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18 July 2022

Dear Maureen,

We are writing to you today as a response to Ofgem's recent consultations on extending the short-term interventions, including Market Stabilisation Charge (MSC) and Ban on Acquisition-only tariffs (BAT), and proposed changes to supplier financial resilience requirements.

In summary, while we welcome measures to improve financial resilience in the market, Ofgem continues to risk over-correcting and serving the interests of established players rather than the long-term interest of customers. Specifically:

- Ofgem has failed to explicitly consider the long-term customer detriment that would arise from market stagnation. The costs of stagnation are very significant, and by our estimates a crisis of the scale of recent events would need to be avoided every few years to justify stabilising measures that significantly weaken competition:
 - A conservative estimate would put the cost of market stagnation at £1.7bn annually and rising further as the energy system transitions to net zero. Within two years, this amounts to £3.4bn.
 - At this rate the estimated consumer detriment will exceed the one-off and now historic costs associated with supplier failure, estimated by the NAO to be £2.7bn within two years.
- The Market Stabilisation Charge and Ban on Acquisition Tariffs will have a highly detrimental effect on competition. There is no case for extending them once measures are in place to tackle financial resilience at source.
- The measures on financial resilience will be more expensive for smaller suppliers than larger ones. Tighter entry standards already mean Ofgem will never again face 70-odd smaller suppliers, and Ofgem now has powers to tackle irresponsible

behaviour through its Financial Responsibility Principle. Ofgem does not therefore need to impose a heavy capital burden on the smallest firms, and should taper its requirements to ensure proportionality.

- Ofgem has statutory duties in respect of competition and the long-term interests of customers. To meet its duties Ofgem must therefore:
 - explain how its package of measures is intended to work together, including those measures already in force,
 - commit that the temporary measures stay in place only to address exceptional systemic risk, and only until permanent measures are in force,
 - demonstrate that the permanent measures are proportionate
 - explain how it has balanced financial stability and competition in determining the overall package; and
 - explain its exit strategy from these emergency measures and show market participants the path back to healthy market normality.

We explain these points in more detail below.

As our letter indicates, we are very concerned by Ofgem's overall stance on competition and would welcome the opportunity to discuss these and wider issues in a meeting with Ofgem.

We welcome measures to improve financial stability in the market, but Ofgem risks over-correcting and serving the interests of established players rather than the long-term interest of customers

Regulating a market that is so crucial for every household while it is experiencing unprecedented uncertainty necessitates balancing and assessing trade-offs between the short- and long-term interests of customers and industry participants, including suppliers.

We have repeatedly warned Ofgem that it may have swung too far towards protecting the interests of suppliers which remain in the market, and the current suite of proposals do very little to bring that pendulum back. These calls have been reiterated by the reports from Oxera¹ and the National Audit Office².

While energy suppliers had a difficult time staying solvent through last winter, Ofgem has already implemented reforms that ensure suppliers recovered losses they made, reduce future losses, and mitigate and reduce the risk of disorderly supplier exits which impose costs on the industry. Ofgem has already:

- Tightened entry standards, and recently made use of these powers in the cases of Alaska Energy,³

1 <https://www.ofgem.gov.uk/publications/review-of-gems-regulation-energy-supply-market>

2 <https://www.nao.org.uk/report/the-energy-supplier-market/>

3 <https://www.ofgem.gov.uk/publications/refusal-supplier-licence-applications>

- Introduced the Financial Responsibility Principle, and made use of this power in the case of Foxglove Energy,⁴
- Exercised its new Fit and Proper person rules for the first time, to remove a director at Neo Energy,⁵
- Across the industry, Ofgem allowed suppliers to recover the costs of acting as SOLRs in full,
- Included an uplift in the April 2022 price cap for serving more default tariff customers than expected,
- Granted additional allowances in the price cap to recover historical costs associated with rising wholesale costs, and
- Updated the frequency of price-cap updates (from twice a year to four times) meaning suppliers can pass-on rising wholesale costs more quickly.

Meanwhile customers on default tariffs have seen their bills increase by the average of nearly £700, with further rises already predicted. Ofgem therefore must now start shifting focus to improving customer outcomes in a period of high prices, rather than further shielding suppliers from potential volatility.

