

Ofgem future price protection discussion paper - Octopus Energy response

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We welcome Ofgem starting this discussion - how price protection should evolve is a crucial and timely question. When taking forward this work, we urge you to consider the following observations:

- **Continued price protection is needed to support a competitive market**, as well as to protect customers. We welcome Ofgem's recognition that the cap is the only thing stopping the loyalty penalty from returning. Interventions like the Ban on Acquisition Tariffs (BAT) also help prevent the return of "tease and squeeze" and the market distorting "unilateral market power" the CMA identified arising from legacy suppliers hold over their loyal customers.
- **The cap is not an affordability measure**. We fully support Ofgem using the price cap to take costs out of bills (e.g. by making suppliers more efficient) but we are concerned with the proposals of a price protection mechanism that only applies to a subset of customers. This kind of approach undermines Ofgem's recognition that the cap is not about affordability. Addressing bill affordability is important - but should not come at the cost of fixing the loyalty penalty and associated market distortions.
- **Price protection interventions should be simple and non-distortive**. We do not accept Ofgem's view that differentiation in cost to serve across suppliers is shaped by so-called "non efficiency factors" - and we further disagree that this merits changes to the price cap, or further levelisation/reconciliation mechanisms, which could be distortive. We urge Ofgem to ensure that the cap creates regulatory certainty by being simple and streamlined.
- **Ofgem and industry need to work together to build consumer trust in smart tariffs and products so everyone can benefit from the cost savings arising from flexible consumer demand**. As domestic heating and cars are electrified, there's a huge potential to make this new demand smart and flexible, while capturing further but lower benefits from some flexibility in other household demand.¹ Capitalising on that potential requires both allowing competition to flourish, and designing consumer protections and price regulation which build trust. For example, forcing customers onto TOU default arrangements could be met with consumer pushback similar to what we have seen in some cases with smart metering and standing charges - and should be avoided.

¹ [Centre for Net Zero \(CNZ\) modelling](#) estimates £5bn in savings each year from demand flexibility in domestic heat and transport alone. Households will see direct benefits through their bills, including 52% lower wholesale electricity costs in 2040, according to [Cornwall Insight](#), or £375 off the average household bill.

How the parameters of price protection should evolve

Price protection should be universal, not targeted, and stringent (though the approach to stringency can evolve). It should adapt for MHHS over time as needed, without trying to solve everything immediately. And this might mean that at least some customers eventually have default tariffs which are not set at a flat rate.

Price protection must be universal and apply to all customers when they do not engage. The protection might not look the same for all customers (e.g. you might have different default arrangements for those rolling off smart/TOU tariffs to those who are long term on the SVT), but we cannot substitute the cap with a social tariff or affordability measure. Doing so would be to move away from ensuring fair prices which is also an important way to help maintain public consent for transition to net zero. Non-universal protection would fail to address the issue of the unilateral market power of legacy suppliers to price discriminate between customers, which was identified in the CMA's Market Investigation.

Price protection should be stringent enough to drive efficiencies - whilst still enabling competitive pricing. This was how the cap worked pre-crisis. It's important Ofgem looks to achieve both these objectives in a market with fewer, more resilient suppliers and the re-emergence of competition. We urge Ofgem to resist calls for a "loose" cap solely in the interests of competition/engagement and avoid making it too "easy" for suppliers to make money through having customers on the cap. We also agree with Ofgem that the key to supplier financial resilience is the capital requirements and associated changes - not an overly generous cap. A focus on stringency does not mean it must be an absolute cap - in principle a relative cap could place stringent constraints on cost recovery and drive efficiency. While the absolute cap is in place, Ofgem should also keep the BAT - more on this below.

Price protection should evolve over time from flat to include more simple time of use (TOU) arrangements, at least for some customers. We will need good value default arrangements for people rolling off smart/TOU tariffs as this could create bill shock and system risks. This might look like a simple default TOU price cap for those customers (though other options are available). We suspect forcing other SVT customers onto a TOU would meet with consumer pushback/be politically unacceptable. We also don't think it's necessary for existing EV customers - our data shows 90% of them already pick a smart/TOU tariff over an SVT.

Suggestions on next steps

We prefer a customer-led and market-led approach to the roll-out of smart tariffs wherever possible and future design of price protection should take this into account. Accordingly, this is what we think Ofgem, working with DESNZ and industry, could do next:

1. **Extend the BAT beyond March 2025.** BAT is not a replacement for the cap, instead they are complementary tools to end the loyalty penalty. The BAT stops ‘teaser’ tactics and the price cap prevents ‘squeezing’ of disengaged customers. Together, they deliver clarity that the regulator will not tolerate unfair pricing.

We suggest Ofgem:

- a. Ensure that a longer-term extension of the BAT is included in its upcoming statutory consultation in this area.
- b. Include the future of the BAT in the scope of Ofgem’s planned review of competition.²

2. **Recognise that adoption of low carbon technology and market-wide half hourly settlement (MHHS) will likely mean price protections have to evolve over time.**

We suggest Ofgem:

- a. Explore options for a good default arrangement for customers rolling off a fixed TOU arrangement. This will build trust and embed helpful demand behaviours even when rolling off. This could look like a simple, TOU arrangement, or it could look like more evergreen arrangements. It also protects those customers from bill shock and insulates against supplier risk and system risk. We are happy to talk to Ofgem to see if we can trial or help in other ways to explore these options.
- b. Prioritise examining how MHHS will work with the cap. The first step is for Ofgem to size the problem by understanding the spread of customer profile usage across suppliers - and the impact of increasing levels of low carbon technology. More on this in question 2 below.

