Bulb’s response to Ofgem’s credit balances proposals

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This response is **not** confidential and can be published on the Ofgem website. If you have any questions, please email policy@bulb.co.uk.

Executive summary

- While Bulb supports steps to reduce the mutualised costs that customers pay, Ofgem’s proposals on credit balances do not address the key issue that causes mutualised costs: unsustainable and irresponsible pricing models in the retail energy market. We disagree with proposals that do not adequately address this problem and would instead result in higher bills for customers.
- We oppose the specific credit balance proposals put forward by Ofgem for six main reasons, set out below. We want to work with Ofgem to find solutions that work better for customers and help Ofgem to achieve its statutory duties. We propose alternatives which we think will achieve the same policy objectives without the downsides of the current proposals.

1. **The proposals increase bills for customers.** Our analysis suggests that the solution proposed by Ofgem would cause customer bills to rise because of extra financing costs, a short-term increase in mutualised costs and ongoing operational costs. Bulb’s mission is to lower bills and these proposals do the opposite.

2. **The current proposals, particularly the monthly credit balances threshold, unfairly disadvantage suppliers like Bulb who take payment in advance.** Taking payment in advance of supplying our service helps us keep costs down for customers, reduces credit risk and facilitates efficient forward purchasing of wholesale energy. This model is common in other sectors such as telecommunications, where companies like BT and Sky take payment before delivering their service. Furthermore, we are very clear with our customers that we take payment in advance and 2.5 million customers have actively switched to Bulb on that basis. To incorporate payment in advance models, Ofgem should adjust the monthly credit balances threshold up by £100.

3. **The proposals will create a poor customer experience.** Aside from increasing bills for customers, the proposals create a poor experience. This mostly stems from the target to refund credit balances above £0 regardless of customer preference or the health of their account. Some customers will receive refunds and then fall straight into debt the next month, limiting their ability to switch suppliers, and risking a monthly payment increase to cover this debit. Some customers will receive refunds based on estimated or incorrect reads and then receive demand for payment once an accurate read is received. Ofgem has presented no evidence that customers support these proposals or accept the potential downsides such as higher bills.

4. **The proposals weaken competition.** These proposals will disproportionately disadvantage challenger suppliers. Weakening the challengers is bad for competition and bad for consumers. Suppliers like Bulb have grown and flourished through consumer demand for an alternative to the old incumbents. In turn, this has exerted a downward pressure on bills and forced incumbents to improve. To understand the impact on competition and consumers, Ofgem must conduct an impact assessment in line with their Impact Assessment Guidance. An impact assessment is necessary because Ofgem has not previously regulated how energy suppliers are financed and the current proposals negatively affect Ofgem's ability to achieve its statutory duties to protect consumers and promote competition. Any proposals introduced by Ofgem must maintain a level playing field between challengers and incumbents and apply equally to all suppliers.

5. **The proposals do not support suppliers to combat climate change.** Ofgem's proposals require suppliers to secure additional financing to cover credit balances, instead of spending on innovation and technology to combat climate change. Energy suppliers are central to achieving emission reductions in homes and transport, whether launching electric vehicle tariffs or working on alternatives to gas central heating. We need to act now to meet the targets recommended by the Committee on Climate Change.

6. **The proposals are being introduced too quickly and at the wrong time.** If Ofgem proceeds with the proposals in some form, we estimate that suppliers will need at least 2 years to secure the necessary financing. With wholesale gas and electricity prices at the highest level for more than 5 years and the economy still recovering from Covid-19, now is not the time to add to customer bills unnecessarily. Moving too quickly could increase mutualised costs in the short term. In addition, suppliers and regulators need to understand the impact of BEIS' yet to be published proposals on reforms to the Renewable Obligation (RO). We ask that Ofgem consider the joint effect of the RO and credit balances proposals on customer bills and competition.

To achieve Ofgem's objectives without the drawbacks of the current proposals, we propose that Ofgem requires all suppliers to provide regular financial submissions under the Financial Responsibility principle. This would involve all domestic suppliers submitting regular financial reports, including cash flow, to Ofgem. This risk-based approach would allow Ofgem to quickly intervene if they saw a deterioration in a company's financial position and the potential rise in mutualised costs.

Main response

Question 1: Do you agree with our objectives set out in chapter 1?

Ofgem's stated objectives with the credit balances proposals are to:

- *minimise the likelihood and extent of costs to be mutualised in the event of failure in the most cost-effective way,*
- *encourage more responsible business practices in the GB energy retail market,*
- *ensure that suppliers bear an appropriate share of the cost of the mutualisation risk they pose to the market, and*
- *ensure that regulatory costs do not unduly hamper good practice, market entry, innovation, and growth*

Bulb supports reducing the risk of mutualised costs and ensuring business practices are responsible. It is important that all suppliers are adequately financed and do not run the risk of increasing costs for other suppliers. However, we do **not** think that the measures proposed by Ofgem achieve the objectives set out above. Our analysis concludes that Ofgem's proposals will increase costs to consumers. We explain why the proposals do not deliver on the objectives in our response to Question 2 and elsewhere in this response.