The result for customers of the last 12 months is a market that is delivering poor outcomes. Many customers are stuck with a supplier they haven't chosen, who may not have the level or quality of service they expect. Furthermore, due to the limited competitive pressure, customers are not being offered the stability of (reasonably priced) fixed tariffs, since suppliers face weak incentives to compete beneath or alongside the default tariff. With the market essentially closed, there is very little competitive drive to develop more innovative tariffs, including Time of Use, which customers will value increasingly in coming years.

Healthy competition is needed so customers can save money now, and so innovative companies can deliver the energy transition quickly and at lowest cost in the coming years. A market with high barriers to entry, artificial barriers to switching, and little room to compete beneath the price cap will result in stagnation and a return to cost inefficiencies, poor service and lack of innovation.

While the one-off costs of supplier failures have been very significant, the costs of stagnation are even higher

In 2016 the CMA estimated that weak competition was costing consumers between £1.6bn and £2.2bn per year in 2021 prices (i.e. £1.4-£2bn in 2016 prices) or roughly £60-80 per household every year.⁶ If Ofgem goes too far with its measures to improve financial stability at the expense of competition, that detriment will reappear.

Looking ahead, the social costs of weak competition could be even higher.

4 <https://www.ofgem.gov.uk/publications/foxglove-energy-supply-ltd-provisional-order-july-2022>

5 <https://www.ofgem.gov.uk/publications/uk-energy-incubator-hub-ltd-notice-proposal-make-final-order>

6 CMA (24 June 2016), Energy market investigation, final report, para 10.50.

BEIS, Ofgem, the CCC and National Grid all agree that flexibility and customer willingness to participate in energy markets are vital to put the UK on the lowest cost transition pathway towards Net Zero. This is particularly true in transport and heating.

Importantly, the market needs new ideas and new entrants to deliver the innovation and investment required to decarbonise homes and transport. Challenger businesses are currently leading the way in developing new customer propositions but the market needs several more serious new entrants like this.

This risk has been recognised by the National Audit Office (NAO). In its June 2022 report on the energy market, the NAO argues that Ofgem's proposed reforms will deter supplier entry and thus hinder the innovation necessary to help customers contribute to the energy transition:⁷

"There is a risk that Ofgem's changes could hinder [...] the supplier market from contributing to net zero. Some of the new suppliers that entered the market offered more innovative products and services that support customers to reduce their energy consumption or make their energy usage more flexible. They also created greater competition on the price of bills."

As a very conservative estimate of these flexibility opportunity, Ofgem estimates that demand-side flexibility (i.e. load shifting), unlocked by its market-wide half-hourly settlement program, would deliver benefits of £2.2bn to £7.5bn for GB energy customers and society as a whole in the period 2021 to 2045⁸. On an annualised basis, these benefits are between £90m at the lower bound, to £300m at the upper bound.

By comparison, the NAO has estimated the one-off cost of recent supplier failures at £2.7bn, or £94 per household.⁹ There is a real risk that the ongoing 'stealth' detriment from weak competition and a lack of innovation over many years dwarfs the one-off but more visible detriment associated with supplier failures.

Therefore, even if Ofgem takes a relatively short-run view, e.g. over a two-year period, these stealth costs – arising from a lack of competition and consumer engagement – already exceed the avoided costs to consumers from supplier failures:

- A *conservative* estimate of the cost of weak competition in terms of higher bills (£1.6bn per year) and missed savings from demand-side flexibility (£90m per year) adds up to £3.4bn over two years.
- As a *pessimistic* estimate of the cost of future supplier failures, we can take the cost of recent failures (£2.7bn) and assume this would be replicated in the future if Ofgem did not introduce new financial resilience measures.

7 National Audit Office (June 2022), The energy supplier market, p.11.

8 Net Present Value of net benefits to GB consumers and wider benefits for society Ofgem (April 2021), Market-wide Half-Hourly Settlement: Final Impact Assessment, page 9.

9 National Audit Office (June 2022), The energy supplier market, p.7.

In practice, future supplier failures should be less costly due to other reforms Ofgem has introduced to supplier licensing, and could not be expected to occur on a similar scale nearly as often as every two years.

