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Dear Dan

Response to the Ofgem Call for Input on the future of the BAT post-March 2024

Uswitch welcomes Ofgem considering the future of the BAT post March 2024. It is appropriate and necessary that Ofgem reviews short term interventions that it put in place in response to a very specific, acute set of circumstances in light of the current market conditions.

In the case of the BAT, Uswitch is firmly of the view that the measure must be allowed to expire in March 2024.

We consider that as a tool for pricing protection, the BAT has significantly more negative consequences in the market than any possible benefits in terms of customer outcomes, both for switchers and customers more likely to remain with their existing supplier.

As a device for market stability, we do not consider there is sufficient evidence to leave it in place, particularly given the current market conditions and the other enduring changes Ofgem has since made to the supplier regulatory framework that better address market stability.

We respond to the specific questions set out in Ofgem's call for inputs below.

1) Do you consider there is merit in keeping the BAT in place post March 2024, after the discontinuation of the MSC?

We do not believe there is any merit in the BAT being retained after March 2024. Ultimately, the BAT is failing on its own terms and is failing to improve either the stability of the energy market or the prices paid by consumers. There are four key reasons that the BAT should not be extended.

First, the price cap itself is a sufficient control for retail overcharging, and the BAT therefore can only reduce the chances of the market to beat this price. Indeed, it is more likely that the BAT is making energy bills more expensive. The energy market does not need an additional measure to try and prevent overcharging when there is no analysis of the costs and benefits, and little indication that it is effective for this purpose.

We appreciate there is a wider debate around whether the default tariff cap is the most appropriate device for retail price protection going forward and whether a device like the BAT might play a role in a future retail regulatory framework. However, we think it's important Ofgem makes a decision on removal of the BAT now given the known regulatory framework. It would clearly not be appropriate by way of regulatory process, to keep a temporary measure in place on the off chance it may be useful in future in a completely different regulatory environment for which there is no certainty.

Second, the BAT is actually leading to higher bills for households. While the BAT was introduced in an attempt to improve the financial stability of the remaining retail energy suppliers, the reality is that it has led to higher prices for households at a time of already higher energy bills because it makes it much less likely that cheaper tariffs will be available to those who would most benefit from them.

Third, the reduction in relative volatility in the wholesale and retail markets means, if there ever were, there is no longer a need for the BAT. As wholesale prices have stabilised, suppliers should be incentivised to compete on quality and price. However, the BAT discourages this, increasing the likelihood that falling wholesale prices are not passed onto household bills. At a time when consumers should be presented with a greater choice of tariffs, the BAT stifles incentives to compete, leading to households paying more than they should.

Fourth, the burden of proof should be on Ofgem to prove that this temporary measure should be retained on a permanent basis. If a temporary measure is to be made a permanent, significant feature of the retail energy market, Ofgem should launch a formal

consultation, gather evidence from all stakeholders in the energy market, and prove that the BAT reduces bills for consumers and genuinely makes the market more stable.

2) Market Stability

(i) Can you provide your thoughts on/evidence of the impact of the BAT to date in terms of market stability?

While the BAT was ostensibly created to make the energy market more stable, it fails to achieve the correct balance between market stability and competitive risk for suppliers. In fact, while the BAT has had a series of negative impacts on the wider energy market, it has done relatively little to improve the stability of suppliers.

BAT is not necessary to create a stable energy market and, given the negative impacts it has on the price and quality of tariffs, it is an inappropriate mechanism for trying to achieve this. This is due to its significant impacts on the level of risk for suppliers, creating a market where they are not incentivised to improve their offering to retain or attract customers.

Ofgem has taken forward a number of other measures to ensure that energy suppliers are financially stable and sustainable. In particular, tightening the requirements on new suppliers entering the market and strengthening the rules on financial prudence are both more effective ways of improving the stability of the market and have fewer unintended consequences for both suppliers and consumers.

Alongside the BAT's limited contribution to the stability of suppliers, it has also made the market less stable for households.

The BAT, along with the Market Stabilisation Charge (MSC), prevented falling wholesale prices from being passed onto consumers, slowing the recovery to a more stable market by preventing bills from dropping as quickly as they should, which would have allowed competition to return to the market. We also believe it hinders the consumer take-up of fixed deals at reasonable prices through limiting offers and thereby increases exposure to the regular price changes now afforded by the price cap.

The costs associated with the BAT were then passed onto consumers, artificially inflating offers available to customers. It has caused stasis across the market with households remaining on tariffs covered by the price cap with their existing providers, as suppliers cannot offer new and more competitive tariffs to try and win these customers. This significantly reduces competition and makes it harder for households to access better, cheaper deals.