We want to work with Ofgem on the proposals to improve them for customers and for the market as a whole. Ofgem's proposals should protect consumers by reducing bills and promote competition by reducing costs.

Question 2: Do you agree that our proposals meet our objectives as set out in chapter 1? Please provide views on both our autorefund and threshold proposals and any alternatives you consider that meet our objectives that Ofgem should assess.

No, the proposals do not meet the objectives set out by Ofgem. As set out in response to Question 1, Ofgem's proposals should also protect consumers by reducing bills and promote competition by reducing costs. Our analysis concludes that Ofgem's proposals will increase costs to the consumer. We provide more detail on how the current proposals do not meet Ofgem's objectives in the table below.

Ofgem objective	Bulb feedback
Minimise the likelihood and extent of costs to be mutualised in the event of failure in the most cost-effective way	Ofgem's proposals will in the short term increase mutualised costs above our baseline costs, as smaller, less well-financed suppliers leave the market. Based on the current timelines proposed by Ofgem, we expect smaller suppliers to leave the market in advance of the new proposals being introduced and in the first 12 months after their introduction. We are particularly concerned that this proposal will lead to higher additional mutualisation costs around the Renewable Obligation (RO).
Encourage more responsible business practices in the GB energy retail market	Ofgem's proposals do not address the problems of tease and squeeze and unsustainable pricing, which are the fundamental irresponsible business practices in the GB energy retail market.
Ensure that suppliers bear an appropriate share of the cost of the mutualisation risk they pose to the market	To ensure a level playing field, Ofgem's proposals should apply to all suppliers equally. However, the current proposals do not share out the risk proportionally. Customers of financially responsible suppliers such as Bulb would see higher bills because of measures brought in to regulate the financially irresponsible. We have previously shared our Financial Responsibility policy with Ofgem.
Ensure that regulatory costs do not unduly hamper good practice, market entry, innovation, and growth	Ofgem's proposals increase costs for challenger suppliers who are innovating in the energy sector. These proposals divert investment away from innovative products which both help customers save money and also help to decarbonise the grid. For instance, Bulb is currently spending millions of pounds on innovation around products like our EV tariff.

In addition to the objectives listed, Ofgem should consider the impact that introducing these proposals would have on competition. These proposals disproportionately impact challenger suppliers. In contrast, the incumbents have parent companies with big balance sheets based on past profits - profits often made by charging disengaged customers more. Ofgem's proposals also favour vertically integrated suppliers who can leverage their generation assets.

We propose an alternative approach below.

Alternative solution

There are a number of different ways for Ofgem to achieve their objectives without increasing customer bills, weakening competition or creating a poor customer experience. We have considered a range of alternatives and outline below what we consider to be the best alternative. We are very willing to work with Ofgem to further develop this solution.

Regular submissions under Financial Responsibility principle Ofgem should deploy its new Financial Responsibility principle (alongside other financial disclosures) to require all domestic suppliers to submit regular financial reports, including cash flow. This risk-based approach would allow Ofgem to move quickly to intervene if they saw a deterioration in a company's financial position. Ofgem can decide whether the supplier is compliant with the Financial Responsibility Principle. This approach would also be consistent with Ofgem's separate proposals to extend the Consolidated Segmental Statements to cover more suppliers, including those which are not vertically integrated. Ofgem could consider only using the measures proposed when they have assessed that a supplier is not meeting the Financial Responsibility principle. In practice, this could mean that, if a supplier's approach to financial management was causing concern, then Ofgem could engage with the supplier to better understand its growth and financial plans. If Ofgem was not satisfied, it could then explore interventions such as requiring the supplier to either seek further financing or protect a proportion of credit balances in line with the threshold proposal.

Amendments to existing proposals

If Ofgem decides to continue with the proposals, we recommend amendments that will achieve the same policy objectives while limiting the negative impact on customer bills and the competitiveness of the sector. These amendments are set out in the table below.

