

Statutory consultation on potential short-term interventions to address risks to consumers from market volatility

We welcome the in-depth review that Ofgem are undertaking (across a number of consultations) to support the stabilisation of the retail energy market should there be prolonged wholesale volatility. Suppliers have been significantly impacted by the cost of hedging for a high number of new SVT customers through the autumn of 2021 and this has partly contributed to the recent spate of supplier exits. The best approach to addressing this risk is through reform of the price cap methodology and measures to encourage stronger retailer financial resilience. Nonetheless, we accept it will take time to implement these measures and we support Ofgem considering a range of short term interventions to stabilise the retail market if there continues to be wholesale price volatility over the spring and summer of this year.

In summary, our view of the statutory consultation is as follows:

- There is justification for Ofgem giving itself additional tools as temporary measures only, as long as these are proportionate to the risk, and the impact on fair competition is properly considered. The design and introduction of temporary measures must not distract from the important work to make sure the price cap changes are successful in reducing the wholesale volatility risk on retailers (and therefore customers) and to ensure measures to strengthen financial resilience provide an enduring solution which avoids the need for further market interventions.
- A ban on acquisition-only tariffs would be proportionate and low regrets in terms of its impact on competition¹. It is arguably a measure Ofgem should be considering as an enduring feature of the regulatory framework, given that unfavourable treatment of loyal customers has brought the industry into disrepute and other sectors such as financial services have moved in this direction. More thought is required on how Ofgem can close loopholes (e.g. supplier ability to hide competitive deals from its

¹ Although we note there are some unintended consequences associated with the drafting of the licence in that it would prevent retailers from offering special tariffs for existing customers coming to the end of their fixed term deal.

existing customers) and enforce this ban. Ofgem may need to issue guidance to ensure this measure is effective.

- There is no instance in which it is in customer interests to apply exit fees to SVT customers. This will have a disproportionate impact on customer switching. If Ofgem believes that retail market stability cannot be achieved through the ban on acquisition-only tariffs, there are alternative measures which could be taken which will not be as detrimental to customer engagement or disproportionately impacting vulnerable customers. Exit fees should not be introduced in any circumstances.
- If there is extreme wholesale market volatility it may be proportionate for Ofgem to stabilise the retail market by requiring gaining retailers to pay a fee to losing retailers. But we would see this as a last resort measure, activated only in highly volatile wholesale conditions and recognising that there are many other factors at play which will dampen the tendency for most retailers to provide low priced FTC tariffs, especially if they are required to offer these tariffs to existing customers. This measure also needs to be practical. More work is needed to consider how it can be designed to avoid disputes between retailers and erroneous transfers, and the implications of its introduction at the same time as faster, more reliable switching (FMRS) goes live. If Ofgem plans to introduce this intervention we ask that there is a proper consultation over the trigger point for activating fees and the sharing factors that determine the size of the fee.

Question 1: Have we correctly identified and assessed the risks to consumers from continued wholesale market volatility?

We agree that Ofgem have correctly identified the nature of the risks to consumers. We have not done our own impact assessment, nor has time allowed us to conduct a thorough review of Ofgem's. However, it is possible that Ofgem has overestimated the scale and likelihood of the impact of wholesale price volatility on the retail market. As Ofgem considers which measures would be proportionate, it is important to consider the following:

Assessing the SOLR costs in different wholesale scenarios

In a falling wholesale market SOLR companies are less likely to need to draw on the industry levy because the cost of serving new customers will be lower than the price cap.

Impact of other in progress Actions

We agree that in a rapid falling wholesale scenario there is a risk that some retailers could lose market share at scale which may trigger further exits. However, parallel work streams should also be reducing these risks. Ofgem's action plan on financial resilience² is designed to ensure suppliers have stress tested a variety of possible shocks to ensure resilience and enable Ofgem oversight of risks. It is not unreasonable to expect these to have an early impact (if they have not done so already) in how businesses are run and capitalised.

Impact of already live Decisions

There is a natural disincentive on retailers with a large, hedged SVT book to price low in the acquisition market, for fear of cannibalising their own book. Ofgem needs to give more heed to this inbuilt disincentive when considering the proportionality of its actions. One source of potential instability is from companies without a significant SVT book (i.e. relatively new entrant retailers) and this risk has been reduced (though not eradicated) through other measures Ofgem has introduced (e.g. the delay on approving new licences).