(ii) Can you provide your thoughts on/evidence of the BAT's likely impact on market stability, if it was retained post March 2024 as a standalone measure?

As outlined above, while the BAT was designed to make the retail energy market more stable, the reality is that it is raising energy prices for households by making it harder for suppliers to offer attractive deals to potential customers. While we appreciate that it was originally designed to control for a particular scenario of instability (a rapid downward correction in wholesale prices), the chances of this scenario are now more remote and in any event Ofgem's more recent changes around financial prudence within suppliers are a sufficient control. For example, imposing strict entry requirements for new market participants and reinforcing financial prudence regulations are more effective approaches to bolstering market stability, and do not have the unintended consequences in the market that the BAT produces.

Ofgem itself admitted that the BAT could be 'disincentivising suppliers from offering new tariffs', and that there was no evidence that the BAT provided market stability without the MSC. It is clear that the measure should be discontinued as soon as possible.

3) Competition: impact on suppliers and consumers

(i) What impact would the BAT's existence post-March 2024 have on market competition for

- a) existing suppliers and**
- b) new suppliers seeking to enter the market?**

Retaining the BAT beyond March 2024 would have a clear and negative impact on competition for both existing suppliers and for new suppliers who are seeking to enter the market.

In the case of existing suppliers, the BAT makes it much more difficult for them to compete for customers, but also for customers to choose from suppliers. The BAT limits the range and price of tariffs that suppliers can offer, creating a market in which the overwhelming majority of households are covered by the price cap. This means that no meaningful competition takes place, as suppliers cannot offer new and better value tariffs.

For new suppliers, this is likely to present an even more significant challenge. First, the extension of the BAT would send a negative signal to those interested in investing in the sector, because the BAT, and other regulatory measures, have essentially created a frozen market, where ability to grow is limited. This will make market entry a far less attractive

option, ultimately reducing the number of suppliers who can compete for customers. Even smaller and mid-sized suppliers are swiftly faced with similar incentive dynamics under the BAT as large suppliers, particularly with the price cap still in effect.

Finally, even if the BAT did enable new entrants to compete against existing suppliers, it would have significant and negative impacts on the energy market, with suppliers largely lacking incentives to innovate or meaningfully compete. As a regulator, Ofgem should not aspire to create or oversee a market in which firms are frozen out of competition and innovation. The logical end point of the kind of market that the current regulatory settlement is creating is a small number of incumbents left to serve their customer bases at an unjustifiably high cost. This is a missed opportunity to encourage innovation amongst the suppliers that would otherwise have the capital to further invest in the market, and it is ultimately consumers who will lose out in the form of higher bills for a lower quality product.

(ii) What impact do you consider the extension of the BAT would have on
a) active and
b) inactive consumers (i.e. less likely to switch), in terms of realising the benefits of any competition?

Continuing the BAT will have a negative impact on both active and inactive consumers by driving up prices and preventing genuine competition. With cheaper tariffs being unavailable, the impacts on active customers are obvious – they will not have a meaningful opportunity to shop around for the best deal possible because there is no genuine competition in the market. This means that they face a serious risk of paying higher bills for a lower quality service for as long as the BAT remains in operation.

While inactive consumers may appear to benefit on the surface, the reality is that with the BAT in place, there is a reduced threat that existing customers more generally may leave their current suppliers. This means that suppliers are not incentivised to provide better deals to existing customers, artificially inflating prices throughout the market, including for inactive customers in the market.

The existence of the BAT also significantly weakens the incentive for suppliers to offer a good deal to customers who will take a fixed deal with their current supplier and not switch. The BAT, along with other regulatory measures such as the price cap, has created a market in which suppliers have virtually no fear that they will lose their customers, meaning that they do not feel that they need to offer the best possible product or prices to the customers they have now. If this is sustained for a prolonged period, there is an increased risk of consumers of more pervasive disengagement from the market.

In addition, the price cap is the intervention through which entirely inactive customers are protected — the removal of the BAT would not change their circumstances. Whilst there is a wider debate on the future of price regulation to protect inactive customers in the most efficient way, this is not relevant to the question of whether the BAT should be retained, because it does not make a meaningful contribution to protecting inactive consumers from higher prices.