3. **Take steps to streamline and simplify the cap, whilst keeping it stringent/effective in driving efficiency and innovation.** This could include:

- (a) Limiting price protection to default tariffs. Under the current price cap legislation, all evergreen (i.e. non-fixed duration) tariffs are regulated and subject to the price cap.³ This is wider than default tariffs. We would like to

² This refers to the planned review planning of competitive pricing required under requirements under section 9 of the Domestic Gas and Electricity (Tariff Cap) Act 2018 and referred to in Appendix 1 of your [discussion paper](#).

³ Section 1(4) of the *Domestic Gas and Electricity (Tariff Cap) Act 2018* defines “standard variable rates” as “a rate or amount charged for, or in relation to, the supply of gas or electricity under the contract that is not fixed for a period specified in the contract”, which captures evergreen contracts.

see the price cap subject only to *default* tariffs - i.e those which customers have rolled onto or for those customers which have never made an active choice about their tariff. While evergreen tariffs are still in scope of the cap, it can be risky for suppliers to offer evergreen TOU tariffs as obtaining assurance from Ofgem that non-standard evergreen tariffs (including time of use defaults or evergreen tariffs) are price cap compliant is onerous and not scalable. This will allow more tariff innovation ahead of MHHS

- (b) Exploring alternatives such as a simplified version of the absolute cap, e.g. a passthrough+ price cap, which has a wholesale allowance set quarterly and a number of other elements (e.g. passthrough system costs/taxes and supplier cost and EBIT allowances) that are set less regularly - perhaps annually at most.
- (c) Exploring different approaches to the absolute price cap. A relative price cap is intuitively attractive as, on paper at least, it solves the issue of “tease and squeeze” in the market while avoiding Ofgem having to effectively set hedging strategies and would be more simple. A relative cap can still be stringent and we would like to see Ofgem do more to explore how a relative cap might work in practice.

4. Rule out certain approaches to price protection. As Ofgem moves forward from this discussion paper, we suggest ruling out some approaches to price protection. In particular:

- (a) Avoid forcing flat rate SVT customers onto a TOU. We suspect that forcing SVT customers onto a TOU default tariff (whether it's simple or dynamic) could be met with considerable consumer pushback (as we have seen in some cases with smart metering and standing charges). We also think that there is no need for intervention in the provision of smart/TOU tariffs to high load users (like EV drivers or heat pump owning households). In a competitive retail market that incentivises suppliers to offer innovative tariffs, we do not anticipate a significant risk of EV customers using their technology inefficiently and imposing costs onto others. We find the majority of these customers aren't on an SVT. Our data shows that 90% of our EV customers actively choose smart time of use (TOU) tariffs already; and only 1 in 10 of them sits on the price capped SVT.⁴ In other words: there's no market failure here yet so we urge you not to design the cap as if there is one.
- (b) Rule out continuous ‘float and true up’ or levelisation approaches. The cap was designed to create an ex-ante price ceiling - not to provide suppliers with a precise revenue allowance (as in networks) nor a regulated rate of return (as in US style regulation). As the cap evolves, Ofgem should, in all cases, avoid falling into a situation of rolling “float and true-up” arrangements as that

⁴ We estimate this is the inverse of the general customer base, where based on our own data ~only 10-15% of switches have chosen a non-SVT deal.

would create uncertainty, undermine incentives, and ultimately result in consumer detriment via a less efficient, less investable, market. Similarly, approaches like levelisation/reconciliation can turn costs into a “tax” that suppliers cannot avoid (and must passthrough) rather than something that can be competed away.

- (c) Rule out other approaches including applying price protections to a subset of customers and a margins cap - see response to question 8.

Finally, we note that other policy changes are needed to ensure that both the energy system and consumers can capture the full value of flexibility. In particular, a customer-first approach to the smart meter rollout (i.e. that does not prioritise infrastructure over a good customer experience and buy-in), on time delivery of market-wide half hourly settlement (Ofgem must not give in to pressure to delay the programme to meet the demands of the slowest) and better market access for consumer flex as well as sharper price signals in time and space. These are the building blocks for smart tariffs which must be delivered alongside this workstream and we urge Ofgem’s retail teams to be joined up with other teams in these areas.

When designing reforms, we think Ofgem should seize the opportunity presented by the reopening of the market after the energy crisis and the growing smart tariff market. It's important that any future price protection reforms focus on competition, don't scare off customers, and support the growth of smart tariffs - rather than just deal with challenges of the last few years.

We appreciate Ofgem's open and collaborative approach, especially their alignment with DESNZ. We're looking forward to working together and discussing our response further.

Alexandra Meagher
Group Head of Regulation

Responses to Call for Evidence questions

Evaluating the cap today

1. Do you have any reflections on our list of the cap's successes and challenges?

The price cap has done a good job. When it comes to protecting consumers, it's one of the most effective policies we've ever seen, ensuring everyone pays a fair price.

