate available from all mandated suppliers would retain the incentive for those customers to engage in the market. Since then, the proportion of the supply market that is exempt from providing the WHD has grown significantly. This barrier to engagement can be easily removed by removing exemptions.

We understand that there may be stakeholders who believe that energy affordability issues are so severe that more support than the current WHD is needed. We sympathise with such concerns.

³¹ https://www.ofgem.gov.uk/system/files/docs/2018/03/centrica_-_response_to_ofgem_on_providing_protection_to_more_vulnerable_customers_-_redacted_non-confidential.pdf

If BEIS and Ofgem share these concerns, it would be better to have a “deeper” WHD (i.e. bigger rebate) with no exemptions than a targeted absolute price cap, to maintain WHD customers’ incentives to engage in the market. To ensure effective targeting and that all suppliers pay their fair share, WHD should be fully data-matched with DWP and there would need to be a reconciliation mechanism as there is today.

We do not believe that a targeted absolute price cap compares well with a reformed WHD. First, whatever level an absolute cap is set, we believe that it would reduce customers’ incentives to engage relative to a fixed rebate common to all suppliers.

Another issue is: what level would an absolute cap be set at? One option would be to set it at the same level as the DTC. However, under the DTC methodology there is already a penalty for suppliers with WHD customers who pay by standard credit; they pay DD rates. Also, retaining the DTC even for a targeted group of customers is likely to lead to calls for expanding its scope, which could lead back to the situation we are in today.

We understand that another stakeholder has proposed an absolute price cap for certain customers that is set below cost. We understand that the loss-making element (presumably the delta between the DTC and the level of the loss-making cap), would be recovered by a market-share levy across all suppliers. Benefits of this idea could be (a) that it reinstates or strengthens the incentive to acquire and retain these customers, and (b) that it mitigates against the risk of scope-creep because it is set below cost. However, it would require someone to determine how big the loss-making element should be, what the benchmark is, and how the supplier levy is calculated. These challenges should not be underestimated.

- **Principle-based approaches, for example principles set by the regulator “which describe unfair pricing approaches – with compliance demonstrated by ex post monitoring and reporting”**

As stated in the covering letter, a principles-based approach to pricing for disengaged customers would appear to be the least distortive of the options for intervening on behalf of disengaged customers who are not vulnerable. The virtues of enforceable principles compared to other options include that they can: (i) cater for unequal distributions of customers who have higher costs-to-serve, and (ii) better allow suppliers to differentiate on the basis of service and innovation as well as price.

Below we discuss different illustrative models of principles-based approaches and their respective merits.

The first model – which we describe as the “transparency” model – is where suppliers have to (a) record and (b) upon request, disclose and explain to the regulator how they justify their prices and margins across different customer groups. This model has the benefit of allowing the regulator to understand and challenge suppliers’ pricing decisions. However, this model may be resource intensive for both suppliers and Ofgem, depending on the way in which it is implemented.

The second model – which we describe as the “process” model – is where suppliers have to ensure that their frameworks that govern pricing decisions are subject to rigorous and senior level internal scrutiny. This model has the benefit of giving the regulator confidence that suppliers have carefully considered their pricing frameworks and that senior management can stand behind them without unduly impacting suppliers’ ability to set their own prices. This model would be resource intensive for suppliers but less so for Ofgem than the transparency model.

The third model – which we describe as the “outcome” model – is where suppliers have to ensure that “prices for existing customers must reflect the cost to serve and risk of serving customers plus a reasonable return”, or something to that effect. A key risk with this model is that suppliers and Ofgem do not agree on costs to serve, risk and reasonable return.

- **Opt-out collective switching**

In this section, we describe the problems that apply *only to opt-out* collective switching and *not to opt-in* collective switching. In the next section, we describe some challenges that are common to opt-in and opt-out collective switching. In the next section we also discuss the proposal set out in the recent paper from Stephen Littlechild.

As set out in the covering letter, we believe that opt-out collective switching would have such damaging impacts on the market and consumers’ interests that it should not be considered beyond this consultation.

As the name suggests, with opt-out collective switching customers are switched to a supplier which is not of their choosing, unless they opt-out. We believe that this would go against consumers interests for a number of reasons including:

- a) Customers may not open, read, understand or remember the opt-out notification(s), so from their perspective they were switched against their will. This is likely to cause feelings of confusion, frustration, disempowerment and potentially anger. Related to this, opt-out collective switching would go against the basic principle of contract law, which is entering into agreement by mutual consent.
- b) Customers may not be happy with the new provider that they are switched to, for example because the new provider did not meet the requirements of the auction or customers did not know what to expect.
- c) Forced expropriation of suppliers’ customers could lead to market exits and deter market entry to the extent that it becomes significantly less competitive, particularly in customer service and innovation.
- d) Customers feel that there is “no point” in engaging with the market because they know that they will be automatically switched if they do nothing.
- e) The opt-out switching service could become a state-sponsored competitor to auto-switching services which are already active in the market.
- f) Opt-out collective switching is tantamount to forced customer divestment or expropriation, which are measures currently reserved for the Competition and Markets Authority (CMA) in serious merger and other antitrust cases. It is not a measure that is appropriate for a highly competitive market such as the GB energy retail market, nor one in which there is a price cap.