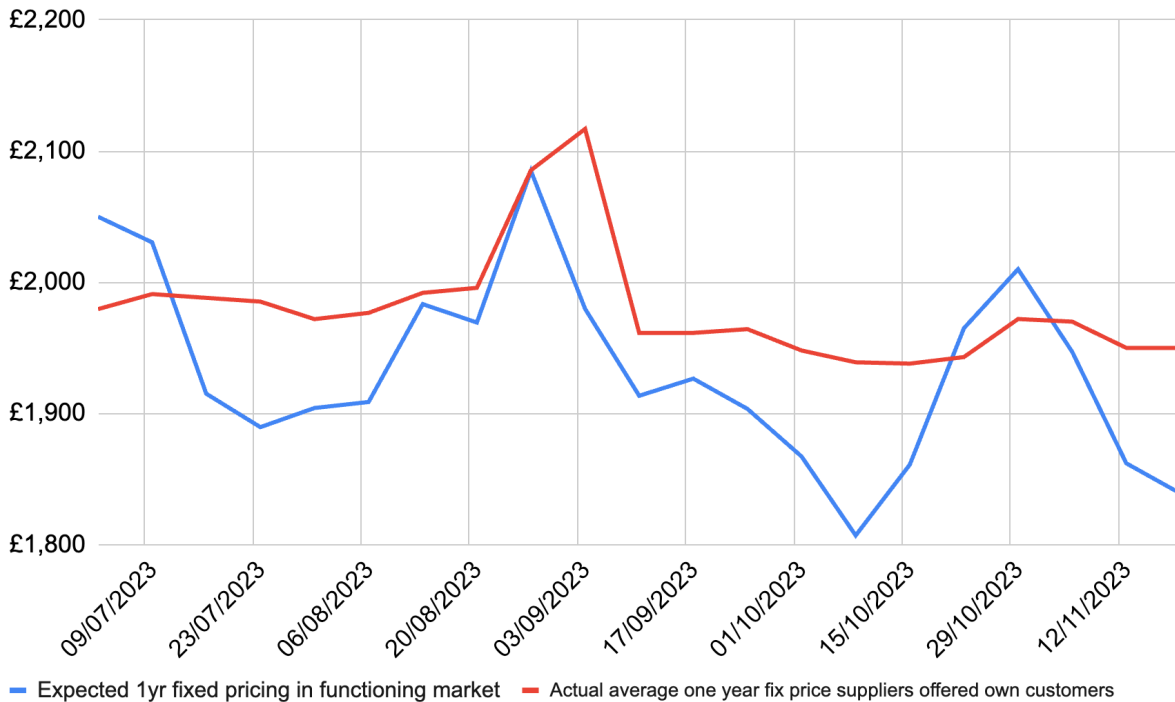
(iii) What are your thoughts on the BAT’s role in making discounted deals available to a supplier’s existing customers, and are you able to provide evidence to support this? Do you consider that there is benefit in having the BAT in place to provide this function while the price cap is also in place?

As mentioned above, the BAT may have directly reduced the number of discounted deals available to existing customers, for two key reasons. First, the BAT disincentivises consumers from shopping around for the best deal, because it makes it very unlikely that these deals will be available at all. Second, suppliers themselves face no meaningful incentive to offer the best possible products and prices to their consumers, because the BAT has created a market in which there is virtually no competitive pressure on suppliers.

Uswitch runs a model every week to look at what we expect one year fixed tariffs pricing to be in a normally competitive market, taking the non-wholesale cost base and margin assumed in the price cap with the prevailing one year wholesale price. We compare this with our best intelligence on supplier fixed tariffs offered (in this period where existing customer only fixes are the most relevant). While there is significant variance between supplier offers, and indeed many suppliers not offering any fixed options at all, since the BAT has been in place it is very rare for us to see pricing that would be close to what we would expect if that market were competitive.

Chart 1, below, illustrates our modelling and data since the price cap overtook the EPG and began setting standard tariff prices again. Across the period, own-customer fixes were £42 more expensive on average than what we would expect in a competitive market for typical consumption. In practice, we consider this a conservative estimate, as we did not consider suppliers that offered no fixes in the period at all (where in a competitive market, they almost certainly would offer an option) and in a competitive market, we would expect some suppliers to sacrifice a level of margin or reduce cost base in order to retain customers (where our model holds a reasonable margin or changes to cost base).

Chart 1 – Post EPG week-on-week comparison of modelled expected one year tariff price (based on wholesale pricing, cost modelling and reasonable margin) vs average actual one year fixed tariff price offered by suppliers



Note: Uswitch model takes one year wholesale contracts pricing and non-wholesale cost base and margin assumed in Ofgem’s price cap model as a proxy for reasonable fixed tariff cost in any given week, with an assumed one week delay on offering the prevailing wholesale one year fixed price in a retail product. Actual tariffs offered average across suppliers offering a deal in a market (some suppliers have not offered fixed tariff options at all in this period), but excludes products where customers are required to bundle with another product.

