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## DEFAULT TARIFFS FOR DOMESTIC CONSUMERS AT THE END OF FIXED-TERM CONTRACTS

Flow Energy *is supportive* of allowing suppliers the choice of moving customers onto a standard variable tariff **or** another fixed term tariff (at the end of any fixed term contract).

However, creating such an option does create a number of risks and issues that need examining.

In advance of that, it would be helpful if Ofgem could provide clarity on the following question.

**Q**. Can suppliers offer the newly created 'Exit fee free tariffs' to renewal customers only, *or* is it a requirement to have this tariff open to all customers?

The long-standing principle of a variable tariff allows suppliers to hedge against price volatility in the energy market, adjusting prices up and down when necessary to reflect market conditions (price movements being passed in part or whole to customers).

Requiring suppliers to consider moving customers to any form of fixed tariff carries a number of potential consequences which are captured below:

- Unable to confidently forecast energy volumes due to absence of exit fees (due to increased customer retention certainty)

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This absence of certainty could result in suppliers being unable to hedge confidently, and therefore may need to price tariffs at a higher price to maintain an existing risk profile. This is a lose-lose scenario for the supplier and the customer, as a supplier loses confidence in energy volumes required and necessarily passes on any increased costs to consumers.

The following scenario bears out this risk

(i) Standard Variable tariff set a price (potentially higher than today) to compensate for increased hedging risk profile across **all** energy purchases, and to ensure a viable fixed renewable tariff remains price equal or below STV.

(ii) Retained customer fixed tariff (no exit fee) set at a price (potentially higher than today) to protect against price movements that cannot be hedged against confidently (due to customers on this fixed tariff being able to leave with no exit penalty fee).

In this very conceivable scenario, customers on the retained fixed (with no exit fee), **and** those on a standard variable tariff would both suffer, as suppliers would need to offset the risk in both tariffs through potentially higher prices at no increased return.

Flow Energy (like a number of Challenger suppliers) is placed at greater risk than the big six by these proposed changes. Why is that?

- They have a customer base that is often more savvy to price changes and their ability to move supplier
- Liquidity of smaller businesses may suffer where sudden customer losses are compounded by hedging positions which move swiftly. To remain competitive, smaller suppliers will have to take increased risks on hedging. This could be compounded even more as they may need to buy the energy later to ensure more certainty.
- Setting the correct fixed term tariff rate with no exit clause may necessitate a higher than normal rate (compared to a regular tariff). Should the variable rate subsequently move downwards (market conditions favourable) then customers on the standard tariff may find themselves in the peculiar situation of being charged more than those on the variable tariff. This in turn may lead to a significant upturn in customers switching away from the supplier leading to the

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consequences bullet pointed above. Switching internally to the STV, does not obviate this risk, since suppliers may have to take strategies that cover the highest risk across both tariffs and apply them to both.

- A further point to consider is that the big 6 can more readily adsorb these shocks as the relative percentage of their customer base that would be effected would be small. Small suppliers may have all their eggs in one basket, often with the majority of customers on the same renewal cycle.

Notwithstanding these particular issues, **there is still considerable merit** in the planned changes. Flow Energy takes the view that the benefits from this proposal can be best realised by adopting the following principles:

- Customers moving from fixed to retained fixed term contract to have exit fees after the first 60 days (of a 365 day) contract. This (coupled with the absence of exit fees on the last 3 months of any preceding contract) gives customers 5 months to switch supplier without any exit fee. This ‘compromise’ would secure the move to an option of a fixed term contract whilst retaining a degree of control over hedging strategy and pricing that is the cornerstone of a suppliers business when setting sustainable and competitive tariffs( having a lot more certainty of the stability of customer numbers once beyond this point).

Should you have any questions relating to our response, please do not hesitate to contact me.

Yours sincerely,

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