Question 2: Do you believe that intervention is warranted in the interests of consumers

Yes, providing Ofgem can ensure the measures are proportionate, have sought to minimise the impact on fair competition, and do not impact or distract industry from the development of enduring solutions (see our response to the Adapting the price cap methodology for resilience in volatile markets and the Call for Input on Ofgem's Action plan on retail financial resilience).

Question 3: Which of these possible interventions, if any, would be most effective and proportionate in addressing the risks identified in consumers' interests?

The first option, the requirement to make all new tariffs available to new and existing customers. There are steps Ofgem must take at pace in order to make this solution effective and in customers' interests. We think guidance will be needed to ensure that retailers do not make use of loopholes to hide tariffs from their own customers - for example timing the release of new tariffs just after regular communications with existing customers or requiring a

²<https://www.ofgem.gov.uk/publications/action-plan-retail-financial-resilience>

digital sign up. We also think it may be appropriate for Ofgem to monitor the extent to which retailers' own SVT customers switch to new tariffs to test whether retailers are genuinely making these tariffs available to their existing customers.

We agree that for this option to be of value the licence condition would need to be implemented at the start of the next cap period. We are concerned that with the (necessary) speed of consulting the licence condition affects not just acquisition tariffs but all tariffs, we review this further in question 6. Finally we see this measure as of potential long term benefit to the retail market and ask Ofgem to consider using this opportunity to review the impact, with intention of keeping the condition indefinitely, see question 4 for more detail.

Of the remaining options we strongly disagree with the proposal to implement exit fees onto SVT customers. We do not see this as proportionate in any situation as it will create inequitable opportunities for consumers, with particular detrimental effect to low income and vulnerable customers. We note that even a small exit fee will have a disproportionate impact on customers' propensity to switch, due to the loss aversion tendency within customer behaviour. Alongside the implementation cost this solution will add a 30 day instant burst of switching demand and fundamentally changing SVT terms will erode trust in the market which will have long term negative impacts on the future retail market, risking the ability to reach Net Zero.

If Ofgem feels it needs to go further than banning acquisition only tariffs, perhaps due to extreme market volatility and uncertainty, then the market stabilisation fee proposal is preferable to the introduction of exit fees. The market acquisition charge needs further engagement with industry and clear parameters set in advance of April. It has the benefit of being able to lie dormant until the pre-defined wholesale price differentials are triggered and being a more equitable solution for customers. We still see risk of short term switching peaks being created (this time through potentially aggressive week long tariffs) and we have concerns around the administrative burden on the industry (see question 5). And we are concerned that Ofgem have not had enough time to consider the possibility of this being triggered during the FMRS 56 day standstill period.

Question 4: For each option, are there particular benefits or risks for consumers, including those in vulnerable circumstances, that we have not identified?

Option 1: All new tariffs available to existing customers

We share the view that, if as Ofgem intends, the implementation of a ban on acquisition only tariffs will ensure all consumers are able to seek competitive deals from both their own (current) supplier as well as the broader competitive market, to the benefit of all consumers. We do not see a risk to long term and active customer loyalty (indeed we have consistently supported the view that suppliers should be building tariffs on a 3 year view of costs to ensure long term loyalty is not penalised).

Active loyalty comes from a combination of long term good value alongside customer service that meets the requirements of the individual customer in question and is not necessarily a bad thing. It creates opportunities for the energy market, for example suppliers have more time to warm up reluctant customers to understand the benefits of a smart metering, translating that into an install where a 12 month relationship or inactive loyalty may not have been able to. It may also help customers navigate the evolving market (for example as MHHS is implemented the traditional 01 and 02 profile classes will phase out potentially increasing the use of TOU tariffs as standard).

We therefore see merit in this as an enduring feature of the market to benefit customers. If it is implemented, Ofgem have the opportunity to review the impact it has and consider extending it indefinitely by using the period between October and March to continue the live condition and in parallel consulting on an enduring solution from April 2023.

However we do see risks to customers surrounding the implementation this spring, due to the pace of consulting. Firstly this risk comes from this measure not being enforced actively or it being undermined by retailers finding loopholes in it - as has happened in the past with RMR measures. And secondly we note that the drafting of the condition creates a significant risk to consumers by removing the ability for suppliers to offer good value renewal tariffs to existing customers only.

We think these risks are best managed through Ofgem guidance, enhanced monitoring and the ability to offer conditional derogations to suppliers who want to offer active loyalty tariffs.

Option 2: Exit fees

We do not see any benefit to forcibly imposing exit fees on customers and believe this will exacerbate the inactive loyalty problem. Further we agree with Ofgem that this solution is inequitable and enables those with higher disposable income to benefit from switching where those most instantly affected by the cost of living crisis will become tied to tariffs that are not best suited to their needs.

