

14 June 2022

Leonardo Costa
Head of Price Cap Policy
Ofgem
10, South Colonnade
London E14 4PU

Email: alisonrussell@utilita.co.uk

Dear Leonardo,

Re:

Price Cap – consultation on possible wholesale cost adjustment

Price Cap – Statutory consultation on changes to the wholesale methodology

Price cap – Notice of statutory consultation on a proposal to modify the standard licence condition 28AD of all Gas and Electricity Supply Licences

Thank you for the opportunity to comment on the consultations listed above. This submission covers all these consultations and comprises this letter only.

Utilita is a smart supplier, specialising in providing a quality smart service to our prepay customers. We offer only variable contracts to domestic customers and as such we have been operating entirely under the price cap(s) since their inception in 2017. As we set out in our recent submission and previous submissions, we have engaged throughout this period with Ofgem's consultations on this matter; we remain frustrated and disappointed at Ofgem's repeated failure to engage properly with our concerns. The price caps have failed to allow Utilita, as a specialist supplier, to recover our demonstrably efficient costs. They have resulted in negative margins and - due to the way in which Ofgem has formulated the caps - have resulted in a significant loss of justified revenue to our business.

While these particular consultations did not utilise a confidentiality ring, we have frequently had to employ specialist economic and legal advisers to access the data, and hence provide the necessary advice and support to ensure that we can substantiate our arguments with rigorous analysis. While expensive, this has been essential due to Ofgem's approach of only allowing suppliers to engage at the detailed level if they do employ such advisers. This makes engagement with price cap processes extremely costly and effectively precludes suppliers from engaging unless they can make such (unfunded) expenditures.

Ofgem has generally either failed to engage with the points we have made or has dismissed them based on poorly justified grounds. We therefore do not accept Ofgem's dismissal of our arguments and continue to consider our points fully justified.

We have considered the two main documents above under separate headings

1) Price Cap – consultation on possible wholesale cost adjustment

We note that this consultation primarily focuses on Unexpected SVT Demand. We believe that this should now be a misnomer. Utilita and the other remaining large suppliers are responsible suppliers. In the light of new licence conditions around financial resilience and sustainability, along with the additional assurance activities carried out by Ofgem, we should now have adjusted their pricing and hedging to take

into account this risk. If suppliers have not taken appropriate actions to meet these licence conditions, then we do not understand how Ofgem can be satisfied that they have a sound approach to risk management.

We do not support Ofgem effectively enabling these high-risk taking suppliers to abrogate their responsibilities in this way. The approach is a mechanism that distorts the market and so allows this group of suppliers to take advantage of this policy as a free option to force the consumer to underwrite their risk.

However, if Ofgem does intend to implement this policy then it must do so consistently, both across consumer groups and with the prior approach applied. To implement an inconsistent approach, as is proposed, appears to unjustifiably favour risk-taking suppliers over those who have taken a more prudent approach.

We do not consider that Ofgem has adequately explained its decision to differentiate between PPM and non-PPM in the 'unexpected SVT demand costs' allowance on this occasion when it did not do so previously. We believe that it rewards irresponsibility to compensate those suppliers that have not hedged in a sensible manner, and that now cannot be said to have failed to understand the risk, without extending the compensation to those suppliers who behaved responsibly, e.g., Utilita.

If Utilita now decides to throw its habitual caution to the winds and expose itself to additional wholesale market risk, will Ofgem compensate us should we lose the gamble? Of course not, and rightly so - but because a number of the larger suppliers all engaged in the same risk-taking behaviour, Ofgem proposes to compensate them for their losses while denying suppliers such as Utilita fair recompense for sensible, efficient behaviour (and the associated costs). In making this point, we are very clear – we protect and defend prepay customers – we have no wish to see them face unfair costs.

However, as a matter of record, prepay customers are more costly to supply, even with smart meters. Ofgem's continuing refusal to allow specialist suppliers to meet their efficient costs, while subsidising risky behaviour, is nothing short of distortionary. Favouring suppliers to this grouping of 'non-prepayment' customers, by allowing the highest return for suppliers to be made on DD and PoRB customers also reduces incentives for the market to invest and innovate for prepay customers - who may be among the most vulnerable in society - and whom Ofgem wishes to protect.

In addition to the points made above, Ofgem is inconsistent in treating prepayment differently to 'non-prepayment' (rather than direct debit and pay on receipt payment methods) and offers no justification as to why it has suddenly adopted this new approach. This is not fair or reasonable and does not meet the relevant requirements under section 1(6) of the Domestic Gas and Electricity (Tariff Cap) Act 2018¹.

The constituent parts of the DTC either apply equally to all customers in receipt of a default tariff or are differentiated by three payment methods. If Ofgem does wish to apply compensation for fixed tariff roll off other than equally to all customers, it must apply it separately by direct debit and pay on receipt of bill payment methods as well as prepay. There can be no logical argument that considers that prepayment customers should be subject to an allowance that reflects the fixed tariff roll off costs for that customer group, but that direct debit and pay on receipt of bill customers should not be subject to the same treatment.

¹ 1(6) The Authority must exercise its functions under this section with a view to protecting existing and future domestic customers who pay standard variable and default rates, and in so doing it must have regard to the following matters—

(a) the need to create incentives for holders of supply licences to improve their efficiency;

(b) the need to set the cap at a level that enables holders of supply licences to compete effectively for domestic supply contracts;

(c) the need to maintain incentives for domestic customers to switch to different domestic supply contracts;

(d) the need to ensure that holders of supply licences who operate efficiently are able to finance activities authorised by the licence.

2) Statutory consultation on changes to the wholesale methodology and Notice of statutory consultation on a proposal to modify the standard licence condition 28AD of all Gas and Electricity Supply Licences

In considering the proposals, we have noted that Ofgem has already moved to the Statutory Consultation stage in this area, and hence we conclude that the decision has already – in fact – been made, irrespective of the current consultation.

We agree with a number of comments made by E-UK on this consultation, in particularly in respect of the degree to which Ofgem has taken into account Suppliers' concerns in respect of the impact on Supplier processes and also on customers, particularly in respect of vulnerable consumers who may find it more difficult to engage with the market in reduced timescales.

We note that Ofgem recognises that the notice period to consumers should be a minimum 10 working days. We are relieved that this has been recognised by Ofgem, but we are seriously concerned that this may not be long enough for consumers. Unfortunately, we believe that price changes processes within suppliers will mean that in most cases, consumers will (unavoidably) only receive this reduced notice and we believe this will not be helpful for some consumers.

The rights assigned to consumers under the licence will assist in this area, but these rights are extremely costly and manually intensive to administer, especially for prepay customers. To administer these rights four times per year rather than two – given that in some cases the administration of these rights will overlap with the next price change will add significant complexity and cost.

This cost is not allowed for under the current cap and operational costs of four price changes per year and associated processes must be factored in and allowed under the cap. Suppliers cannot be expected to simply absorb yet another regulatory cost without support. We also agree with those suppliers who have advised that price change notifications in the run up to Christmas are unlikely to be either welcomed or absorbed effectively by consumers, adding to the risk of detriment where prices increase.

In conclusion, we continue to believe that Ofgem has failed to update the DTC in a way which fairly reflects the costs faced by suppliers to prepay customers. Ofgem has perpetuated pre-existing errors, continued to prevent prepay suppliers recovering their efficient costs and has not taken these combined opportunities to correct the present errors or the past under-recoveries.

We hope this submission has been helpful, and we would, of course, be happy to discuss any points in more detail with the team.

Yours sincerely,

By email only

Alison Russell
Director of Policy & Regulatory Affairs