We agree with your assessment of the cap's successes and want to share further data:

- (a) It has improved efficiency - beyond Ofgem's estimates: Analysis from Public First has found the indirect costs for legacy suppliers fell by 18% in real terms from 2019-2021 (and customer satisfaction remained mostly stable in this period)⁵ - higher than the 11% that Ofgem cites.
- (b) It has protected disengaged customers from price exploitation: Public First analysis shows that the price cap has saved 'sticky' customers across all suppliers (those that don't regularly switch) £1bn a year over 2019-2021: £3bn in total. It has also found that as a proportion of disposable household income, the poorest 10% benefited from savings 6-7 times that of the wealthiest 10% - the cap has had a distributional benefit as well as protecting all loyal customers.
- (c) It has preserved conditions for competitive pricing and switching: Despite concerns that the cap might stifle competition, suppliers continued to offer competitive fixed tariffs priced under the cap and switching rates sat at between 2% and 9% from 2019-2021. The cap also fostered an environment that allowed challenger firms to compete with legacy suppliers and grow.

We would add a couple more points to your assessment - and would like to see Ofgem recognise these roles when it assesses the cap:

- (a) The price cap also plays a vital role in generating a level playing field and effective competition in the retail market. A key finding of the CMA's Energy Market Investigation was that legacy Big Six suppliers had "unilateral market power" (based on the low price elasticity of their loyal/inactive customers), that they exploited their power through discriminatory pricing, and that this had a negative impact on competition in the market overall - including through lessening consumer engagement.⁶ Consumer engagement is even more important in a future retail market - this CMA concern should not be forgotten.
- (b) The price cap has helped build trust in the energy market - especially during a time of crisis. Public First's polling data found very positive public views of the price cap: over

⁵ Public First, [Fuelling Fairness: Five years of the energy price cap](#), February 2024.

⁶ CMA, [Energy Market Investigation: final report](#), 2016, paras 156-160.

51% of those polled agreed that the price cap means energy customers are not charged unfair prices.⁷

- (c) The price cap's role changed in the energy crisis, but it still played a safeguarding role. We do not agree with Ofgem's assessment that the cap "*led to additional costs for consumers during a period of volatile energy prices*". Rather, against a backdrop of soaring wholesale energy costs, the cap safeguarded consumers by slowing the pace of price increases. Without this delay, some form of government support would likely have been required much earlier. In addition, the cap really just exposed existing risks in the market with supplier business models. It is clear that suppliers with prudent finances and better hedging were able to survive the crisis.
- (d) The price cap enabled government bill support to be designed and implemented quickly. As a trusted, 'reference price', it helped the Government to confidently pay a fair compensation to suppliers for charging customers the discounted Energy Price Guarantee rate.

Evaluating the current cap for the future

2. Do you believe that the growing diversity of electricity consumption patterns will make it challenging to retain a flat, universal and stringent price cap? How quickly do you think this will materialise and with what impacts? What evidence can you provide to support your view?

We can identify two possible issue around the growing diversity of consumption patterns when combined with MHHS:

- (a) Supplier effects - Post-MHHS, we might see a range of different costs to serve across suppliers depending on the mix of load profiles in their customer portfolio. There is a concern that as load profiles are not likely to be distributed evenly across suppliers there could be winners and losers across suppliers post-MHHS, with some suppliers sitting with a higher proportion of high cost customers on the cap than others.
- (b) Customer effects - Post-MHHS low load profile customers will be cross subsidising high load profile if the SVT remains a single rate tariff.

It is crucial for Ofgem to take an empirical approach to understanding the materiality of these issues. We urge Ofgem to conduct market-wide data analysis in this area as part of its upcoming review of how MHHS will work with the price cap. We have conducted initial analysis of our own customer load profiles and would welcome an opportunity to share and discuss this with you in the coming days.

At this point, we offer two observations:

⁷ Public First, [Fuelling Fairness: Five years of the energy price cap](#), February 2024, Figure 25.

- First, the growing diversity of electricity consumption patterns will not necessarily manifest as significantly greater diversity of consumption patterns amongst customers on the SVT. Our data shows that 90% of our customers with an EV actively choose smart time of use (TOU) tariffs already - only 1 in 10 of them sits on the price capped SVT.⁸ So what will materialise is not necessarily a growing diversity of load patterns on the SVT where the supplier provides a range of attractive, easy to use smart tariff options to its customers. We share more detail on our smart and TOU offerings in question 3 below.
- Secondly, our initial analysis of a sample of our customer data shows that, at the moment, there is a very narrow spread across customers in terms of the profile of their usage (and therefore their cost to serve post MHHS).

If Octopus is typical (and we are the largest electricity supplier) this suggests that - at least initially - there are likely to be minimal cost implications for suppliers of retaining a single/flat rate SVT in the early period after MHHS has been introduced. In this case, keeping a flat/single rate SVT would encourage suppliers to keep innovating to encourage high load profile customers off SVT and on to competitive TOU/smart deals in the market where they can save money and support the system. However, there still remains a question whether those customers with low load factors should benefit immediately from MHHS through lower prices. This would be a positive outcome for certain customers, but - without further analysis - it's not yet clear if this is sustainable for the supplier.

