

Rachel Fletcher  
Senior Partner, Consumers and Competition  
Ofgem  
9 Millbank  
London SW1P 3GE

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By email: [vulnerability@ofgem.gov.uk](mailto:vulnerability@ofgem.gov.uk)

Dear Rachel

## **Statutory consultation for a vulnerable customer safeguard tariff**

Centrica welcomes the opportunity to respond to this statutory consultation. We recognise and endorse the objective of protecting vulnerable customers, some of whom have difficulty engaging in the market.

There are many ways of supporting vulnerable customers. We believe that Centrica does more than any other energy supplier in this respect. We work systematically to understand our customers' needs, and to gather insights from them and from expert bodies, so that we can continuously improve our service and develop new ways to make sure all customers are treated fairly, no matter what their circumstances. In May 2017, British Gas achieved verification of the British Standard Institution Standard 18477 for Inclusive Services Provision - Requirements for identifying and responding to consumer vulnerability. This summer we announced a special winter credit to support around 200,000 vulnerable customers on our standard variable tariff.

We are already working to implement the proposed safeguard tariff for this winter. However, we do have concerns about the stated rationale for intervention, and the proposed remedy itself.

While we will press ahead to implement the safeguard tariff in the short term, we believe an urgent and fundamental review is required before the tactical intervention becomes embedded, given the risks it poses to a coherent framework to support vulnerable customers and sustainable competition in the longer term. This review should start immediately and conclude in good time before the PPM price cap period starting next October.

Our key concerns, which the review should address, are:

- The classification of a vulnerable consumer who is unable to engage and the consequential rationale are unclear. They require greater investigation and analysis to inform regulation in this sphere more broadly;
- WHD is a poor proxy for identifying those vulnerable customers that are unable to engage in the market (given that this appears to be the basis of Ofgem's concern); WHD is more closely related to fuel poverty, although it suffers from serious weaknesses that require urgent review, notably in relation to the process for identifying broader group customers and the exclusion of small suppliers. These must be addressed as a matter of utmost priority, and if they are addressed appropriately the case for superimposing a price cap falls away;
- CMA's PPM cap methodology suffers from flaws that have led to unsustainably low prices. These flaws partly result from key elements of the CMA's methodology being revised ahead of Final Report, and not being subject to consultation. An unsustainably low cap will not serve the interests of vulnerable customers if it undermines commercial incentives to serve those customers;
- More thought needs to be given to the appropriate duration of any remedy. Given the substantial issues regarding the specification of this proposal, it is important the present intervention, built on two unsatisfactory foundations, does not become an ongoing barrier to a more coherent approach better serving the needs of vulnerable customers; and
- We see no rationale for a wider price cap and Ofgem should not link the proposed vulnerable customer safeguard tariff with any wider cap or the enduring problem of supporting vulnerable customers in fuel poverty. Were any such price cap introduced, it would be essential that it was specified carefully, unlike the short-term, tactical intervention proposed in this consultation.

The points above are elaborated more fully in the attached appendix. In relation to the PPM cap, I also enclose a report from Frontier Economics detailing the deficiencies with the methodology that should be addressed as part of the general review. At headline level, Frontier identifies three weaknesses with the currently methodology:

- It does not accurately model the wholesale energy costs that an efficiently-run energy supplier can be expected to incur;
- It is based on only two benchmarks (Ovo and First Utility), neither of which is a good comparator for an efficiently-run large energy retailer serving a diverse set of customers. Indeed, the comparators are now out of date;
- It does not accurately model the policy related costs that an efficiently-run energy supplier can be expected to incur.

If you have any questions about this response, please contact [tim.dewhurst@centrica.com](mailto:tim.dewhurst@centrica.com) in the first instance.

Yours sincerely

**Sarwjit Sambhi**  
Managing Director, UK Home

## Appendix

### 1. **We support Ofgem's stated objective, but see a mismatch between the objective and the proposed means to achieve it**

In principle, we support the objective of protecting vulnerable customers who are unable to engage in the market. But we are concerned that Ofgem's proposed approach will not meet this stated objective coherently without substantial review; the form of intervention chosen does not effectively identify vulnerable customers who cannot engage. Yet it risks undermining competition and entrenching disengagement among those that could engage, without properly targeting appropriate support where it is most needed.

If the problem is that some vulnerable customers have difficulty engaging, the challenge is to identify those customers and explore the root cause of their difficulty to see how it may be overcome. This might require different approaches for different vulnerable customers. For instance, the appropriate support for customers with a physical disability might be different to that for aimed at customers who are digitally excluded.

If, on the other hand, the problem Ofgem perceives is more to do with a requirement to channel financial assistance to those vulnerable customers most in need of it, the challenge is to identify which customers are most in need of support and then find an appropriate mechanism to deliver appropriate, targeted support without undermining competition and incentives to engage.