Implement the proposals over 2 years	Implementing the proposals over 2 years from the decision being made would allow suppliers to prepare for the changes, source alternative financing and hire people to design technology solutions to manage the new operational impacts. Implementation against Ofgem's current timescales (56 days + 30 days) is not possible.
Increase the de minimis value for autorefunds to £100	Autorefunds should apply to credit balances over £100 rather than £0 after 12 months. This would minimise refunds that put consumers into debt and allow for unusual consumption

	events, e.g. a prolonged cold spell or Covid-19. Under this amendment, if a customer held more than £100 of credit balances with Bulb after 12 months and had provided a meter reading in the past 30 days, then we'd refund anything over £100. Ofgem has provided no evidence that consumers are unhappy with keeping their accounts in credit, as long as they can obtain a refund if requested.
An opt-out for autorefunds	We recommend that Ofgem commission research to investigate whether credit customers prefer to keep a credit balance in their accounts, for example, to cover a cold spell or unplanned consumption. We are aware that other energy suppliers have conducted research which shows their customers prefer to retain a certain amount in their account to help smooth energy payments through the year. We expect this research to show that customers would prefer the option to opt-out of autorefunds.
Require a recent meter reading before issuing an autorefund	Autorefunds should only take place where a validated meter reading is received in the 30 days prior to the 12 month anniversary, or the customer has a commissioned smart meter. We estimate that 25% of gas and electricity customers with traditional meters do not provide a meter reading within 3 months of their 12 month anniversary. This means the autorefund is likely to be inaccurate.
Exclude referral bonuses from autorefunds	Referral bonuses help suppliers to grow based on the quality of service and word of mouth. The current Ofgem proposals are not clear on how referral bonuses would be treated. We recommend that referral bonuses are excluded from autorefunds because they do not relate to consumption.

Question 3: Do you agree that our draft Standard Licence Conditions reflect our policy intent?

Given our concerns with the unintended consequences of the proposal and its failure to meet the objectives set by Ofgem, we do not provide a view at this stage on the drafting of the licence conditions. We are very willing to work with Ofgem on the drafting of any new licence conditions as the proposals change ahead of statutory consultation.

Question 4: Do you agree that autorefund of credit balances above £0 at the end of 12 months should not be tied to receiving a meter reading from the customer?

No, we disagree with Ofgem. To deliver a positive customer experience, Ofgem should amend its proposals so that any autorefund requires an up-to-date meter reading. We are very willing to provide refunds to customers and have a well-established process to do so (see here). Our main concern is that the refund is accurate. We secure reads and provide an accurate bill for 97.6% of customers at least once a year (see Citizens Advice star rating here) - but this would not be frequent enough to ensure the autorefund is accurate. We estimate that 25% of electricity and gas customers with traditional meters do not submit a read within 3 months of their 12 month anniversary. In all of these cases, the autorefund is likely to be inaccurate and could lead to unnecessary customer hassle. If we were required to refund a customer based on an estimated read, it is likely that we will need to bill them for at least part of that refund not long after. This creates a very poor customer experience, with customers more likely to fall into debit.

We also do not think Ofgem has adequately considered the costs of the proposed autorefunds policy. We estimate that implementing and operating Ofgem's current autorefund proposal would cost Bulb at least £750,000 / year in processing costs alone. There would also be additional headcount required to amend our software to facilitate autorefunds and to manually check that autorefunds are processed correctly. As we price according to the true cost of energy, these costs would unfortunately mean higher bills for our customers. It is not clear to us that the benefits of the proposal outweigh the costs.

Question 5: Do you agree that suppliers operating a payment in advance business model should face the cost of the risk they pose to the market?

No, we disagree with Ofgem. Ofgem asserts that suppliers who take payment in advance *"receive a working capital benefit as they do not have to raise these funds via equity or debt on the commercial markets and face the cost of capital for this"*. Ofgem has not explained why this is problematic when it reduces customers' bills, is a more efficient use of capital and reduces systemic risk to the energy sector. The payment in advance model is used in other sectors such as telecommunications and operated by companies such as BT and Sky. If payment in advance is acceptable in a similarly regulated sector such as telecommunications, we do not understand why Ofgem is concerned by the practice in the energy sector.

In our view, the problem is not with payment in advance models but rather with unsustainable pricing. Ofgem's current evidence base on payment in advance is weak and does not support the conclusion that payment in advance models lead to suppliers leaving the market. For instance, Bulb operates a payment in advance model, is financially responsible and does not offer unsustainable tease and squeeze tariffs. Indeed, Bulb is not the only challenger supplier to grow while operating a payment in advance model and avoiding tease and squeeze.

Ofgem should conduct an assessment of energy suppliers that have left the market in the last 5 years to understand:

1. How many operated a payment in advance model
2. How many operated a “tease and squeeze” pricing model

We expect this analysis will show that “tease and squeeze” pricing is the common problem, not payment in advance.

Question 6: Do you agree with the obligation and compliance approach for thresholds as outlined?

If Ofgem was to introduce the threshold, we would prefer that all suppliers were required to demonstrate compliance with the threshold on an annual basis. Ofgem should look to find ways to minimise the cost of demonstrating compliance.

Question 7: Do you agree that there should be tolerances around the threshold and how do you consider these should be set?