If, however, Octopus is not typical, and market-wide data analysis shows that continuing with a single rate SVT would cause significant financial problems for some suppliers, possible options include developing a simple two-rate arrangement (e.g. building off the current E7 arrangements) for those customers who have higher load cost factors, or developing two different price cap profiles for customers with outlier load profiles. We recommend that Ofgem examine options like this in its upcoming review of how MHHS and the cap will work.

3. What plans do suppliers have to launch ToU tariffs and to incentivise customers to shift their electricity consumption once MHHS is implemented?

We will continue to innovate in smart TOU tariffs, regardless of the progress on MHHS. However, we do expect this programme to improve the incentive on suppliers across the market to innovate in these products which is why Ofgem should not give in to pressure from suppliers, DNOs or other parts of industry to delay the introduction of MHHS. We also expect that the increasing adoption of LCTs like EVs, heat pumps, solar and home batteries will provide a further catalyst to innovation and competition in the provision of these tariffs.

⁸ We estimate this is the inverse of the general customer base, where based on our own data ~only 10-15% of switches have chosen a non-SVT deal.

Below we say more about our own development of TOU/smart tariffs and what we expect to see in the market.

Octopus Energy development of smart TOU tariffs

Octopus Energy is a global leader in consumer demand flexibility and we are constantly developing and launching new tariffs and products to shift energy consumption, most recently innovating to develop an intelligent control offering for customers with storage heaters. This is a business objective which will be helped, but is not dependent on, MHHS - as we are currently able to use elective HHS. We estimate that we have 3x as many products as any other supplier and expect product development to continue at pace. We have over half a million customers on smart tariffs and products. These customers save over £200m/year in aggregate.

Our smart tariffs range from relatively familiar static day / night tariffs (like Octopus Go for EV off-peak charging, with similar options available through Cosy Octopus for electric heating), to more innovative hourly time of use tariffs (like Agile Octopus, where the customer's electricity prices change every half hour depending on wholesale prices) and automated control products (like Intelligent Octopus Go for EV charging). We also offer products that customers can opt into on top of their standard (potentially price capped) tariffs, which will reward them for enabling a greener grid – such as our “Fan Club”, where consumers who live near to an Octopus-owned wind turbine get a discount when their local turbine is spinning, or the 30k customers on Power Up that save around £120 a year from using power when there is excess solar on their local electricity grid.

Our experience is that when a customer joins a TOU tariff, their usage pattern naturally shifts to respond to the price signals of the tariffs. For example, 40% of Intelligent Octopus Go home consumption is shifted to off-peak hours. With MHHS, we can expect price signals to be stronger, and therefore consumption to be shifted even further. This is even more true in the case of automated/device-controlled tariffs like Intelligent Octopus Go.

We expect a considerable uptick in innovation and competition in smart/TOU tariffs

We expect that the introduction of MHHS will accelerate the competition we face and the scale of innovation in smart TOU tariffs across the market. Introducing these tariffs requires investment in technology, consumer interface design and customer service - and requires considerable time in testing and learning. It is not costless. However, with MHHS, there will be a stronger return to those suppliers who can incentivise customers to adopt cheaper demand patterns, making this investment more worthwhile for more suppliers than at present. This is why we do not think Ofgem should give in to pressure to delay MHHS introduction.

The adoption of low carbon technology, (such as EVs, heat pumps, solar and home batteries) will also be a very (and potentially more) significant driver of tariff innovation. As customers adopt LCTs, their electrical demand and their ability to flex that demand increases. This means the cost savings customers can make from responding to TOU signals are considerable. For example, at the moment our IO EV users are saving on average £500 a year from this automated smart offering - far in excess of savings that can ever be made from simply switching from one standard tariff to another with a different supplier.

With the adoption of these technologies, we fully expect more and more customers to choose their electricity supplier on the basis of how well the supplier can help them unlock these savings (and the ease of using these arrangements). We also fully expect more suppliers to launch TOU tariffs as adoption of Low Carbon Tech such as EVs, heat pumps, solar and home batteries increases. We're also expecting to see more type-of-use tariffs and more device-controlled tariffs in the future as the technology develops.

4. How quickly and at what scale do you expect customers, especially those with large flexible loads such as EV and solar / battery users, to take up ToU tariffs once MHHS is implemented?

If the right conditions are set for a competitive retail market - enabling a proliferation of good value TOU tariffs to be made available - then we are very confident that there will be strong take-up of smart tariffs as more and more customers adopt the LCTs which give them large flexible loads. As noted in question 3, the availability of good value TOU tariffs in the market should be enhanced considerably by MHHS, and this is why this programme and its timely delivery is so important.

Our experience is that where customers with high shiftable load (at this point, predominantly EV users) are given the option to go onto competitive smart tariffs that reward them for shifting their demand, they do so. We estimate that only 1 in 10 of our EV customers are on the default tariff cap, with 90% actively choosing one of our smart tariffs in the competitive market, and so the risk for the system of these customers sitting on a non-TOU tariff is relatively low. In other words, we do not see any evidence of market failures like the example cited by Ofgem that an EV driver prefers to charge at peak times, when those drivers are given great value and good service propositions to choose from (and the flexibility to charge at peak from time to time).

