



Flexible and Responsive Energy Retail Markets - response form

The consultation is available at: <https://www.gov.uk/government/consultations/flexible-and-responsive-energy-retail-markets>

The closing date for responses is 16 September 2019 at 23.45

As this is a joint review with Ofgem, please return completed form to both email addresses below:

Email to: energyretailmarketsreview@beis.gov.uk and futuresupply@ofgem.gov.uk

If preferred, you may submit your full response by post by using the following addresses:

Write to:

Energy Markets and Affordability Team
Department for Business, Energy and Industrial Strategy
3rd Floor, Area Abbey 1
1 Victoria Street
London
SW1H 0ET

AND

Future Retail Market Design Team
Ofgem
Fourth Floor
10 South Colonnade
Canary Wharf
London
E14 4PU

Any enquiries to:

Email: energyretailmarketsreview@beis.gov.uk

Please be aware that we intend to publish all responses to this consultation.

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes. Please see the consultation document for further information.

If you want information, including personal data, that you provide to be treated as confidential, please explain to us below why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we shall take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

We will process your personal data in accordance with all applicable data protection laws. See our [privacy notice](#)

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Comments: [Click here to enter text.](#)

Questions

Organisation (if applicable): Octopus Energy
Address: 1 Upper James St, Soho, London W1F 9DE

Please check a box from a list of options that best describes you as a respondent. This allows views to be presented by group type.

	Respondent type
<input type="checkbox"/>	Business representative organisation/trade body
<input type="checkbox"/>	Charity or social enterprise
<input type="checkbox"/>	Individual
<input checked="" type="checkbox"/>	Large business (over 250 staff)
<input type="checkbox"/>	Local government
<input type="checkbox"/>	Medium business (50 to 250 staff)
<input type="checkbox"/>	Micro business (up to 9 staff)
<input type="checkbox"/>	Small business (10 to 49 staff)
<input type="checkbox"/>	Other (please describe)

Flexible and Responsive Energy Retail Markets: a consultation response from Octopus Energy

September 2019

Executive Summary

Octopus Energy welcomes the opportunity to respond to the Government's consultation into the future health of our energy retail market. We have sought to answer the questions most pertinent to Octopus Energy and those which we believe we can provide the most solid evidence and add the most value.

Our vision of a future energy retail market is one that drives the transformation of the system to one that is zero carbon, efficient, secure and truly built with customers at its heart.

A healthy energy retail market needs to both bring the benefits of a smart, low carbon energy system and be the key driver of the transition to that system. If a future energy market is to be truly customer-centric, it needs to both reward and empower citizens.

It should be noted that the energy price cap is entirely consistent with this vision, behaving like the National Minimum Wage – it is a minimally interventionist 'decency' limit under which competition thrives and companies are incentivised to keep costs down.

This consultation response sets out key measures that the Government can commit to now to improve the future energy retail market such as:

- Address market distortions against local energy and flexibility
- Keep the energy price cap in place to 2023, or even permanently
- Impose a legal limit on loyalty penalties
- Reform energy price advertising and marketing to bring it in line with the financial sector
- Retain the customer protections embodied by the supplier hub model and block industry attempts to introduce meter splitting
- Adopt 'no customer left behind' approach to vulnerability

About Octopus Energy

Octopus Energy is a British technology business disrupting the energy market to reshape the system around citizens and accelerate the shift to a zero-carbon future. Launched in 2016, our UK energy retail business now has an annual revenue of over £1bn and supplies 1.2m households with 100% renewable electricity and gas on our proprietary digital platform, Kraken.

Since our launch we have redefined what is possible in terms of sustainable, low, transparent prices, outstanding customer service and ground-breaking innovation, winning multiple awards for service to customers and our suite of smart products and tariffs. We are the only Which? recommended energy supplier two years running, were this year named Which? Utility of the year and maintain a 9.6 rating on Trustpilot.

Innovation of the energy retail market

The UK has historically been a world leader in energy system development and, as the digital revolution transforms global markets, we are keen to ensure that this remains a fertile environment for technology-driven disruptive innovation. Britain is home to three tech unicorns in the retail

energy sector alone, and we believe that there is a huge opportunity for this country to demonstrate world leadership as a centre for tech investment and an exporter of digital innovation.

Furthermore, 2019 has been a year of international expansion for Octopus, with our Kraken platform licensed to South Korea-based Hanwha Group in May and due to be launched as a new energy retail offer in Australia in October. We recently acquired the German energy company 4hundred and plan to bring our disruptive power to bear on that market and others globally.

Consultation Response

Question 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?*

We agree that a future energy retail market should enable innovation to bring greater choice and allow customers to take advantage of the flexibility and lower costs of a smarter, low carbon energy system. However, we believe this is only half the picture. The energy retail market needs to both bring the benefits of this smart, low carbon energy system, but also be the key driver of the transition to that system. If a future energy market is to be truly customer-centric, it also needs to both reward and empower citizens.

Octopus Energy's vision of a future energy retail market is one that drives the transformation of the system to one that is zero carbon, efficient, secure and truly built with customers at its heart. This means incentivising consumers to use the cleanest energy (to tackle the climate and air quality crises) that has travelled the shortest distance (to minimise losses) at times of lowest grid congestion (to avoid upgrade costs); and rewarding citizens and communities who contribute power and services to the grid.