Further, the comparison we have set out above understates the growing cost of a lack of competition as the net zero transition progresses:

- As renewable electricity generation makes up a larger share of generation, the value of flexibility to the electricity system, particularly demand-side flexibility, grows.¹⁰ BEIS estimates that demand-side flexibility in the electricity system can drive system-wide savings of up to £2.7bn per year by 2050.¹¹
- Stagnation in the energy supplier market will increase the cost of meeting Net Zero. Net Zero is a binding target for the UK, and if households and transport fail to deliver carbon reductions, then other sectors must do more between now and 2050. Low engagement risks reducing households' willingness to transition to low carbon technologies such as electric vehicles and heat pumps, and will slow their purchase of related products such as insulation and energy-saving technologies. Valuing this effect is difficult, however as an indication, the CCC has estimated that a lack of engagement could increase the total cost of the transition to net zero by up to £175bn (almost £6bn annually) between 2020 and 2050.¹² A significant degree of this difference can be explained by a lower rollout of low-carbon heating systems and electric vehicles, and a less flexible energy-system.

Therefore, Ofgem must carefully and explicitly balance the risks it observes. Erring on the side of protecting financial stability at the expense of competition serves incumbent supplier interests, not the long-term interests of customers.

Government's commitment to effective competition in retail energy was also reiterated in the Energy Bill¹³. To ensure alignment, Ofgem must set out a clear plan for ensuring the Government's commitment is delivered.

There is latent demand from customers to exercise choice

So far, we think customers have been fairly understanding of the situation with the market and their engagement has not diminished. Customer desire to take control of their energy costs has been illustrated by the numbers of meter readings submitted ahead of the April 2022 price cap and by rising interest in energy pricing, especially the standing charge. Our own recent customer research shows that 74% of disengaged customers (who do not switch, or have not switched for 3 years) would be interested in using a price comparison website to switch supplier, compared to only 33% prior to the crisis.

10 Department for Business, Energy & Industrial Strategy (July 2021), Smart Systems and Flexibility Plan 2021, p. 11.

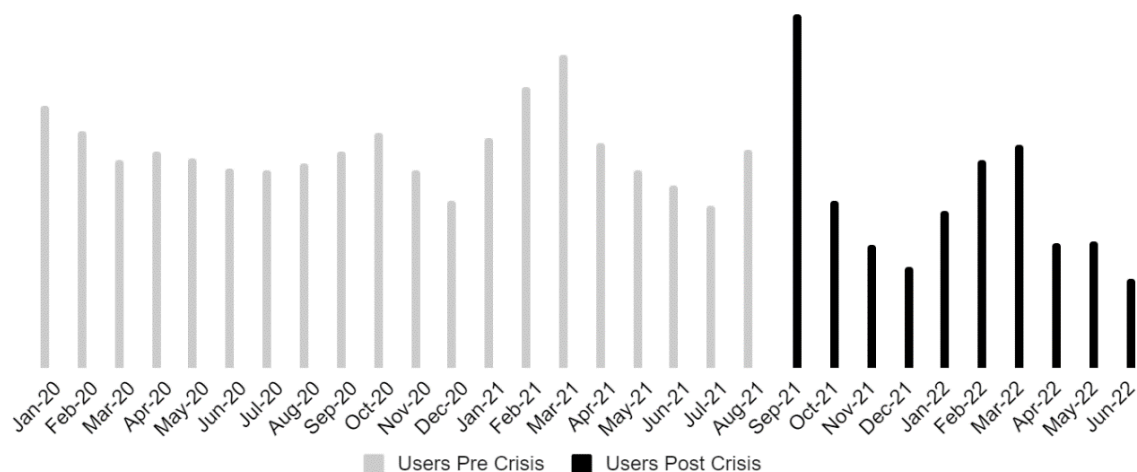
11 I.e. 15GW out of 57GW total flexibility, worth £9.9bn per year in total by 2050. Source: Department for Business, Energy & Industrial Strategy (July 2021), Electricity System Flexibility Modelling, page 23 to 24 for flexibility volume, and Table 1 for total system savings.