We are concerned that suppliers will be provided with a derogation in February and be able to set fees as soon as customers have been provided with reasonable notice of the disadvantageous variation. Logically this will result in suppliers updating terms in line with issuing price increase notifications in February/March, a double blow to customers and likely to cause the industry significant bad publicity. Further the determination of what is deemed proportionate will vary from supplier to supplier so as well as being inequitable it also becomes a lottery for customers. Finally, whilst Ofgem are aware that it would need to “be prepared to take compliance or enforcement action if suppliers were found to be charging excessive exit fees”³ we are concerned that it will be a tricky and lengthy process to establish excessive fees have been set, at which point it will be too late to prevent risk of detriment to customers who do switch and near impossible to determine how fees have impacted customer decisions to not switch.

Option 3: Market Stabilisation Charge

This solution is better than imposing exit fees on SVT customers and certainly a more equitable way to tax switching. However we are concerned that once triggered this option creates multiple potential switching risks that impact customers, primarily relating to the weekly publication, as set out below.

Gamification of switching data

We are unsure what the date is for determining the charge due to the losing supplier - contract sold date, the switch commenced date or the switch completed date? Each of these become highly gameable trigger points for suppliers that could lead to confusing and detrimental customer journeys. For example if based on customer switched date, suppliers could encourage longer or shorter switching windows depending on their view of the evolving acquisition cost risk. If, when nearing the switch date, a supplier perceives the cost to be worse than projected they could then withdraw or attempt to ET the switch. Further

³ 3.54 p28

suppliers may start to split dual fuel switches dependent on the charges and in the knowledge that electricity currently has a far more speedy and controllable switching process.

Implementation of Faster More Reliable Switching

Prior to FRMS Go Live (currently expected to be 18th July 2022 but not confirmed until 26th January 2022) switching is expected to take 17 days to complete and cooling off is incorporated into the inflight window. Post Go Live switches will take 48 hours as a default for our customers, but customers will retain the right to select their start date. The cooling off period will likely therefore occur whilst a customer is live. If a customer cancels post Go Live in this cooling off period they may return to their old supplier under similar terms they left on; which would be another switch event potentially in a different charging week to the first. For the 14 days prior to Go Live suppliers will stack switches, not using the old process and instead waiting for the new. They will be released in a phased fashion w/c 18th July. The phases could impact the Market Stabilisation Charge significantly, customers may be sold a contract when no (or low) charge is expected and, if charging is based on switch date, supplier could then encounter an expected charge. At scale this could in fact risk supplier financial resilience.

Having weekly Market Stabilisation Charge updates between July and August puts the FMRS programme under extra and unnecessary pressure and will make the centralised charge delivery mechanism extremely difficult, if not impossible, to administer.

Encouraging short run deals

If triggered, this solution will encourage suppliers (and PCWs) to present week-long deals to consumers that are of benefit to the digital savvy but not consumers who require assistance or are unable to access the internet.

Cost of implementation

We expect that it would come at a significant administrative cost that will end up impacting all customers.

Question 5: For each option, do you agree that we have identified the full range of expected impacts on suppliers, consumers and competition?

Option 1: All new tariffs available to existing customers

As mentioned in question 4 we are concerned that due to the speedy consultation window and near term implementation timetable Ofgem will not have been able to assess the full impacts on the retail market and therefore are at risk of being unable to enforce the licence condition in real time. With the current plan to have a defined end date of September 2022 it is crucial that Ofgem are able to monitor compliance agilely and effectively. We challenge Ofgem to consider how it can monitor the marketing of 'good deals' to existing customers alongside new customers during this period.

SLC 31F considers some key principles around encouraging and enabling engagement with consumers with, for example, SLC 31F.4 stating that "The licensee must ensure that each Domestic Customer is provided with information in a Form and at a frequency that is sufficient to enable that Domestic Customer to understand that they can switch Tariff and Electricity Supplier, and may benefit from doing so, including financially."

SLC 21B.5 states that "The licensee must make available a Bill or statement of account to each of its Customers at least twice yearly". With suppliers potentially quarterly billing customers (digitally or by post), alongside the minimum standard of a biannual bill there is a very real possibility that some customers may have little to none billing information issued between the implementation of this licence condition and its expiry. The billing of customers is the prime place where SLC 31F.4 can (and should) be adhered to and so we challenge Ofgem to develop robust guidance that highlights the need to develop more agile views of SLC 31F.4 in light of the implementation of SLC 22B (option 1).