For this vision to be realised requires energy retailers to be exposed to strong, dynamic and granular time and locational price signals from the energy system. Retailers will then be incentivised to build strong trusting relationships with customers, drive the smart meter rollout, encourage behaviour change, purchase renewable power from citizens and community energy schemes and advocate for customers all the way down the supply chain.

Retail market-specific regulation should aim to create the competitive market conditions to incentivise:

- Long-term, engaged, trusting relationships between suppliers and all their customers
- Genuine transparency
- Operational efficiency to drive down prices
- Accelerated transition to a zero-carbon, smart energy system

It should be noted that the energy price cap is entirely consistent with this vision. Indeed, our data has shown that it is increasing competition, improving innovation and hastening the transition to a more customer-centric retail market.

Outcomes and Challenges

We have also used this section to respond directly to some of the outcomes and challenges as set out in Section 2 'Overarching Approach' of the consultation document.

Wide choice of energy services

While we agree with the objective that the future energy retail market should support the development of innovative products and services, we disagree that the current retail regulatory framework inhibits this. There are a number of fast growing, efficient and high-quality suppliers which have developed highly specialised and innovative services, fully supported by the existing regulatory framework and indeed by Ofgem itself. Octopus Energy has, for example, launched a dynamic half hourly time of use tariff (Agile Octopus), an EV tariff, smart charging technology, a smart export guarantee (Outgoing Octopus) and many customer service and user experience innovation.

Suppliers who complain that they are not able to develop innovative products are constrained not by regulation but by their own outdated systems, poor customer care and high prices.

Barriers to innovation certainly do exist, but these are the result of outdated network charging frameworks which provide no market incentive for suppliers to innovate smart products and services that reward customers for higher engagement, behaviour change and flexibility.

Minimal market distortions

We agree with the aspirations around policy obligations not distorting competition and involving minimal administrative burden.

In addition, policy makers and regulators should seek to remove the current significant market distortions against flexibility and renewable power.

Competitive prices for all

The energy price cap has already increased competition in the energy market and, if kept in place, will bring down prices for all customers permanently, as suppliers are seeking to regain margins by investing in efficiency and digital transformation programmes. The price cap behaves like the National Minimum Wage – it is a minimally interventionist ‘decency’ limit under which competition thrives and companies are incentivised to keep costs down. Any subsequent regulation should be measured against the price cap for simplicity and effectiveness in addressing the loyalty penalty for all customers.

Ensuring consumers in vulnerable situations receive services they need

Suppliers should put care for their customers at the heart of everything they do. This should include innovating to make life easier and more accessible for customers, striving to reduce bills, and helping them to avoid getting into debt.

Vulnerability is personal and can be transient, and so any strategy that seeks to treat ‘vulnerable customers’ as a distinct segment risks missing customers who don’t fall into the right ‘tick box’ but who do need extra help. It also reduces pressure for suppliers to treat ALL customers with a high degree of care and charge fair, transparent prices across the board.

Retailers should be encouraged to build high quality, long term, trusting relationships so that all customers are treated well, feel comfortable letting retailers know when they need extra help, and the risk of those customers falling into vulnerable situations is reduced.

Question 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?

There are no genuine examples of products, services and business models that would benefit consumers but are blocked by the current retail regulatory framework. Octopus Energy first entered the energy market in 2016 and encountered negligible regulatory burden below 50,000 customers. It is our view that any company that is not able to navigate this minimal barrier and effort is not likely to be able to bring high quality, or even safe, products and services to market.

There are a number of business models that seek to provide flexibility services such as demand side management and response, community energy and aggregation technology – all of which have the potential to benefit consumers to varying degrees. These are blocked by network charging regulation, which does not provide the strong, granular and dynamic time and locational price signals required to provide a route to market for these services. This should be addressed urgently through the various network charging reviews.

In our experience, companies that claim their products or services are being blocked by the retail regulatory framework, and in particular the supplier hub model, are either unaware of the commercial block imposed by the current network charging framework (which would still exist if retail regulations were removed) or are seeking to avoid necessary, appropriate and proportionate customer protections.

Question 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?

The main harm to customers that is currently out of scope of the regulatory framework involve the sale and communication of energy products and services that are carried out by companies not subject to the supplier licensing regime. For example:

- There is no requirement for price comparison websites to offer accessible communications or show truly transparent views of prices that do not only show a 'discount' rate. This means that customers are almost always presented with a 'per year' price that only applies to the first year of a contract, which is highly misleading given that very few customers switch every year. This is much more closely regulated in other markets like financial services, in which the 'default' rate has to be shown in large letters alongside any discount.
- There are no regulations placed on how auto-switchers communicate with and support customers, and they can act as a barrier to necessary communication between suppliers and their customers.
- There have been reported examples of mis-selling of high cost in-home technology such as solar panels that have been marketed on the basis of long-term payback that does not materialise.

We believe that an assurance regime that more closely regulates these activities, like that run by the FCA, would both offer greater protections to consumers and have the advantage of harmonising regulation across the multiple sectors in which many of these companies operate.

Question 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?