12. The cumulative cost of the net zero transition in the Headwinds scenario and Widespread Engagement scenario are calculated by totalling the Annualised Resource Cost between 2020 and 2050 (£454.01bn and £278.79bn respectively). £175.22bn is the difference in cost between the Headwinds and Widespread Engagement scenarios. Source data: Climate Change Committee (December 2020), Sixth Carbon Budget Dataset v2, "Scenarios summary" sheet.

13 BEIS (July 2022), Energy Security Bill Factsheet, Default Tariff (Price Cap)

In many ways, households are more engaged than ever in their energy consumption, but the market situation is preventing them from exercising their ability to switch. We have seen an increase in our user numbers and views of our energy guides since September 2021 when the crisis began (see graphs below).

Site traffic



Energy Guide traffic



While prices are of overwhelming concern at the moment, quality of service and customer satisfaction also deteriorate when competition weakens. According to Ofgem's surveys, customer satisfaction has fallen from 74% in early 2020 to 66% in Q1 2022, the lowest average score on record. Some customers will be looking to switch away from poor service when they have the opportunity to do so again.

Therefore, the short-term interventions, and the long-term changes, should be working to ensure customers are given back their agency as soon as possible.

Ofgem must consider its interventions holistically, and ensure the total package is balanced and proportionate

We support sustainable competition and agree this requires stringent criteria to ensure new entrants are responsible businesses. Previous entry criteria were clearly insufficient for the regulatory environment in which suppliers had to operate. The unsustainable pricing and poor quality of service offered by some failed suppliers were bad for customers as well as for the wider market.

We welcome Ofgem's tightening of entry rules, asking more probing questions of potential new entrants, and rejecting supply licence applications where owners are not Fit and Proper. We also welcome Ofgem's use of enforcement powers under the 'financial responsibility principle' to tackle unsustainable practices directly.

We accept that Ofgem may need recourse to emergency measures (the Market Stabilisation Charge and Ban on Acquisition Tariffs) to address systemic financial stability risk. However, these should be removed at the earliest possible opportunity, and there is no case for such measures to continue once financial resilience rules are in place to tackle financial risk at source. We offer more detailed comments on these measures below.

We support higher standards on financial resilience but believe these should be proportionate. The major costs of supplier failure are associated with the failure of major suppliers. Financial risks at smaller players can be dealt with adequately and more proportionately through enforcement of the 'financial responsibility principle' than by imposing onerous financial requirements that cost more for smaller players than larger players to comply with. We offer more detailed comments on this below.

The key point here is that Ofgem is at risk of layering on interventions without properly considering how they work in combination, and therefore cumulatively whether they amount to an over-reaction to the problems experienced during the current exceptional market conditions.

Ofgem's short-term Market Stabilisation Charge must be temporary

When triggered, the MSC would undoubtedly have a significant impact in preventing switching. It would discourage suppliers from offering cheaper deals, effectively preserving the hedges suppliers made during the more expensive period. As a result, customers will face the same poor outcome they have experienced in recent months - they are stuck with their current supplier on their current tariff with limited options to save.

We understand that one of the main reasons for the temporary introduction of MSC is because Ofgem is instructing companies how to hedge at the moment. Forcing all suppliers to implement similar hedging strategies adds cost given limited liquidity in wholesale markets for hedging contracts. It is also a barrier to healthy price dispersion re-emerging,

which is essential for allowing customers to benefit quickly once prices start to fall and for ensuring healthy competition and value in the long-run. Ofgem should explain its exit strategy from this level of intervention.

Emergency measures (such as the Market Stabilisation Charge and Ban on Acquisition Tariffs) can only be in place to address the financial stability of the sector pending the implementation of rules around financial resilience, not to manage hedging strategies. Therefore:

- Such measures should be introduced and triggered only in response to systemic risk, and the parameters set accordingly; they should not be used to prop up individual suppliers whose exit can be managed safely through other mechanisms.
- Some artificial stability for suppliers might be needed coming into autumn/winter, to ensure there are no further shocks to the market. However, such measures should not last any longer than is absolutely necessary, particularly once measures to tackle financial resilience at source are in place and established.

