

17 January 2022

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Dear Neil,

Re: Statutory Consultation on potential short-term interventions to address risks to consumers from market volatility

The Statutory Consultation seeks views on three proposals, two of which we believe can be expected to have significantly anti-competitive effects. We believe that by taking these two anti-competitive proposals out of context, and by moving straight to statutory consultation rather than a more measured approach, Ofgem risks imposing additional detriment on customers.

The industry is facing a number of major problems at present. We understand Ofgem's approach in trying to address these matters specifically where possible, and in some cases that is helpful – for example, the approach to the next scheme year of Warm Home Discount, or the approach to granting new supplier licences in the short term. However, in the broader areas of actions needed to address market failure, we don't believe the issues with the price cap, market volatility, short-term interventions and issues of market resilience can be divorced in this way.

These are bigger, broader issues and need a holistic solution – fundamental reform rather than marginal tinkering. The fundamental reform must also stick to key economic principles of allowing suppliers to recover efficient costs and make normal profits, while rebuilding balance sheet strength and regulatory recognition that customer choice is key. This means real choices for customers including quality of service and specialist offerings rather than focusing only on lowest price.

In our responses to the other documents in this suite of consultations, we have set out our concerns with the price cap as currently operated. We have explained these to you in detail previously and they are not restated here, but can be summarised as:

1. Excessive complexity – there are three price caps where there should be one
2. Poor wholesale indexation – slow to respond to shocks and failed to reduce volatility; and
3. Insufficient margin – failure to allow efficient cost recovery and a positive margin

Together, these have increased supplier risk, reduced resilience and contributed to a rapid reduction in competition over the last few months.

In looking at broader, holistic solutions, the requirements to move from current to future state must be addressed, as well as the other 'moving parts' at the time. For example, the proposals to adjust the Renewables Obligation (RO) payment process. Change is essential, not the least because the resultant liability is socialised amongst the remaining suppliers and the price cap doesn't allow for

this cost. However, change to the RO payment methodology must include transition provisions as no supplier is capable of paying two years' worth of RO in the same year, under the price cap.

In addition to the above, Ofgem should not seek to favour particular supplier groups or to bail out suppliers failing as a consequence of risky decisions or poor business practices. To seek to assist a subset of suppliers by implementing anti-competitive measures rather than by addressing the underlying issues which it does not help in creating a sustainable market going forward.

In terms of the three proposals in this statutory consultation, we support the first proposal and strongly oppose the other two.

New prices for existing customers

Requiring suppliers to offer existing customers their new tariffs would be the best course of action for Ofgem. As identified, this would reduce incentives on suppliers with respect to risk and acquisition pricing strategies which operate to the longer-term detriment of consumers, it would also help ensure competition was more sustainable. As a consequence, this would be expected to reduce the overall volatility that suppliers must manage bringing more stability to the sector. We agree this approach would help build trust in the market and that vulnerable consumers would be better off than in a do-nothing scenario.

This option also aligns with our view that Ofgem should consider the measures that the FCA has implemented to prevent price walking in the insurance market as an alternative to the price cap. The approach of making new prices available to existing customers would also therefore support our longer-term recommendation to remove the cap entirely. We disagree that this measure should only be implemented for only 6 months and can see no reason why this should not be a permanent feature of a well-run and healthy competitive market. Participants who oppose this approach are likely to be those that wish to use acquisition pricing techniques to entice customers, who may then become sticky and experience detriment in future.

The impact on competition in the interim would help stabilise the market and can be mitigated in the longer term with the removal of the price cap. The FCA implemented their "price walking" measures on January 1st and despite concerns that in the short-term prices may spike there has been little evidence of this. The change is similar to the removal of gender from motor insurance pricing, where over time market forces leveled out pricing. Where energy prices are already high and market forces very strong the impact to consumers would be less. Such a change would also affect those that are more engaged and viewed as Ofgem as less vulnerable.

Exit Fees

We disagree with the proposal to allow exit fees on SVTs, ultimately this leads to consumers underwriting a supplier's losses from their chosen hedging strategy and does not incentivise suppliers to make decisions that are in the longer-term interest of consumers. For example, suppliers are incentivised to hedge far more than they would have otherwise in the knowledge that the consumer will pay, this would distort the market and could add to the current volatility.

Over 4 million consumers find themselves with suppliers that they have not chosen, trust in the sector is low and this option has the potential to undermine what trust is left, particularly with vulnerable customers.