Suppliers are already able to specialise and provide products and services to targeted groups of customers under the existing universal service obligation, and we do not consider these things to be in tension. Just a few examples include:

- **‘Agile Octopus’** - this product is targeted at customers who have smart in-home technology or are able to change their behaviour to consume electricity out of peak and when there is more renewable power on the grid. This is a smart meter-enabled half hourly dynamic time of use tariff that reflects grid prices, for which 48 prices are published the day before and also made accessible to third party smart technology via an open API. When wholesale prices go negative, so do Agile prices, meaning that customers can get paid to consume energy¹. Some of its functions include:
 - Electric vehicle cable company Ohme has partnered with Octopus to enable EV customers to automatically charge their vehicles when prices are cheapest via the open API².
 - Customers with products such as Tado, Hive and Nest can automatically optimise their household energy use to Agile prices via our partnership with If This Then That.³
 - Customers of Amazon’s Alexa are able to ask Alexa what prices are at certain times of day and instruct Alexa to run appliances when prices are cheapest, or greenest⁴.
- **‘Octopus Go’** - a smart meter-enabled static time of use tariff targeted at electric vehicle drivers. Between the hours of 12:30 and 4:30am prices are set at 5p per kWh, which can equate to around 1p per mile⁵.
- **‘Outgoing Octopus’** - **this product** was launched on the day the Feed in Tariff (FiT) closed and pays customers to export electricity to the grid. The product comes in two tailored options:
 1. Outgoing Fixed guarantees 5.5p per kWh for every unit customers export. This is higher than the export rate under the FiT and is targeted at customers with solar panels who want to get paid for the power they don’t consume themselves.
 2. Outgoing Agile matches half-hourly prices with day-ahead wholesale rates, and so varies dynamically with market prices. This product is targeted at customers who have solar panels and another form of flexibility such as battery storage, allowing them to store power from their solar panels and sell it back to the grid for a higher price when there is high demand.

While in theory all of these products and services are available to anyone, in practice their highly specialised nature and the fact that they are carefully marketed means that we are easily able to target them only at customers, or potential customers, we believe would benefit from them. We

¹ <https://octopus.energy/static/consumer/documents/agile-report.pdf>

² <https://www.ohme-ev.com/>

³ https://ifttt.com/agile_octopus

⁴ <https://octopus.energy/blog/alexa/>

⁵ <https://octopus.energy/blog/ev-tariffs/>

also have many more examples both on the market and in development, which we would be happy to discuss with you in more detail.

Question 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?

While a modular regime might be appealing in theory, we do not believe it is necessary or proportionate to achieve the required reforms and warn that the disruption and risk of unintended consequences would outweigh any potential benefits.

We agree that some incremental reforms, particularly around ensuring consistent consumer protections, would be welcome. However, it has been our experience that the greatest barrier to innovation does not come from retail market regulation but from other areas, particularly network charging arrangements, which are blocking access to market for digital energy products and flexibility services. We believe that there are key areas that focused on in order to deliver this which we have set out below.

Enabling innovation

We are deeply concerned by the efforts of industry parties to address supposed barriers to innovation through industry code arrangements. In particular, the industry-led code modification seeking to enable industry systems to support the splitting of energy volumes at a single meter is alarming from the perspective of customer protection and could fundamentally distort and undermine competition in the industry. The fact that such far-reaching and disruptive reforms are being pushed through by organisations which have no accountability to consumers or citizens, nor any track record in customer service and protection, offers compelling evidence to support the view that responsibility for code administration should be removed from industry and brought under the remit of Ofgem.

Enabling incremental innovation through derogations

We agree that derogations are useful in supporting innovation when a supplier's plans are blocked by a very narrow and specific issue and should proceed on a case-by-case basis.

Supporting local innovation through geographic licenses

We do not see any reason to make more use of Ofgem's power to grant supply licenses that are limited to specific geographic areas. The main barrier to innovation locally is the scarcity of locational price signals under the network charging regime. Currently there is very little difference in price for a supplier to procure energy that is generated 1 mile away from a customer vs 100 miles away – in spite of the losses that are incurred by the system over that distance. This means that there is very little incentive to support local generation. In an ideal system, buying electricity generated by solar panels on the roof of your local school should cost much less than buying it from the national grid, thus increasing system efficiency and supporting local communities to benefit from the transition to a low carbon grid. We strongly urge BEIS and Ofgem to reflect the value of local, decentralised energy by:

1. Lowering the policy cost burden on energy generated locally
2. Reforming network charging so that energy procured locally is subject to negligible grid costs.

Octopus Energy has already had great success building local brands and innovation, and we intend to continue to build on this unhindered by existing retail regulation.

For example:

- Our Leicester Business Power⁶ tariff has been a runaway success, and now serves 250 businesses in Leicester with locally generated renewable energy. Its branding was designed by local schoolchildren and for every new business that joins we plant a tree and donate £25 to a local charity, creating strong community links and encouraging local engagement in energy and environment.
- Octopus and Co-op Energy have recently announced a joint venture to develop the community-generated energy market in the UK⁷. The joint venture will invest in projects, provide practical support to community groups and increase the volume of energy purchased from community schemes.

We also note that white label and co-brand arrangements are ideally suited to business models that offer local energy products and services.