These changes can be explained by the significant savings that customers can make by switching - it is rational consumer behaviour. TOU tariffs make it cheaper for a customer with low carbon technology such as an EV or a heat pump to run their devices. For example, for an average household who drives 10k miles a year, Intelligent Octopus Go is ~£500 cheaper than SVT. We're seeing that our customers actually shift a lot more of their home energy usage (~40%) vs. what we thought they'd shift, making it even cheaper for them. One third of our Intelligent Octopus Go customers are also on an export tariff with us.

The uptake of smart tariffs is also driven by how easy to use and convenient they can be. For example, Intelligent Octopus Go customers can “set and forget” their charging and receive cheap prices, without any need for plugging in their EV at different times.

Some of the biggest challenges for adoption of TOU tariffs is that these tariffs are new, which means consumer awareness and understanding of the tariffs is low. When promoting these tariffs to customers who would benefit from them, we’re seeing a significant increase in the number of customers choosing them. For example, early results from a trial we’re doing with the Centre for Net Zero (which will be completed in the summer) show a 5-7% conversion rate (vs a baseline of 1% for the control group) for customers when promoting Intelligent Octopus Go on customers likely to have an EV.

5. In addition to the factors set out in this chapter, are there any other important changes that might affect the ability of the current default tariff cap to achieve its Objectives?

There are two other issues with how the price cap is operating right now which we want Ofgem to consider.

First, we are concerned about the increasing focus of Ofgem’s price cap work on seeking to change the allocation of costs between groups of customers, and the tendency to solve this using socialisation mechanisms like levelisation/reconciliation mechanisms. This approach turns factors that suppliers currently compete on (such as effective debt prevention and recovery) into a tax that all billpayers have to pay. We also remain very concerned that this significantly stretches the original intention of the cap which was designed to reflect the efficient cost of a “notional” supplier - and possibly goes beyond the original powers of the cap.

Second, we are concerned that the cap has become increasingly complex and subject to constant tinkering and changes, like true-ups. This undermines regulatory certainty which has an in turn effects the investability of the retail sector. It could, if left to continue, also destroy public and political confidence in the cap as setting a fair price for customers when they are not engaged in the market.⁹

We have previously suggested that Ofgem prioritise opportunities to significantly streamline and simplify the cap - could this be an objective of all Ofgem’s price protection work?

Options for evolving price protection for the future

6. Do you agree that we need to retain some form of price protection in the retail

⁹ For example, Citizens Advice has already referred to the cap as a “lobbyist charter”.

Market?

Yes. It's really important to retain price protection in the retail energy market, even as it evolves to a world of more TOU tariffs and more low carbon technology. Price protection can also help build consumer confidence in the market which is important as price competition returns to the market - it helps that customers know it's safe to go back, and they will get protected at the end of their fixed deals.

We agree with Ofgem's view that if price protection was removed, we would see a return of price exploitation of inactive customers.¹⁰ Continued price protection is required for all customers whenever they are not actively engaged in the market.

There is considerable research to support the consideration that the loyalty penalty is an issue in the energy market that would return if the price cap were removed:

- (a) Public opinion research from Public First in late 2023 found that even post-energy crisis the two-tier energy market (made up of engaged and disengaged customers) is still very much in existence. See Figure 21 below. As set out further in Figure 22 below, the engaged tier are hungry for deals and more competition, but there are others that regard switching as too much hassle.
- (b) Research commissioned by the CMA into loyalty price discrimination found that loyalty penalties are especially detrimental in markets where consumers underestimate the loyalty penalty or perceive it to be low.¹¹
- (c) This is clearly the case in energy. Public First's 2024 report found that the disengaged, long term non-switchers exhibit a higher (+6%) level of trust that their suppliers will provide a fair price without any action on their parts.¹²

Looking ahead, as the retail market transitions we expect that there will be an even larger need for a "backstop tariff" that protects customers:

- (a) We need energy suppliers to compete over products and services that help customers transition, rather than just on teaser tariffs. If price protection for loyal (default) customers is removed, the path of least resistance would be for incumbents to compete based on the tried and tested practices of "tease and squeeze", raising prices for existing customers and making it hard for them to leave, rather than fighting to reduce prices and compete based on new products that benefit customers and the energy transition.
- (b) The retail energy market will become more complex with the introduction of smart TOU tariffs and there is a risk that consumers lose out from this complexity. Price protection can act as a backstop and a helpful reference price to give customers

¹⁰ Ofgem, [Future of Domestic Price Protection: discussion paper](#), March 2024, para 4.1

¹¹ E.CA Economics, [Economic Research on Loyalty Price Discrimination](#), December 2020 (commissioned by the CMA to review academic literature on the economic theory of the loyalty penalty).