If this measure had been introduced before the reference window of the April-22 price cap it would have effectively created a 6 monthly fixed contract based on the price cap for consumers. We believe that such intervention is disproportionate.

Market Stabilisation Charge

We disagree with the implementation of a Market Stabilisation Charge (MSC) for similar reasons to the exit fees proposal. While the MSC is not paid explicitly by consumers the costs will ultimately be borne by them. However, no detail has been provided on recovery of the MSC and, as on other aspects, we cannot therefore give a considered view.

We also expect that this measure would have significant unintended consequences, including investors losing further confidence in the sector with well established, well run businesses still losing significant amounts of customers. This is not something that customers should be expected to pay for in a well-run, competitive market. If an MSC is implemented, this will force customers to pay the charge, when triggered, without transparency. We strongly oppose such an anti-competitive outcome.

In addition, while the information available on the MSC proposals is currently limited, the 12-month period defined in the appendix suggests a rolling 12-months hedging strategy should be applied. It appears from the text that this is Ofgem's intention, in terms of the supplier behaviours they seek to incentivise and reward. If our interpretation is correct, then we ask that Ofgem clarify the logic of using a different duration in the MSC to the period driven by the price cap. Based on this approach, the more congruent option would be to match the period of the MSC and the price cap. If participants hedged in line with the cap, the outcome would be demonstrably less volatile. We would argue that this option should be explored further first.

As a supplier who hedges as close as possible to the price cap methodology this option does provide us greater confidence and would help underwrite our potential losses in a falling market. However, we do not support the underlying principle.

Conclusion

We agree with Ofgem's conclusion that both Exit fees and an MSC are highly interventionist and we oppose implementation. At a time when the overwhelming industry issue is volatility the primary focus needs to be on correcting fundamentals with minimal intervention in market operation and allowing as much regulatory certainty as possible. Greater intervention, and the imposition of anti-competitive measures will cause greater volatility and further unintended consequences.

There is merit in suppliers having to offer new tariffs to existing customers. This is in line with our previous recommendation to implement similar measures to that of the FCA, with regard to price walking which would offer longer term benefits to consumers and removing the loyalty tax. It will also disincentivise suppliers from offering unsustainably low introductory offers, followed by higher prices and poor business practices - thereby promoting trust and sustainability within the sector.

We have provided brief answers to the questions raised in Appendix 1.

We trust this submission has been helpful, and would, of course, be willing to discuss any points or questions Ofgem may have in more detail.

Yours sincerely

By email

Alison Russell
Director of Policy & Regulatory Affairs

Appendix 1 – Answers to Consultation Questions

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

Ofgem has identified a risk to consumers, this risk is primarily a risk of further supplier failures whose business model is not compatible in a market that has a capped SVT. As the current crisis has shown, a business model based on fixed tariffs is not compatible with a market in which a capped SVT tariff exists. This current crisis was not only foreseeable, it was inevitable that at some point costs would materially exceed the price cap, resulting in the current crisis.

To rebuild industry confidence, Ofgem needs to demonstrate transparency. Government has stated clearly that there will be no bailouts for failed businesses which did not properly manage their risk.

The second and third measures in this consultation appear designed to bail out the remaining suppliers whose business model is focused on low (or even unsustainably low) fixed price deals, and who are therefore unable to manage the volume of customers they now have on SVTs. Ofgem has identified this is a risk to consumers, however it has not recognised that it is in fact the price cap that has caused the current crisis. We oppose these two measures.

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

Utilita has argued for intervention previously while the price cap has continued to operate an unjustified cross subsidy and has failed to allow recovery of efficient costs, meaning we, and many other suppliers had to operate at a loss. The CMA acknowledged the errors and despite our detailed evidence and representations, Ofgem chose not to allow recovery of our lost efficient costs.

Ofgem also continues to state in public consultation that specialist suppliers may be unable to recover efficient costs by allowing a cross subsidy between PPM and Credit tariffs.

We agree that Ofgem are justified in taking action to protect consumers, but we believe that policy decisions to date have put consumers at risk. We ask Ofgem to act in the longer-term interest of present and future consumers as we set out in our submission to the call for input.

We accept that the “unexpected SVT demand” has created a material problem for the sector and consumers but intervention should be proportionate and have the longer-term interests of all consumers and the broader sector in mind, not just the impact on a subset of suppliers who followed a consciously risky business model, and therefore are asking for a bail out.