Delivering universal service in the future

The Universal Service Obligation as it currently stands is a gold standard in consumer protection and should continue as it is. As stated elsewhere in this consultation, there are no meaningful barriers to local energy business models or innovative products and services from the current retail regulatory framework. Any barriers can almost exclusively be found in the network charging regime, which urgently needs to be overhauled to incentivise flexibility and local generation.

Customer protection

A cross-sectoral regulatory regime for third party intermediaries to reflect the greater role these firms play is urgently needed to improve protections for consumers and move towards a more competitive future market.

We would need to see more detail regarding the ‘relevant set of rules’, but of the two options outlined the authorisation regime alongside the supply licence looks the most sensible. We suggest that Ofgem seek to align this regime with the financial services sector as many of these companies operate across multi-sector markets.

In particular, rules should be tightened around how prices are presented by any party – including suppliers - involved in the marketing and sale of energy:

- The default view on a price comparison website should be reflective of the length of time a typical customer stays with a supplier – around three years.
- Companies should be banned from characterising one-year discounts as a ‘per year’ price.
- Wherever the first-year discount rate is displayed, a representative default/SVT price should be displayed in equal or greater size.

⁶ <https://octopus.energy/business/leicester/>

⁷ <https://octopus.energy/blog/coop-energy-partnership/>

Question 6: Are there any other potential market distortions we should be considering as part of our views?

We believe there are three additional market distortions:

- 1) **Weak temporal price signals** - distortions against flexibility should be removed urgently by exposing suppliers to the greatest possible extent to strong, granular, dynamic temporal price signals. Currently suppliers are not incentivised to encourage their customers to use electricity at times when there is less congestion on the grid, which in turn leads to higher upgrade costs that are borne by all consumers.

This means that, for example, people who are elderly or unemployed who may wish to benefit from shifting their time of use are not able to do so and must instead bear the costs of those who choose to run their tumble dryers or charge their electric vehicles at busy times. In turn this distorts the market against businesses that wish to provide flexible technology and services, such as aggregators and heat pump providers. It blocks the route to market for innovative products and business models and slowing the transformation of the energy system to one that is smart, flexible and zero carbon.

- 2) **Weak locational price signals** - distortions against locally generated power should be removed urgently by exposing suppliers to the greatest possible extent to locational price signals. In an ideal system, buying electricity generated by solar panels on the roof of your local school should cost much less than buying it from the national grid, thus increasing system efficiency and supporting local communities to benefit from the transition to a low carbon grid. We strongly urge BEIS and Ofgem to reflect the value of local, decentralised energy by lowering the policy cost burden on energy generated locally; and reforming network charging so that energy procured locally is subject to negligible grid costs.
- 3) **Policy costs levied on electricity rather than gas** - as we seek to decarbonise the UK's energy supply it is less and less justifiable to load all policy costs onto the electricity section of an energy bill, which in effect acts as a fossil fuel subsidy. This practice is also highly punitive for consumers who are not able to access the gas grid – often the rural fuel poor – who are then doubly penalised.

Question 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?

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

Ofgem's reforms to the retail market within the past decade have been extremely successful in removing barriers to entry for new suppliers, as Octopus Energy's own experience has shown.

We believe that the thresholds for the Energy Company Obligation and Warm Home Discount are no longer necessary and removing them would help remove imbalances in the retail market so long as the administrative burden of implementing them could be reduced.

This would immediately reduce barriers to expansion in the retail market by removing the 'cliff edge' suppliers face as they reach the threshold and could be done without significantly increasing barriers to supplier entry through the introduction of a buyout mechanism.

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

Question 10: What actions could Government take to reduce any negative impact of Energy and Climate Change Policy Levies?

The main impact of energy and climate change policy levies is the distortion against flexibility as a result of a large (and growing) element of fixed costs per kWh levied on suppliers and necessarily passed through to customers.

To achieve a smart, flexible energy market that delivers innovative products for customers, reduces system costs and accelerates decarbonisation, requires suppliers to be exposed to granular time of use (TOU) price signals that are as strong and responsive to the system (dynamic) as possible. This will incentivise suppliers to encourage behaviour change and better balance variable (renewable) supply with demand and will create a route to market for the digital technologies that will enable this behaviour change and demand response to be automated and optimised.

The chart below demonstrates this issue. Only Balancing Services Use of System charges are levied on a dynamic TOU basis. In all, unit costs levied upon suppliers that cannot be mitigated by behaviour change or smart technology make up around a third of customer bills.

Furthermore, the direction of travel according to Ofgem's Targeted Charging Review and the Government's likely Regulated Asset Base funding model for new nuclear power is for more of these fixed costs to be piled on to customer bills. This further reduces the opportunity for retailers, technologies and customers to benefit from and accelerate the decarbonisation and digitisation of the energy system.

Unit rate policy levies		
Fixed	TOU	
CfD	Static	Dynamic
RO	TNUoS (but becoming more fixed)	BSUoS
FiT	DUoS (but becoming more fixed)	
Nuclear RAB (likely)	Capacity Market	

To reduce these negative impacts we propose that the Government:

1. Examine Ofgem's network charging review to ensure it is consistent with the aspirations set out in the Smart Systems and Flexibility plan, and with subsequent Net Zero legislation. These reviews should seek to vastly reduce the residual (fixed) element of charging and create incentives to generate and consume energy locally by allowing charges to be reduced or avoided when energy is consumed close to supply.