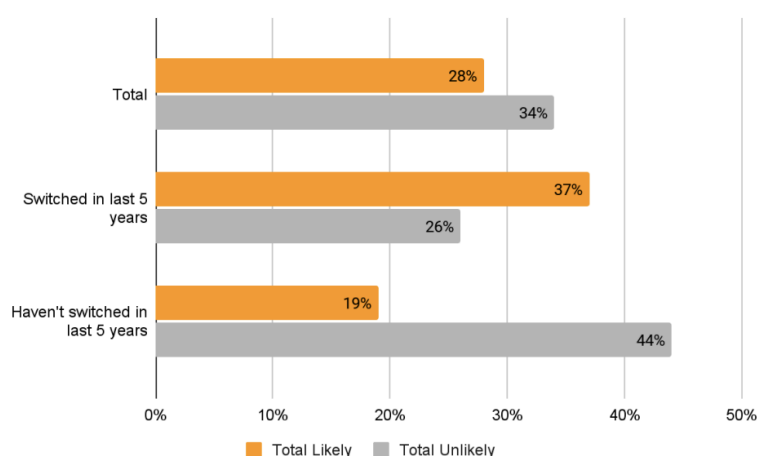
¹² Public First, [Fuelling Fairness: Five years of the energy price cap](#), February 2024.

assurance that they are on a fair deal and confidence that they will get a fair price when their competitive deal is over.

- (c) Price protection can also help fairly distribute system costs in a changing energy system. Research and analysis has shown that harnessing the flexibility from customers with LCTs along with flexibility from other technology such as grid scale batteries will help keep the costs of the transition down minimising the need for investment in networks, back up generation and balancing costs. Households will see direct benefits through their bills, including 52% lower wholesale electricity costs in 2040, according to Cornwall Insight, or £375 off the average household bill.¹³ Continued price protection will help to ensure that these system benefits are passed through to all customers - not just those who are active in the market or can easily flex their load. It is an important measure to make sure that the market does not bifurcate into another unfair “two tier” system where customers who cannot manage their load do not share in these overall system cost reductions.

Finally, universal price protection has helped build trust in the energy market - something that will only be needed more as we transition to a net zero. Public First’s public opinion research has found that customers accept that some form of price protection is needed: only 7% of the public think energy prices should be left purely to market forces.¹⁴ Trust in the energy market and guaranteeing fair prices for all is an important way to maintain public consent for transition to net zero.

Figure 21: Likelihood of switching in the next 12 months, by whether customers have switched supplier or tariff in the last 5 years

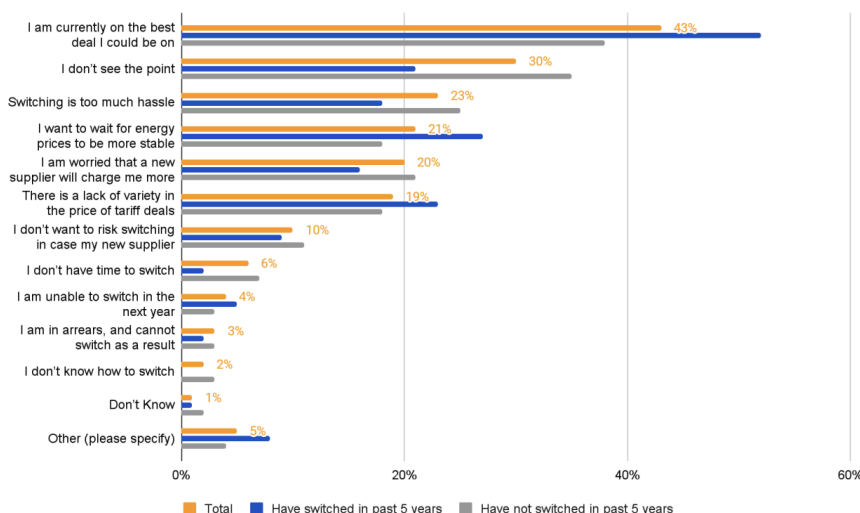


Survey question: ‘How likely or unlikely are you to switch energy suppliers or tariffs in the next year for either your gas or electricity?’

¹³ Cornwall Insights, [The power of flex: rewarding smarter energy use](#), August 2023.

¹⁴ Public First, [Fuelling Fairness: Five years of the energy price cap](#), February 2024.

Figure 22: Respondents reasons for saying they were unlikely to switch tariff or supplier in the next year, by whether customers have switched supplier or tariff in the last 5 years



7. Do you have views on which of the three key parameters – the cap being flat, universal and stringent - should be relaxed when considering future price protection Options?

Price protection should be universal, not targeted, and stringent (though the approach to stringency can evolve). It should adapt for MHHS over time as needed, without trying to solve everything immediately. And this might mean that at least some customers eventually have default tariffs which are not set at a flat rate.

Price protection must be **universal** and apply to all customers when they do not engage in the market. This parameter should not be relaxed to, for example, only give price protection to a subsection of customers, for example those that are fuel poor. This is the best way of ensuring fair prices for all and because you lose the positive impact the cap has on competition if it is only for the vulnerable. Guaranteeing fair prices for all is also an important way to help maintain public consent for transition to net zero.

Price protection should be **stringent** enough to drive suppliers to become more efficient - whilst still enabling competitive pricing in the market. As shown by Public First's review, the cap was able to achieve both these objectives pre-crisis, driving supplier cost efficiencies whilst not dampening the incidence of competitive market deals and switching.¹⁵

Looking ahead, the definition of stringency needs to evolve to reflect how the retail market looks today, post crisis and with fewer, more resilient suppliers. The concept of the "notional

¹⁵ Public First, [Fuelling Fairness: Five years of the energy price cap](#), February 2024.

supplier” is increasingly fraught in a market where there is greater variance across the cost make-up of suppliers than there was previously. This challenge is exacerbated by the increasingly granular approach to deciding on price cap allowances which involves identifying granular costs (e.g. bad debt costs, opex costs, cost of capital) for a “notional supplier” without stepping back to look holistically at the cap. Stringency requires Ofgem to move away from the current approach which is beginning to lose the trust of consumer bodies.¹⁶ For this reason we urge Ofgem to think broadly about how stringency can be driven through different forms of price protection, e.g. a relative cap arrangement could also be retain pressure on suppliers to be efficient: vigorous competition could mean that market driven prices place a very stringent constraint on default tariffs.