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

Option 1 – Requiring suppliers to make all new tariffs available to existing customers offers vulnerable consumers enduring protection while helping to stabilise the market by dampening unsustainable acquisition savings that suppliers use to entice new customers. This will also decrease churn in the market as a whole giving suppliers greater confidence in hedging their exposure.

As we have set out in this and our other submissions to this suite of consultations, we fundamentally oppose the bailing out of companies who are failing as a result of risky decisions and hedging practices. We therefore oppose strongly both other options.

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

Inevitably there will be unintended consequences of any action that Ofgem decides to take. We therefore believe that right now less is more. We are pleased that Ofgem has recognised that at this point, the primary focus needs to be on stabilising the sector and rebuilding confidence. The actions proposed within the suite of documents would reduce switching however we believe options 2 and 3 to be disproportionate and favourable to the more engaged, less vulnerable consumer. We believe this is a good opportunity for Ofgem to focus on the broader aspects of service in a competitive market rather than the narrow aspect of price.

We believe that an MSC could have longer-term detrimental consequences if suppliers take advantage of the more anti-competitive proposals, if implemented. This could potentially undermine investor confidence in the market as a whole and so, in the longer-term disadvantage consumers.

Vulnerable customers will be disproportionately impacted by the coming increases in prices and any future prices. We urge Ofgem and Government to accept that fuel poverty is not specific to energy suppliers; fuel poverty is a wider social issue that is better addressed by government through wider policy decisions.

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

For option 1 we believe that there are further benefits for the longer-term sustainability of the sector as we have documented in our companion submissions.

For option 2 and 3 we believe that such intervention is unnecessary alongside the proposed changes to the price cap to ensure all suppliers can recover efficient costs and an additional margin for the increased risk that investors are taking in with the increased volatility in the market.

Such intervention will have unforeseen consequences as both enable suppliers to underwrite losses at the consumers expense and therefore suppliers as not incentivised appropriately when considering how to manage their risk.

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

We have a number of concerns on the Licence Drafting.

There is no information in the licence condition about the trigger for a payment to be made or the principles in respect of how that payment is calculated. Instead, these points are left entirely to guidance to be published by Ofgem (please see definition of Market Stabilisation Charge and Losing Supplier Loss Trigger).

Such an approach to licence condition drafting does not accord with Ofgem's statutory duties, including the principles of better regulation and best regulatory practice.

It also appears to us that a licence condition drafted in such a way could be ultra vires:

- Ofgem appears to have chosen to refer to these points being set out in guidance, perhaps seeking to rely on section 7(4)(b) and section 7(6A) of the Electricity Act, rather than providing for the matters to be determined in a direction to be issued by it pursuant to section 7(3)(a), although this is in substance what Ofgem is proposing to do.
- Section 7(3)(a) provides that conditions included in a licence may require the licence holder to comply with any direction given by Ofgem as to such matters as are specified in the

licence or are of a description so specified. The CMA has recently confirmed, with respect to equivalent language in section 7(5)(b), that “specified” means that the matter must be specified clearly or to be stated explicitly. In our view, this would require significantly more detail to be included in the licence condition than Ofgem is proposing.

- There must be limits to the powers set out in section 7(4)(b) – it would clearly defeat the purpose of the protections of the legislation, including those in Section 11A as well as Sections 7(3) and 7(5) if all the detail of the obligations contained in a licence could be moved into guidance, which is effectively what Ofgem is proposing here.
- It would also be helpful if Ofgem could explain what it understands by the requirement to designate a document for the purpose of section 7(4)(b) and whether the guidance would be so designated.

In addition, the impact assessment lacks detail and is not well substantiated. The assumptions used are not clear and the assessed cost benefit analysis is both very broad brush and poorly defined. It is not clear, based on the detail available whether these proposals are truly in the interests of consumers or are simply intended as a rescue package for large suppliers.

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

No – we disagree that a market stabilisation charge would be appropriate, regardless of the methodology used in calculating it.

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

This should only be published ex-ante, publishing after would mean suppliers could not adjust their sales and pricing strategies as the market evolved.

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

Weekly would be too frequent, monthly would be a better frequency to allow suppliers time to consider the impact of the changes to their sales and pricing strategies.

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

Yes a centralised payment approach would be better than a bi lateral payments amongst suppliers. However, as Ofgem has noted this will come at a cost for consumers which we believe to be unnecessary given our overall stance on Option 3.