2. Transfer as many fixed costs as possible to general taxation – ECO, WHD, RO, FiT and RAB are all good candidates for this. This would also be a far more progressive way of collecting these costs.

Question 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?

Network cost recovery regulation poses the greatest barrier to retail market innovation and should be addressed urgently and with the highest priority placed on enabling customers – both directly and via reduced system costs – to take the greatest possible advantage of flexibility.

We urge government and Ofgem to prioritise this work over the vast majority of proposed retail market regulation reform, as it is likely to fundamentally transform the retail market and so will render many retail market interventions redundant – and potentially require new ones.

Question 12: What total costs do suppliers face with regards to bad debt and supporting customers who struggle to pay for their energy

Question 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?

The discussion around how to deal with bad debt and manage distortions relating to high cost-to-serve customers is an interesting one. While we recognise the challenges faced by the larger suppliers who have adopted inefficient processes to service such customers, we do not believe this is compounded by the price cap as they claim. In the context of this section, we are using the price cap level simply to illustrate an industry standard as it is an independent level set by Ofgem.

We understand that the high cost-to-serve these customers by the larger suppliers is as a result of poor customer service and inefficient business practices. Therefore, any push for the removal of any price-based intervention in the market on the basis of claimed distortion relating to the relative proportions of 'high cost to serve' customers and levels of bad debt between challenger and incumbent suppliers is unfounded.

Much of the rationale behind this argument rests on the differences between suppliers in the number of customers with someone in their household listed on that supplier's Priority Services Register (PSR)⁸. Ofgem's figures show that the incumbent suppliers (previously known as the 'Big Six') have around 25% of households listed on their PSR, while - for example - Octopus Energy has around 7% of customers on its list. Further, it is our understanding that bad debt levels for the 'Big Six' currently sit around 3% while our level is around 1.5-2%. In actual fact, if you take a look across a full portfolio of customers there are a number of reasons why incumbent suppliers should be a lower cost-to-serve than newer energy suppliers. From a straightforward analysis of our own data we are able to make the following assertions:

1. Big Six customers should be lower cost to serve than Octopus Energy customers
2. Octopus has proven it is possible to reduce the cost-to-serve of Big Six customers

⁸ In order to conduct this exercise, we have set aside concerns around the workability of PSRs as they are not comparable between suppliers as each company manages its own; and the longer a supplier has been in business the more customers it will recruit to its PSR as it will have more interactions with them; even when customers no longer require PSR support they remain on the supplier's register as this data is rarely, if ever cleansed.

3. There are things that can be done to reduce the volume of bad debt and keep cost-to-serve well below price cap levels

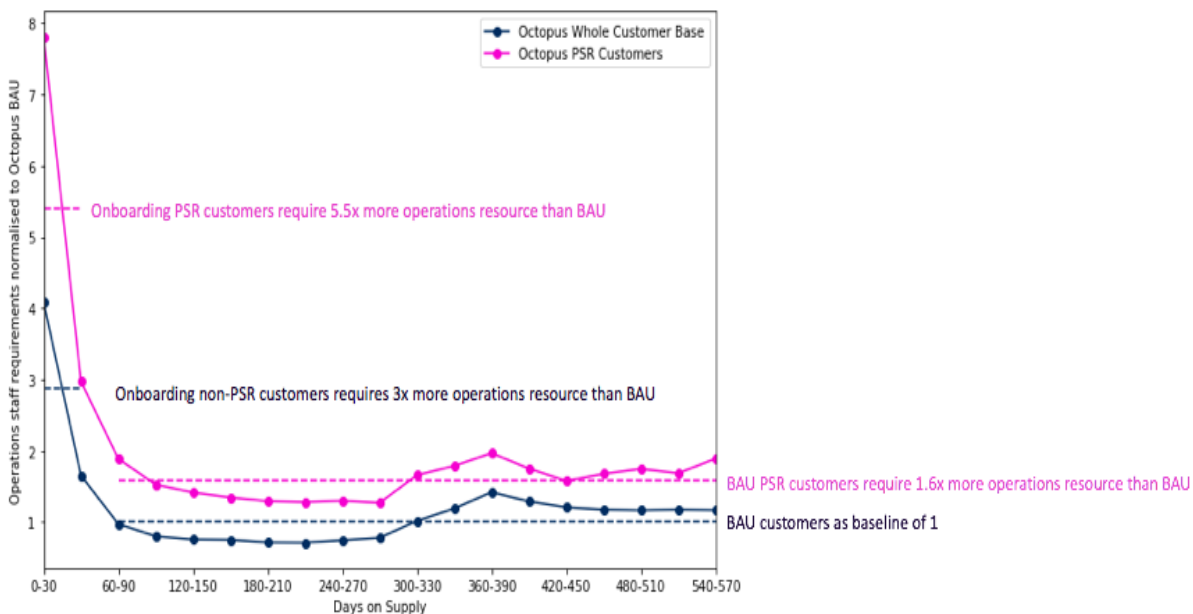
1. 'Big Six'⁹ customers should be lower cost to serve than Octopus Energy customers

In order to establish a true picture of what level high cost-to-serve customers should actually be, we thought it worth examining the assumptions inherent in Questions 12 and 13 - that 'disparities in PSR numbers and levels of bad debt lead to distortions in reported 'cost-to-serve' between suppliers that cannot be addressed by supplier behaviour'.