We do not feel that the BAT makes discounted deals available to suppliers’ existing customers, or at least not at a price we would otherwise expect, and therefore do not think there is a benefit to it – regardless of whether the price cap is also in place or not. If the price cap is in place, it has to be the control for retail overcharging, and the BAT therefore does not meaningfully reduce the prices paid by consumers. If it is not in place, the BAT still reduces the likelihood of existing customers switching suppliers, as suppliers are not incentivised to offer discounted deals to existing customers since there is little to no risk of these customers finding a better deal elsewhere.

More broadly, the current system of consumer protection – including the price cap and the BAT – is not fit for purpose. Any effective system of consumer protection must achieve three goals: protecting the most vulnerable; driving down prices for the majority of

households; and preventing future spikes in wholesale prices from making bills unaffordable. We do not believe that the price cap or the BAT adequately do any of these.

(iv) What are your thoughts on the existing policy and process for market-wide derogations for fixed retention tariffs?

As we have set out in this response, we believe that the BAT should be ended as soon as possible in order to improve competition in the energy market. This would improve the pricing and quality of tariffs available to consumers.

However, the current position on market-wide derogations under the BAT creates a lottery for consumers on whether fixed retention tariffs are available. Some suppliers have offered reasonable options for fixed tariffs, whereas others have not offered them at all. Whether or not a customer has access to fixed deal options would be the luck of the draw, since it varies so much between suppliers.

4) Impact on tariff offerings

(i) Can you provide your thoughts on/evidence of the BAT's likely impact on supplier tariff offerings?

As outlined above, the BAT has a negative impact on supplier offerings. Given the BAT significantly reduces the competitive pressure on suppliers to offer better and cheaper deals to both new and existing customers, it ultimately reduces the range and quality of tariffs that are on offer. In practical terms, this means that consumers end up paying higher bills for a lower quality product.

Active consumers will face limitations in finding cheaper tariffs, reducing their ability to explore better deals. Inactive consumers, while seemingly benefiting, will experience a drawback as the BAT reduces the likelihood of existing customers switching suppliers, meaning that suppliers are not incentivised to improve their offering, while market prices are potentially inflated.

(ii) What are your thoughts on whether changes should be made to the BAT in order to make it a more effective policy to encourage competition (rather than as a policy to support market stability)?

Notwithstanding our concerns on Ofgem's enforcement and derogation with the BAT, there are unlikely to be changes that can be made to the BAT that will enable it to

encourage competition, rather than its current objectives on market stability. Ultimately, the BAT as designed significantly reduces the amount of competition in the market.

Further, similar initiatives have historically reduced competition in the market. For example, while the non-discrimination condition introduced by Ofgem in 2008 reduced the average price differential between in-area and out-of-area electricity Standard Credit Bills, this was actually accompanied by an increase in the average bill. Studies have found that Ofgem data indicated significant increases in dual fuel gross and net margins, suggesting that there were aggregate price rises since the introduction of the measures.

The non-discrimination condition and accompanying interventions resulted in less effective competition between regional incumbents and large competitors, ultimately creating a market resembling a duopoly between British Gas and whoever regional incumbent happened to be. There was also a significant reduction in switching rates. The creation of regional duopolies and a reduction in switching will ultimately both lead to consumers paying higher prices while suppliers have no incentive or competitive pressure to improve the quality or cost of their offer. This is, in many ways, the exact set of problems created by the BAT, although it has achieved this by freezing the existing market rather than creating a duopoly.

Whilst Ofgem aimed to remove 'unfair differentials' to save £500m for some customers with suppliers' revenue remaining constant, suppliers' revenue actually increased by £1bn despite the reduction in differentials.¹ This indicates that the policy actually led to a significant increase in the costs facing consumers, which has a clear and negative impact on consumers, particularly those with existing vulnerabilities.

This is why we believe the BAT should be removed from the market as soon as possible. The reason for its initial inception has since ceased to exist, regardless of whether or not it was responsible for achieving these goals.

Additionally, if Ofgem wishes to retain the BAT — either as it stands or with significant reforms — on a more permanent basis, it should launch a formal consultation, gather evidence from all stakeholders in the energy market, and prove that the BAT improves competition and reduces bills for consumers.

¹ [Promoting competition and protecting customers? Regulation of the GB retail energy market 2008–2016](#)

We hope our response is useful. We would welcome the opportunity to discuss any points raised with Ofgem further.

Yours sincerely

A handwritten signature in blue ink that reads 'Richard Neudegg'. The signature is written in a cursive style with a horizontal line underlining the name.

Richard Neudegg
Director of Regulatory Affairs