If Ofgem was to introduce the threshold, we support Ofgem including a tolerance around the threshold. In our modelling, we estimate this tolerance should be set at £100 / customer, i.e. the average customer monthly bill. A tolerance would allow suppliers to manage sudden variations in usage, as in the case of cold weather events. Suppliers can not always update Direct Debits quickly enough to capture unexpected colder weather and forecasting consumption is going to become more difficult in the coming years because of the effects of climate change. A £100 tolerance would reduce the risk of suppliers accidentally not complying with the threshold in these situations.

Question 8: For suppliers: For your fixed direct debit customers what is the average percentage difference between estimated annual bills and actual annual bills for those accounts that ended with a positive credit balance?

Since Bulb started supplying energy in 2016, our actual annual bills have on average been 1.2% less than estimated annual bills for those with a positive credit balance. However, if we just look at more recent data (annual bills ending in 2020 and beyond) the difference is only 0.2%. This shows how Bulb successfully ensures that fixed Direct Debits accurately cover consumption.

Question 9: Please provide your view on the credit balance threshold model published alongside this consultation. Do you agree:

a. With the methodology we have used to calculate surplus credit balances in our draft threshold model?

b. That our threshold needs to reflect that consumers who start at different points of the year have different credit balance requirements?

c. That our model methodology accounts for the impact of contract start date on our threshold?

We disagree with the threshold model as proposed by Ofgem, especially the lack of a tolerance. If Ofgem introduces the threshold anyway, we agree that the threshold must reflect the difference between customers joining at different points in the year, e.g. those joining in April and those joining in October. It must also include a tolerance to allow for usage variation.

The method proposed seems reasonable for a theoretical TDCV dual fuel customer. However, Ofgem should consider that focusing on 'the average user' ignores other types of customers. Customers' circumstances are unique and complex. For instance, it is unclear how Ofgem's proposals, including in relation to the threshold, accommodates single fuel customers or customers on tariffs like Economy 7 or Economy 10 or restricted metering set-ups. These customers in particular need to build up high credit balances for electricity to cover higher usage in winter.

If Ofgem introduced the threshold, we agree that we must account for the contract start date on the threshold.

Question 10: Do you agree that these measures should apply only to domestic consumers?

Yes, we agree these measures should not apply to non-domestic customers. We recognise that costs for non-domestic customers are not mutualised in the event of supplier failure.

Question 11: Do you agree with the proposed implementation timings?

No, we do not agree with Ofgem's proposals implementation timeframes. Ofgem's proposed [56 + 30] days for implementation is not possible. Ofgem should allow at least 2 years for implementation from the date of the decision. Suppliers already operating in the market would need this time to implement the proposals, particularly to allow suppliers time to find alternative sources of financing.

The timings in the consultation are not clear, and - if Ofgem proceeds with these proposals - we ask Ofgem to provide a more precise implementation timeline in the statutory consultation. For instance, Ofgem should be clear what month and year that (a) the autorefund policy and (b) the threshold policy would begin. Some suppliers have previously advised Ofgem that an implementation period of two years from the decision being made is required. We agree.

In addition, we ask that the impact and implementation period for the RO proposals be considered jointly with Ofgem's credit balance proposals. BEIS and Ofgem will shortly be consulting on proposals to reduce RO mutualisation. Ofgem's consultation makes clear that RO mutualised costs are more material, worth up to £6.5 billion compared to around £1.4 billion in total credit balances. In the last 3 years, the total RO mutualisation has been £189.2 million, compared to £47.6 million from credit balances. We do not yet know when possible changes to the RO scheme will be consulted on or introduced.

Moving too quickly could increase additional mutualised costs in the short term by forcing a number of smaller suppliers to fail and enter the Supplier of Last Resort process. For this reason, we recommend that Ofgem considers the impact of its proposals on competition and whether any changes should be introduced over time.

Finally, while we oppose the introduction of the proposals as presented, we ask that Ofgem ensures a level playing field if any new rules are introduced. This means applying the rules to all suppliers, large or small. To apply the proposals unequally across suppliers would distort competition. We also encourage Ofgem to continue to work with BEIS to reduce and remove the thresholds for schemes such as the Warm Home Discount, Energy Company Obligation (ECO) and offering Pay As You Go meters. While the thresholds have recently reduced from 250,000 customers to 200,000 customers for the Warm Home Discount and 150,000 for ECO, more can be done. Lowering the threshold further would ensure customers do not miss out on protections and rewards just because they choose the wrong supplier.

Additional comments on the proposals

These comments did not neatly fit into the consultation questions.

Customers in credit are able to switch suppliers more easily than those in debt. Customers in debt may see their switch objected to by their current supplier. Ofgem's proposal would likely mean more customers are in debit, especially during the winter months. Has Ofgem considered the impact on switching rates?