It is clear from Ofgem's impact assessments for these measures that it has not fully considered the effect of its measures on competition – in part because it originally envisaged these as temporary measures that would be gone within 6 months.¹⁴ They have now been in place for 15 months, which makes it all the more important that they do not 'creep' into permanence and that their impact on competition is properly thought through.

Ofgem makes no case for the Ban on Acquisition Only tariffs becoming a permanent feature of the market, and now is not the time to risk effective competition

The proposal to extend the BAT is particularly confusing and we do not agree with its extension. Ofgem's rationale for retaining the BAT seems to be rooted in its desire to test the impact of the intervention once the market stabilises, rather than any evidence that it will benefit customers in the meantime. It is inappropriate for Ofgem to conduct such an experiment in the market at a time when competition and innovation are so vital to consumers and the sector.

Ofgem is wrong to suggest that the BAT has a role in addressing the “perceived loyalty premium” in the energy market. While a BAT may have a theoretical role in a market where a supplier can pursue aggressive acquisition targets coupled with a high financial risk appetite, such behaviour is prevented by Ofgem's financial responsibility and licensing reforms, and Ofgem's cap on default tariffs will protect customers who become disengaged after choosing a supplier's acquisition tariffs.

Retaining the BAT will simply keep good deals off the market at a time when households desperately want to save money on energy bills. Ofgem has a legal duty under the price

¹⁴ See, for example: Ofgem (15 December 2021), Statutory Consultation on potential short-term interventions to address risks to consumers from market volatility, para 3.29.

cap legislation to ensure that there is room for competition below the price cap; a ban on acquisition-only tariffs will discourage suppliers from offering tariffs below the level of the price cap, without providing any benefit to the price paid by customers who remain on SVTs.

And the derogation which allows incumbent suppliers to offer fixed deals to their own customers which are not available on the open market potentially exacerbates these problems even further. Such deals are not transparent and are difficult for customers to assess and compare (in part because they do not appear on price comparison websites). There is a risk that suppliers are able to move customers onto fixed contracts that are poor value and include high exit fees – such that those customers are unable to access better options when a competitive market returns.

Finally, given that the market has recently experienced a severe shock with widespread ramifications for consumers and the sector, it would be completely inappropriate to test a long-term intervention as soon as it achieves any level of stability. If Ofgem wishes to test such a measure in a market context, it should be done in a controlled, stable environment, similar to Ofgem's customer engagement trials, once the market is sustainably stable to produce viable results.

Ofgem's supplier financial resilience reforms must be proportionate

Short-term measures should provide remaining suppliers some financial stability and, if Ofgem commits to only keeping them on for as little time as possible, should give customers confidence that their current forced lack of choice is not a permanent predicament. However, Ofgem also needs to start signalling to the market that going forward its commitment to a competitive market has not diminished, in line with the overarching energy policy. Proposals which deter market entry will not achieve this.

While we support the introduction of better standards around financial resilience in the sector, we are concerned that Ofgem's measures may disproportionately impact smaller suppliers in the following ways:

- By requiring suppliers to ensure that hedged energy contracts can be transferred to the supplier of last resort, Ofgem risks make it harder and more expensive for smaller or newer companies to secure wholesale supply, as wholesalers would have less recourse in the event of supplier failure.
- Requirements to hold more capital are more expensive for smaller suppliers, who have fewer sources of funding and face a higher cost of capital

We note that the bulk of the cost of recent supplier failures was associated with the failure of mid-tier rather than smaller suppliers. Of the 4.0 million customers directly affected by supplier failures since July 2021, 1.6m of those were Bulb Energy customers, and a further 0.6m were Avro Energy customers.

Ofgem should taper its financial resilience requirements so that mid-tier firms whose failure would be costly to the wider system face robust standards, but smaller firms whose failure is less disruptive face more proportionate requirements. Imposing lighter requirements on smaller suppliers going forward will not mean a re-emergence of the problems of the past because:

- Ofgem's tighter entry standards almost certainly mean it will never again face a 'long tail' of 70-odd small suppliers, vulnerable to wholesale market shocks.
- Ofgem can now take enforcement action against specific suppliers who are behaving irresponsibly under its Financial Responsibility Principle - as it has demonstrated it can do – which allows it to contain risks, for example by imposing bans on new customer acquisition.