Price protection should evolve from (mostly) **flat** to include more simple time of use (TOU) over time for at least some customers. We will need good value default arrangements for people rolling off smart/TOU tariffs as this could create bill shock and system risks. This might look like a simple default TOU price cap for those customers (though other options are available). There may also be a case for TOU default arrangements for customers with low load/usage so they can benefit from the cost savings they present when MHHS is introduced. Wherever possible, we should avoid a system that forces customers on TOU default arrangements and favour a consumer-led approach to the rollout of TOU tariffs.

8. What are your views on options discussed? Do you have any preferred options or combination of options?

A number of these options should be ruled out now, while others deserve further explanations. Of these options we strongly urge Ofgem to keep the BAT, explore a simple, static TOU default for those rolling off TOU tariffs and to consider alternatives to the absolute cap in the interests of simplicity and adaptability as the market changes. The idea of price protection only for vulnerable customers should be dropped and is particularly disruptive at this point in the market development.

Static TOU should be explored further at least for some customers: A static TOU price cap could be a good way of managing the introduction of MHHS and the likely rise in TOU tariffs across the market, however we do not think this arrangement would be appropriate for all customers. It might apply to certain customers such as customers rolling off TOU arrangements, or customers with very low load.

Dynamic TOU should be ruled out: We do not see a role for a dynamic TOU price cap in the market in the medium term. Only particular types of people are in a position to manage their energy use to take advantage of a dynamic tariff and dynamic arrangements would expose many customers to considerable risk (even if this was mitigated through caps on upper price levels). We note that in Spain the dynamic default tariff is accompanied by

¹⁶ Eg. Citizens Advice has referred to the cap as a “lobbyists’ charter”.

Government support for customers who may lose out. Similarly, we cannot see a case where automated smart tariffs like Intelligent Octopus are default tariffs as these require a more involved relationship with the supplier than you would typically expect from those on default arrangements. We would also not expect there to be a large number of regulated default arrangements.

Target cap based on vulnerability should be ruled out: As set out in our cover letter, it's important for fairness to ensure price protection mechanism are universal and not restricted to a subset of customers. We do see a role for tax-payer funded bill support targeted at those struggling to pay, but do not want to exclude customers from the benefits of the competitive market, which is what a cap based on vulnerability would do.

Bottom up cap excluding customers with certain ToU or type of use products is unlikely to be necessary, would be impractical and could be harmful to customers:

The premise of this proposal is that customers with high load such as EV drivers will sit on the SVT and that this will create system cost. Octopus is the largest provider of smart tariffs in the country and our data shows that 90% of our EV customers actively choose TOU and smart tariffs already over the SVT; and only 1 in 10 of them sits on the price capped SVT.¹⁷ In other words: there's no market failure here. Further, a proposal of putting apparent EV customers on a specific cap would be impractical (it's not always straightforward to identify who an EV driver is and what the best cap is for them) and could be harmful as it would involve forcing SVT customers onto TOU when they have no experience of these tariffs. to be avoided.

Market basket cap (relative price cap) should be ruled out: If Ofgem were to proceed with a relative cap, we think a "within supplier" approach work better than a market basket approach as it avoids the instability that would arise from tracking market movements and removes the risk of suppliers being able to game the relative cap.

'Within supplier' relative cap should be considered further: We remain supportive of this version of a relative price cap because it helps create a market where savvy customers benefit everyone - not just themselves. In well-functioning and trusted consumer markets like supermarkets, those who shop around trigger price wars that drag prices down for everyone. A relative price cap would, in principle, drive these kinds of behaviours. The appropriate benchmark for such a cap would be the acquisition tariffs of the individual supplier¹⁸, not a market basket. This would mean that all customers could benefit from the efficiency and innovation of their supplier - not just those who switch. We consider that the key challenge here will be finding an approach which is simple and gets around the issue that suppliers

¹⁷ We estimate this is the inverse of the general customer base, where based on our own data ~only 10-15% of switches have chosen a non-SVT deal.

¹⁸ One matter still to be considered is whether this benchmark also includes the tariff charged to FTC renewals.

hedge differently for SVT and acquisitions products. We set out some further thoughts in response to question 11.

Ban on Acquisition Tariffs (BAT) should be retained: There are strong reasons the BAT should be a permanent feature of the market. BAT is not a replacement for the current price cap. It is a complementary tool. The BAT stops 'teaser' tactics and the price cap prevents 'squeezing' of disengaged customers. Together, they deliver certainty for customers that the energy regulator will not tolerate unfair pricing tactics. We would urge Ofgem to extend the BAT until the decisions on the future of price protection are made.