To do this, we must analyse cost-to-serve across a whole portfolio, taking into account the full spread of customer segments, and not solely focus on individual segments that tell a convenient narrative. When we looked at Octopus data, we can see that customers on the PSR do cost more to serve than our other customers - around 1.6 times more. But this is not the full story. Our analysis also shows that PSR customers are by no means our highest cost-to-serve customers. In actual fact, we can see that cost-to-serve is highest with customers that are in their first two months of acquisition.

As you will see from the graph below the cost to serve new customers is 3 times the operational cost of the average customer in the first 60 days. This is because customers, including those on the PSR register, are most likely to get in contact with their supplier during the relatively disruptive switch process - to set up accounts, give meter readings, adjust payment schedules etc.

Operational cost-to-serve Octopus new customers and PSR customers (0-60 days and beyond)



As a newer energy company, Octopus has acquired all its customers since 2016. Therefore, 15% of our customers currently sit within the definition of 'new customers' - as in they have been customers for less than 60 days and they cost 3 times as much to serve as the average customer as previously mentioned. Despite established PSR customers requiring 1.6 times more resource

⁹ We are referring to the 'Big Six' as a shorthand for the large incumbent energy suppliers that have dominated the market since privatisation and before 12 September 2019 when Ovo took over SSE.

that the general customer base, the volume of new customers and PSR customers overall means that we have a higher cost-to-serve across our portfolio than the 'Big Six' incumbent suppliers.

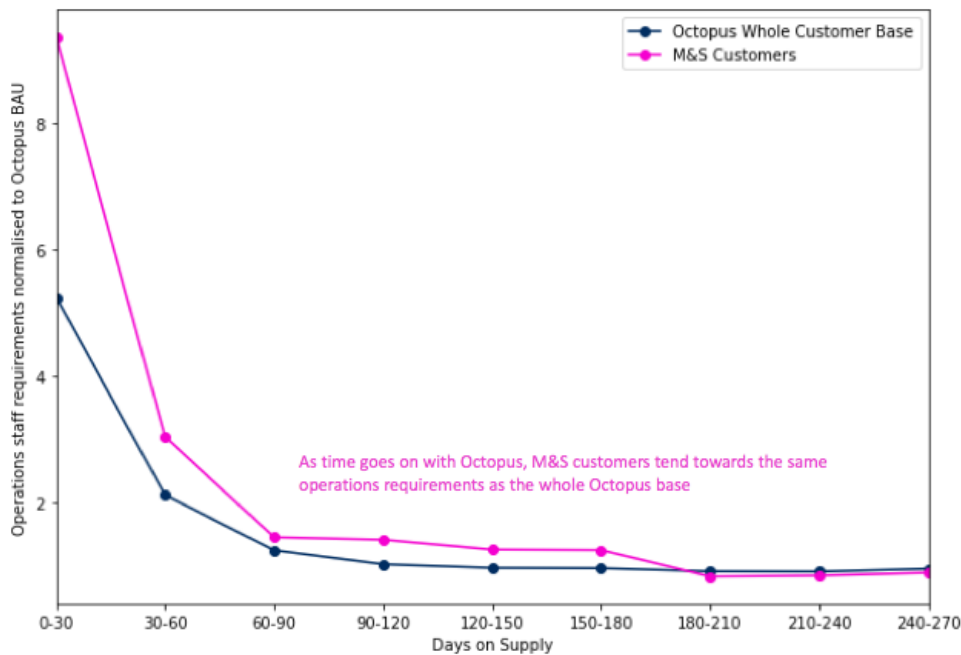
Segment	Proportion of Big 6 Customer Base	Proportion of Octopus Customer Base
Stable PSR	25%	7%
Stable Non PSR	72%	78%
Acquisition PSR	0.8%	1.1%
Acquisition non-PSR	2.3%	14.0%
Weighted	0.160	0.177

A weighted average of Big Six vs Octopus customer portfolios demonstrates that Octopus should face roughly the same cost to serve as the Big Six if not slightly higher. This is clearly not the case. Despite our customer base being 15% new customers, we still manage to achieve a lower cost to serve over time across our full portfolio than other energy companies. In fact, our cost-to-serve is a third of the level of the price cap standard as set by Ofgem.

2) Octopus has proven it is possible to reduce the cost-to-serve of Big Six customers

We also know it is possible to migrate customers from their previous supplier and lower cost-to-serve in the process. We evidence this from our recent experience moving M&S Energy customers into the Octopus portfolio, in which the cost to serve customers formerly served by a 'Big Six' supplier reduced within 6 months to fall in line with the rest of our customer base. This is because we effectively transitioned customers onto a more efficient digital platform and treat them better, resolving their issues quickly when they get in touch. M&S Energy customer satisfaction has increased from 1.7 under their previous supplier to 9.5 under Octopus Energy according to Trustpilot.

