

Thursday 13 January 2022

To: Price Cap Adaptation Team
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Response to Call for Input: Adapting the Price Cap Methodology for Resilience in Volatile Markets

Price Cap Adaptation Team-

Summary: the need for a clear understanding of the risks being mitigated

We welcome the opportunity to comment on this call for input. UW is committed to delivering positive customer outcomes through a sustainable business model, by offering good value and service across a range of utilities.

The essential point - which will be raised by many and to which we add our voice - is that the return of price volatility to the wholesale market highlights the case that the current cap is indeed too rigid in terms of its structure.

However, it would be incorrect to assume that the current design of the price cap was the primary cause of the recent high count of supplier failures and market exits. It was instead that a flaw in market design, whereby entry requirements were set too low for too long, incentivised many new entrants to operate with unsustainable business models.

The menu of options Ofgem presents in this call for input all look to increase the resilience of the price cap. Alongside this work on potential price cap adaptations, a simple and more fundamental safeguard solution should be considered.

The energy supply licence should ban suppliers taking payment in advance for new customers, before a unit of energy has been supplied. This would close the door permanently on this problem, whereby under-capitalised suppliers could fund their operations by forcing consumers to hold a credit position with them from the outset; which was the default strategy typical of failed suppliers.

Further work: potential adaptations to the price cap

Considerations yet to be exhausted

Ofgem should allow more time for the original concept of a relative price cap, as widely understood across the sector, to be examined, as it could resolve many of the issues the market is having to clean up now.

This is broadly captured in the consultation document as the 'relative price cap within suppliers' but is then too readily discounted. A maximum allowable differential

between a supplier's cheapest and default tariffs would overlay a powerful control for ensuring fair and sustainable pricing.

A supplier's option to offer unsustainably cheap tariffs - which in practice has proved immensely inefficient and costly for all consumers - for the purpose of unsustainable customer acquisition, would be curtailed by the potential cost of maintaining a low default tariff in parallel. Similarly, a supplier's option to set a relatively expensive default tariff would be curtailed by the requirement that all suppliers have to be attractive to new customers, not least to maintain their scale as they lose customers who switch away.

On examining this option, we have not found an impediment to applying a relative price cap within suppliers in tandem with the absolute price cap as now. A supplier's default tariff could be both within a tolerance relative to its cheapest tariff and within the absolute price cap. A variant of this solution would be to create an economically efficient competitive pricing corridor by introducing a price floor pegged to the current cap.

The key point is that there appears to be some considerable supplier consensus that this potential relative price cap solution should be worked up further, and there is still sufficient time to do so.

In contrast, we have detected no support, rightly, for the concept of using a basket of current tariffs to create a relative cap across suppliers. The idea would risk a return to a subset of suppliers unduly influencing the market with unsustainable pricing, and with the risk transferred to all consumers: precisely the costly market failure that needs to be consigned to history.

Option 1 - Enhanced Status Quo

We broadly support this option, and note that the sector would require specification of the circumstances that would lead to a 'circuit breaker' or intervention.

Option 2 - Quarterly Updates

We have a neutral view for this option, but do have concerns that quarterly variances to energy prices could be a poor customer experience.

Option 3 - Fixed Term Default Tariff

This option would cause significant confusion for customers, while also being very challenging for suppliers to implement in billing systems.