Margins cap should be ruled out and would be a backward step: In addition to the concerns Ofgem has raised about the way that a margins cap removes efficiency incentives and could impede investment, we note that this cap is very difficult to regulate - and does not move towards the simplicity and regulatory certainty that future price protection arrangements need. Ofgem effectively tried a margins cap by the back door via reporting before the price cap was introduced - this did nothing to instil public confidence and entailed continued arguments and analysis to understand supplier costs, especially wholesale costs and appropriate hedging.

9. In particular, which options or combination of options do you think would best protect vulnerable customers?

We support universal price protection, benefiting all customers, not just a specific group like the vulnerable. Besides ensuring fair prices, it fosters healthy competition by addressing the "unilateral market power" held by legacy suppliers over loyal customers, as highlighted by the CMA. Targeting the cap solely at vulnerable groups undermines this positive impact on competition. Vulnerable customers struggling to pay their bills need to be assisted through target government bill support - not through a special price cap which could lead to these customers becoming unattractive to suppliers.

We consider that the **current market arrangements of the price cap and the BAT do go some way to supporting the vulnerable**. Public First's research found the price cap has helped distribute savings proportionally across income levels, with the poorest 10% saving 6-7 times more of their disposable income compared to the wealthiest 10%.¹⁹

A poorly designed static TOU price cap arrangement could harm vulnerable customers with a high load factor, especially if those customers cannot easily move their usage (e.g. using electric heating in the evening peak for medical reasons). For this reason, we think a static TOU arrangement needs to be carefully designed and perhaps limited to certain customers such as customers rolling off TOU arrangements, or customers with very low load. This

¹⁹ Public First, [Fuelling Fairness: Five years of the energy price cap](#), February 2024.

further illustrates the concern we have with the option of moving the SVT to a default TOU and the consumer harm that could occur with this top down approach.

A dynamic default arrangement would have even more room for unintended consequences and we urge against introducing a measure like this without targeted bill support - as has happened in Spain, for example.

10. How should consumers with large flexible loads, mainly EV and solar / battery users, be treated with regards to future price protection?

Universal price protection is important for fairness and competition reasons. To allow the market for smart tariffs to grow (and therefore consumer flexibility to thrive), it's crucial that default arrangements are not more attractive to customers in terms of pricing or protections than other competitive tariffs.

We do not see the need for specific default/price protection arrangements for customers with large flexible loads just because they have those loads. This is because our data on these customers shows that, given choice in a competitive market, these customers are likely to engage. As set out in question 4, our data shows that 90% of customers who have an EV are on a smart tariff. We don't see any market failure yet here that means we need to manage the risk of these customers not using TOU tariffs.

Where we do think there may be a need for more thoughtful default and price protected arrangements is when customers on a fixed TOU contract come to the end of that contract. We can see a case for customers who have chosen a smart/TOU tariff to have different default arrangements from just rolling onto a single price SVT, e.g. this might look like a static TOU arrangement. This avoids bill shock for those customers. For example, if the customer has been on a tariff where are managing load to take advantage of low cost periods, their cost could go up significantly if they roll off onto a flat rate tariff unless they also change their behaviours. This is not the same as creating a default TOU tariff for all EV drivers - it is just for those customers who have already chosen a different type of tariff.

11. Are there any additional options that we haven't considered, but should be considering?

When assessing the next steps and options to take forward, we ask Ofgem to consider:

- (a) Taking a data led, iterative approach to reforming price protections, e.g. starting by a data collection exercise to explore how MHHS will work with the current cap arrangements (considering both impact on suppliers and impact on customers), and also considering applying default price cap TOU arrangements initially only to customers who roll off a smart or TOU arrangement.

- (b) Looking at ways to simplify and streamline the absolute cap to drive the same competitive and consumer protection outcomes, without lowering the regulatory burden. This could include: (i) considering what can be done to ensure that the cap only applies to default, not evergreen tariffs. This will allow more tariff innovation ahead of MHHS; and (ii) a simplified passthrough+ price cap, which has a wholesale allowance set quarterly (using the current methodology) and a number of other elements (e.g. passthrough costs and supplier cost and EBIT allowances) that are set less regularly - perhaps annually at most.
- (c) Exploring different approaches to an absolute price cap. A relative price cap is intuitively attractive as, on paper at least, it solves the issue of “tease and squeeze” in the market without Ofgem having to set the hedging methodology and define the efficient supplier cost (including cost of capital). We consider that the key challenge here will be finding an approach which is simple and gets around the issue that suppliers hedge differently for SVT and acquisitions products.²⁰ It is more straightforward to define what the default/price regulated tariff is for customers who roll off fixed deals. In these cases, the default cap would be set relative to the fixed term product closest to the one the customer was on at the time they roll off. So if a customer is on a “tracker” tariff and rolls off, they can;t be charged more than, x% above the supplier’s current tracker. Similarly, for a customer on a flat fix, the price would depend on point of market entry, e.g. you roll off a competitive fixed term deal in January, your default cap is set based on your supplier’s fixes in January. The chief difficulty is around those customers who have not engaged and are on an SVT and we urge further thinking in this area.

²⁰ Suppliers generally hedge SVT products on a rolling portfolio basis and in line with the price cap methodology. In comparison, they hedge fixed products by buying at the time the fix is offered/the customers comes on board and covering the duration of the fix. Wholesale market volatility means there can be considerable price differentials between these two types of tariffs, which makes linking them challenging.