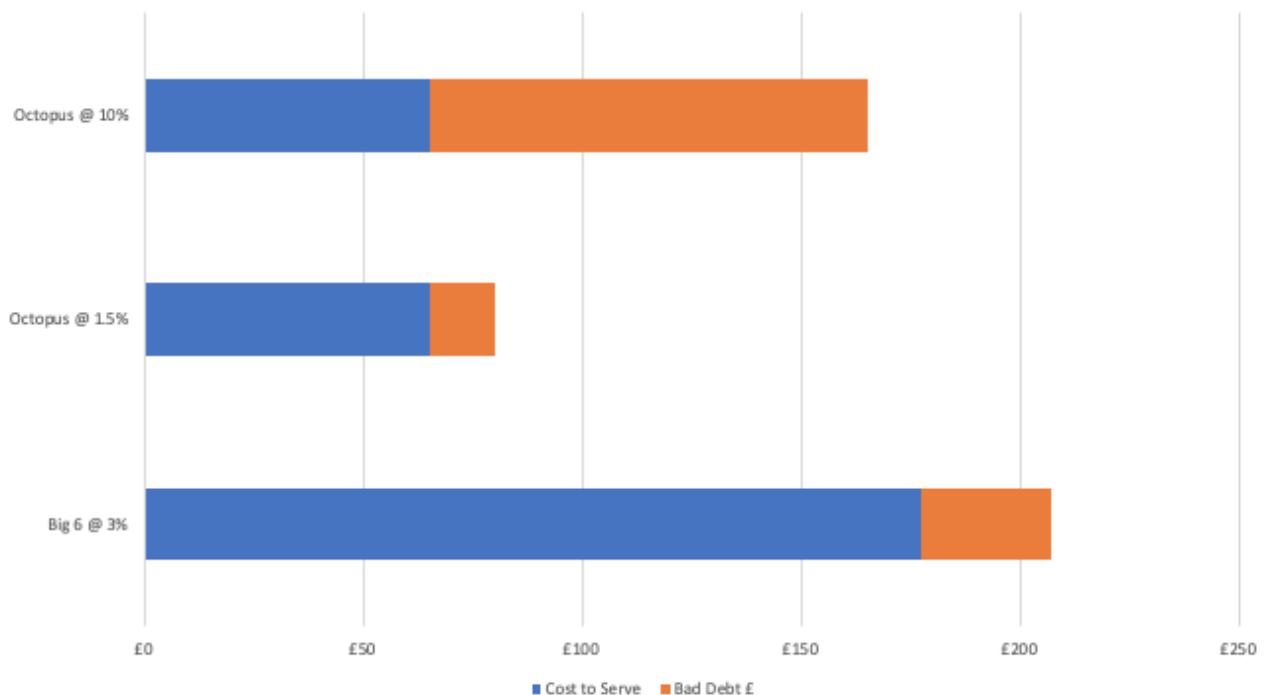
Operational requirements to onboard M&S customers over time



3) This remains true when considering relative exposure to bad debt

To test whether the different levels of exposure to bad debt might make a difference between the relative cost to serve of Octopus Energy and incumbent suppliers, we compared the Octopus cost to serve with that of the energy price cap (which incumbent suppliers are claiming is a low rate of comparison).

The cost to serve is shown in blue, with bad debt levels added in orange - at 3% for the Big Six. By comparison, even at an *extreme* hypothetical 10% level of bad debt, Octopus would still be dramatically lower cost to serve than the Big Six.



It is worth noting that bad debt is already provisioned for in price cap payment adjustments.

Reducing bad debt

We don't believe you can't do anything to tackle bad debt. Much like cost-to-serve, we firmly believe it is possible to reduce the impact of bad debt by helping customers to avoid falling into debt and managing it when it does occur by taking the following steps:

1. **Build trust with all customers** by being open, honest and transparent in all interactions so that customers are receptive to conversations about debt and more likely to follow a supplier's recommendations. Octopus Energy has a 9.6 rating on Trustpilot and our customers have demonstrated that they trust our recommendations to them and are comfortable getting in touch with us when they need extra help.
2. **Prevent customers from falling into debt** by ensuring that they are paying the right amount for their consumption early on and encouraging them to move onto safer payment options (ie fixed direct debit) if possible. This means having a very clear sign up process combined with making it easy, convenient and desirable for customers to provide meter readings. When customers submit a meter reading to Octopus via any method (online, over the phone or via a smart meter) they are eligible to spin our 'wheel of fortune' to win cash prizes.
3. **Review payment adequacy regularly** to identify customers that are at risk of falling into debt. Octopus runs payment adequacy continuously, meaning all accounts are reviewed at least once every three months. Customers who are deemed to be at low risk can be encouraged to manage their own accounts, allowing customers deemed to be at high risk to receive personal attention. Our Kraken Technology does this for all our customers.
4. **Identify debt early.** This can prevent the problem from getting unmanageable – once debt reaches a certain level customers can feel helpless to do anything about it.
5. **Manage the problem compassionately.** Customers can be helped to manage their use better through help with energy efficiency, and a portion of debt can be written off to make the overall amount less intimidating and increase the chances of some of it being paid back.

Further data and analysis

If either Government or Ofgem would like to explore this topic in more detail, we have many more rich sources of data we would be very happy to make available. However, we urge policymakers and regulators to avoid falling into the trap of fixating on customer segments and instead focus efforts on increasing market pressure on energy companies to invest in efficient digital technology, improve customer service and reduce cost-to-serve for all customers.