Option 2: Exit fees

Yes we believe that Ofgem are aware of the significant reputational and inequitable challenges that this option faces and are pleased to see that this is not a preferred solution at this stage. Alongside this we highlight three implementation costs to consider, firstly the cost of all suppliers notifying all customers of a terms change, including but not limited to those who are on SVT tariffs. Secondly the adjustments that will need to be made to renewal letters and journeys to highlight that if customers do not take action they will fall onto a tariff with exit fees that will come at a cost to all suppliers. Finally, there will be a tech build required affecting only suppliers who do not currently have tariffs with exit fees.

Option 3: Market Stabilisation Charge

In line with 3.68 p31 we presume that suppliers who have exit fees on fixed tariffs will end up gaining the economic cost of loss twice and question Ofgem as to whether this is a fair solution. Market Stabilisation Charge should be less the cost of exit fees, which have already been calculated by the losing supplier to be the proportionate and economic cost of switch loss.

On review of the formula we note the sharing factor could skew in favour of the losing supplier and is using a 12 month view of energy usage. We believe both these factors will contribute to an overly generous charge. Typically retailers do not hedge the full 12 months in advance, but instead in line with the period of the price. Therefore energy usage should not be the full months and take into consideration this assumption in the formula.

We have not seen evidence to understand what would happen if a supplier does not pay their invoice(s). If the supplier entered into administration before paying this charge will REC become a creditor to the administrator or will this charge become a mutualised cost to industry?

Question 6: Where applicable, do you agree that the draft Licence Condition text accurately implements the intervention as described?

Option 1: All new tariffs available to existing customers

No, we do not believe that the proposed SLC reflects the intention behind option 1. In fact it not only accurately implements the intervention as described but also significantly inhibits the rationale. Our particular concern is that SLC 22B.2(d) where the text states [compliance does not apply to] “Tariffs only offered to a particular group of Domestic Customers defined on the basis of criteria specified by the licensee, provided that the criteria **do not in any way relate to whether or not the Domestic Customer is a new or existing Domestic Customer.**”

This additional sentence removes the right for suppliers to compliantly provide loyalty tariffs to existing customers. As mentioned in question 4 there are a number of reasons why active loyalty is a good thing and in fact the rationale behind Option 1 is primarily to reduce churn and limit price discrimination⁴. Loyalty Tariffs allow suppliers to quote customers at point of

⁴ 3.20 page 20

renewal for another fixed term less the acquisition cost and therefore should rightly be only for existing customers to enter into. Submitted alongside this response we have written a formal derogation request to the licence conditions 22B.1 and 22B.2. The derogation would be contingent on us meeting the principles based intention of 22B - "Requirements to make new tariffs available to existing customers"

Option 2: Exit fees

Market wide derogation appears to refer to SLC 24.3 (a). Presuming this to be the only condition where a derogation is applied we agree that this will ensure exit fees are only enabled as described.

Option 3: Market Stabilisation Charge

Yes this licence condition appears to accurately implement the intervention as described.

Question 7: Do you agree that the methodology outlined in Appendix 2 best delivers the charge described in this consultation document?

Yes although there are a number of variables that make it tricky to be sure in line with the time frame of this consultation. The parameters need to be designed carefully to make this proportionate, we think the sharing factor should be at most 0.5 and we disagree with not reducing the energy consumption to match the cap window. We do not feel it is reasonable to presume suppliers will have hedged for a full 12 months at the point of switch loss and believe the formula should be using 0.5 the consumption at most.

Question 8: Do you agree that an ex-ante publication of the charge delivers the best outcome for customers?

Yes, as it can influence the price that retailers put in the acquisition market and influences market stability.

Question 9: Do you agree that a weekly publication represents an appropriate frequency of charge update?

There will be less room for disputes if a longer period is applied and it may be that a longer period in line with a ban on acquisition-only tariffs is a more stable solution (presuming the two can be effectively enforced).

Question 10: Do you agree that the payment mechanism described here is the most effective way of ensuring that charges are collected and paid?

We agree that a centralised system appears to be the best solution. Our main concern stems from the lack of information about how this will work, aside from the need for a working group. We do not believe that the implementation of FMRS within this period has been considered nor which switching date will be the trigger for REC to work from. We also don't fully understand how post FMRS cancellations will work in respect to this charge nor how gamification can be monitored. And finally how will REC recover costs if a supplier collapses.