- **Opt-in collective switching**

There are a number of serious questions regarding the merits of opt-in collective switching, both in terms of how it might impact market dynamics as well as more practical challenges. We describe some of these below. For avoidance of doubt, we mark with an asterisk those that also apply to opt-out collective switching, even to an extent.

- a) *What would be the impacts on customers?

As was seen with the ScottishPower trial, some customers may switch to the winning bidder, and others may switch to a different supplier. Others may decide that they are happy to stay with their current supplier. They may or may not be happy with their choices.

There are a number of questions about the service that customers are offered in the switch, and the service they actually receive. The nature of collective switching is that it values price to the detriment of customer service, with impacts on competition.

- All collective switching auctions that we are aware of have been won on the basis of price. It is assumed that all qualifying bidders have the same customer service. The cheapest bidder then wins. But this misrepresents reality. No two suppliers have the same customer service. Yet from the customer's perspective in the collective switch every bidder had the same customer service. This could lead to customers only considering price, and so suppliers not competing (or competing less) on service.
- What customer service levels do customers being entered into the collective switch need and want? What does this mean for the auction rules? Will Ofgem enforce them? Different groups of customers need and want different standards of customer service (e.g. some want to be able to phone their supplier, others would prefer to use a smartphone app). But even customers within groups have different needs and wants. It also seems impractical to ask customers to read a list of standards in the T&Cs. The risk is that customers could experience detriment if they do not get what they need or want, and they could lose trust in switching if this happens. As to Ofgem enforcement, we have already noted that some suppliers appear to be in breach of the obligation to allow customers to pay by cash or cheque, and likely have been for some time. That does not bode well.

There are other questions about what impact collective switching might have on future customer behaviour beyond those covered immediately above (i.e. price eclipses service as a consideration, risk of detriment and distrust). For example, let's consider a customer who switched to the winning bidder and was happy with their choice. What do they do in the future? To an extent it depends if they expect to be included in another regulator-imposed collective switch. If they do expect to be included in another one, why would they engage with the market in the intervening period? If they do not, or suppliers do not consider them likely to?

b) *What would be the impacts on supplier behaviour?

- As discussed above, competition in collective switching is oriented around price rather than service. Depending on scope, there is therefore a risk that suppliers orient their business models around price, with service seen more as a "tick-box" exercise. This could dampen suppliers' incentives to innovate and differentiate their customer service offering, and also their proposition offering. They might focus just on simple, cheap products and cost cutting.
- If there are customers who expect to be included in intermittent regulator-imposed collective switching and they do not engage in-between, suppliers might not seek to compete as vigorously outside of the collective switches as they do today.
- If there are customers who experience detriment or distrust the switching process, they may be put off engaging in the market in future. This could put off potential new entrants and make it more difficult for suppliers to compete.
- More generally, potential new suppliers might be more reluctant to enter the market if they see the prospect of regulator-imposed collective switching. The investment in customer acquisition might not be worth it.

Overall, considering impacts on supplier behaviour, opt-in collective switching appears to pose a risk of lessening of competition, with reduced innovation and differentiation, reduced market entry, and more focus on intermittent price-based auctions with participants “ticking the customer service box”.

- c) *What would be the costs and benefits of implementation? The administrative costs of collective switching appear to be significant, and the lost revenue to the supplier whose customers are included much more so. In his recent paper, Stephen Littlechild cites the Government’s Cheaper Together policy of encouraging collective switching schemes as having cost nearly twice as much as the benefits secured from switching. He also cites the opt-in collective switch trial that Ofgem imposed in autumn 2018 trial as being estimated to cost the relevant supplier £30 million in lost revenues.
- d) *What would be the scope? It seems obvious that in any event the scope would need to be narrower than all customers on default tariffs. There are around 10 million customers on default tariffs. It would take 25 years to get through these customers if there was one collective switch of 100k customers every quarter.
- e) *When would it start? The DTC is designed to ensure that no customer on default tariffs pays more than the efficient costs of serving them. It is therefore difficult to see how starting opt-in collective switching while the price cap in place is justified. If it is started while the price cap is in place, costs would need to be factored into the cap.
- f) *When does it end? We presume that Ofgem does not want to have this kind of role in the market of facilitating opt-in collective switching on a near-permanent basis.
- g) *Which suppliers’ customers are included, and when? This would need to be done in a fair, reasonable and non-discriminatory way.
- h) *How many customers are included in each tranche? Smaller suppliers may not be able to take on larger groups of customers.

In his recent paper Stephen Littlechild recognised and addressed some questions and challenges with collective switching. Some notable features of the Littlechild model include:

- It is opt-in only, and not opt-out.
- The scope is initially restricted to groups of 10k customers in the WHD Core Group.
- It would be a one-off intervention for each customer included.
- Having been compelled to include their customers in a collective switch auction, a supplier would have the option of selling their customer book rather than proceeding to the collective switch.

We therefore consider the Littlechild model to be the most credible of its kind. However, even this proposal does not fully address any of the questions and challenges listed in a-h immediately above that apply to opt-in collective switching.