Question 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)?*

Question 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?*

Question 16: What other approaches could be adopted to ensure loyalty penalties do not re-emerge?

The only market distortion that incentivises pricing strategies that lead to high loyalty penalties is the historic pursuit of these pricing strategies by oligopolistic energy suppliers. The tendency of these suppliers to encourage and exploit customer disengagement through poor customer service and opaque pricing, combined with their large inherited market share following privatisation, has created a race to the bottom.

Rather than seeking to drive down costs through efficiency improvements and technology innovation, these companies chose, over the course of two decades, to systematically exploit their long-term customers, allowing them to attract new customers with misleading fixed-term 'deals' that hid their inefficiencies by employing 'tease and squeeze' pricing tactics to recoup below-cost tariffs after the first year.

This made it extremely difficult for any new company entering the market to acquire new customers by offering genuinely good value tariffs, as they were forced to compete with businesses operating at scale and pricing below cost.

An intermediary market sprang up to profit from this 'tease and squeeze' pricing dynamic by fetishising switching as a way to game the system, advertising first year discounts as 'per year' prices. However, this increased churn did little to benefit customers as almost none switched every year, and the large energy companies were able to optimise their pricing strategies around renewal windows. Moreover, these intermediaries added to bills overall by driving up marketing costs and exacerbating loyalty penalties as companies competed to be at the top of the tables.

Markets that force customers to shop around to avoid high prices, rather than incentivising retailers drive costs down and service levels up, result in excessive consumer prices and high levels of dissatisfaction and disengagement. A healthy retail market in which competition genuinely drives down costs should harness the behaviour of engaged customers to the benefit of all customers – as happens in well-functioning retail markets, like groceries.

This could be achieved by all, or any combination, of the following methods:

- 1. Keeping the energy price cap in place beyond 2023** - the energy price cap is succeeding in reducing loyalty penalties, increasing competition and stimulating investment in productivity and efficiency. Much like the National Minimum Wage, the energy price cap is a 'decency' limit under which competition thrives. So long as suppliers are consistently pricing their default tariffs at or very near the level of the cap, it should remain in place. Once suppliers have invested in productivity sufficiently to price their default tariffs below the level of the cap, there should be no reason to remove it.
- 2. Imposing a legal limit on loyalty penalties** - another possibility would be to impose a legal limit on first year 'discounts' in order to increase price transparency and directly address loyalty penalty strategies. On any given day, within any given region, the price a supplier quotes to a customer should not represent more than a (for example) 6% discount from its default tariff for a customer in the same region on the same product. This would allow suppliers to set their prices wherever they liked but allow disengaged customers to benefit from the market power of engaged customers, driving down prices for everyone.
- 3. Reforming energy price advertising and marketing** - Rules should be tightened around how prices are presented by any party – including suppliers and price comparison sites - involved in the marketing and sale of energy:

- The default view on a price comparison website should be reflective of the length of time a typical customer stays with a supplier – around three years.
- Companies should be banned from characterising one-year discounts as a ‘per year’ price.
- Wherever the first-year discount rate is displayed, a representative default/SVT price should be displayed in equal or greater size.

Question 17: What protections or support may be required to engage consumers in vulnerable situations in the future market?

Customers in vulnerable situations often suffer double harm in the current energy market. First, they are likely to suffer more when subjected to impersonal and uncaring service that does not put customers first or treat them as human beings. Second, they are less likely to be able to put in the time and work often required to go into battle with their suppliers or the marketplace to find a deal which will likely only give them respite from high prices for one year, and so end up paying more.

However tempting it may be to seek to target retail market reforms to customers in certain vulnerable situations, this approach should be avoided for four reasons:

1. Any approach that attempts to identify customers within vulnerable situations through market segmentation will inevitably miss some people who really need help and include some people who do not.
2. Vulnerability is often transient. There is no way of identifying in advance a person who suddenly loses their job, or suffers the death of a close family member, for example. Attempting to identify customers by ‘inherent’ characteristics will always miss these people.
3. Any approach that allows supplier to focus their customer service efforts on customers who they identify as vulnerable can act as a fig leaf that allows them to get away with treating the rest of their customers badly. In turn this can contribute to vulnerability, as customers who find themselves in difficult situations do not trust their suppliers enough to talk to them about it – or simply can’t get through.
4. Any approach to marketing to that defines specific targeted services for customer segments is only suited to suppliers who have access to this information about customers. It misses the barriers to engagement associated with the marketing and sale of products by third party intermediaries. So this needs careful consideration.

Instead, government and regulators should take a ‘no person left behind’ approach. Rather than seeking to force customers in vulnerable situations to engage in the market to avoid high prices and inconsiderate service, the future retail market should seek to harness the behaviour of engaged customers for the benefit of all customers.

On price, we believe the approaches outlined in our answer to Question 16 will achieve this.

On service, companies should be measured on the basis of ‘behaviours’ rather than ‘programmes’. Day-to-day operations and service to all customers should be tested against defined vulnerabilities – including physical disabilities, mental ill health, learning difficulties, neurodiversities - and scored, with compliance demonstrated through reporting. This approach can be applied to an authorisation regime alongside the supply licence for third party intermediaries.