Ofgem's presently proposed approach confuses these issues, by taking an already imperfect WHD scheme intended to address the latter issue, namely fuel poverty, and superimposing a problematic price cap designed for an altogether different purpose. The result is a 'remedy' weakly related to its stated objective, but with a high risk of unintended consequences – not least by exacerbating weaknesses of the current WHD scheme that distort competition and limit customer choice.

We believe both problems are valid, but both require a fundamental review of WHD if they are to be tackled effectively. We recognise that a holistic review is beyond Ofgem's scope to address alone. But Ofgem can and should make the case to government to reform WHD in a way that supports customer engagement and minimises competitive distortions.

### 2. **Ofgem's proposed remedy is to apply the PPM price cap to customers in receipt of the Warm Home Discount (WHD). But neither the PPM cap nor WHD as it currently operates are fit for Ofgem's stated purpose.**

We appreciate that Ofgem has rejected some options as impractical within the compressed timescale it has allowed itself. However, there are serious flaws with the PPM cap methodology and with use of WHD as a proxy that require fundamental review

as soon as possible to minimise and mitigate unintended adverse consequences for consumers.

- 3. For pragmatic reasons, we are willing implement Ofgem's proposed remedy, but only as a stop-gap measure pending an immediate review of its policy.**

Despite our reservations, we will implement Ofgem's proposed cap so that some vulnerable customers receive the additional support they have been promised for this winter. This can only be on a short term stop-gap basis, however. It is imperative that the issues Ofgem has not been able to consult on fully to date are subject to proper review which should be completed in good time ahead of the cap period commencing October 2018.

- 4. Ofgem must proceed to an immediate review of the policy, with a view to changing it as soon as is practicable beyond the initial application in February 2018.**

We recognise that the unusual process Ofgem has followed in this case has been driven to some extent by external pressures. Unfortunately, urgency has led to short-cuts that fall short of normal regulatory best practice. The resulting proposal is not well designed to meet its stated objective in the long term and must not become entrenched. Therefore, Ofgem must commit to a fundamental and open-minded review, refining policy to ensure it can meet the stated objective sustainably and proportionately in the longer term.

- 5. The problem that Ofgem perceives is currently poorly-defined.**

- Ofgem insists it is concerned with inability to engage rather than fuel poverty**

Ofgem appears to eschew fuel poverty as the basis for its intervention because fuel poverty is a matter for government. This is perhaps surprising considering the proxy for vulnerability it has selected (WHD). But we take at face value Ofgem's statements that it's concern is rooted in vulnerable customers' difficulty engaging rather than their financial circumstances.

- Ofgem needs to define which type(s) of vulnerable customer it is concerned about, and why.**

Vulnerability is a broad term with many potential facets which do not necessarily relate to a customer's ability to engage.

In principle, we recognise that some vulnerable customers – for example, those with learning difficulties – may face barriers to engaging that warrant special protection. But it is far from clear that a safeguard tariff based on receipt of WHD is the best way of providing appropriate, and appropriately targeted protection.

Ofgem needs to move beyond general statements that 'vulnerable customers may be less likely to engage' and identify the precise characteristics that make it difficult for particular customers to engage. Membership of a broadly defined group of vulnerable customers says nothing intrinsic about ability to engage.

- **Ofgem needs to set out, with evidence, which vulnerable customers are unable to engage.**

Ofgem oscillates between a range of different potentially vulnerable customers without ever settling on a defined group of customers or adducing clear evidence demonstrating that any perceived lack of engagement is rooted in some aspect of their vulnerability.<sup>1</sup>

This lack of precision about the customer cohort Ofgem is concerned with makes it difficult to establish clearly what 'inability to engage' means in practice. Is it due to a permanent physical handicap, for example, or digital exclusion, or temporary circumstances that make it hard for the customer to review options and make an informed choice?

Ofgem relies heavily on a general assertion that vulnerable customers are less likely to engage. However, it's stated objective is *"to protect vulnerable consumers who have difficulty engaging in the market"*<sup>2</sup>

There is no simple equivalence between vulnerability and inability to engage. Ofgem explicitly recognises this:

*"Some vulnerable consumers do engage, and we want this engagement to grow. In line with our Consumer Vulnerability Strategy, we want to ensure that vulnerable consumers have equal access to the market. We seek to empower consumers in vulnerable situations, as well as protecting them."*<sup>3</sup>

Ofgem implicitly equates default tariffs with disengagement, but this is at best an over simplification. The CMA considered it appropriate also to consider the length of time a customer may have been on a default tariff in framing its proposed database remedy for

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<sup>1</sup> Ofgem lists some general characteristics at 2.10 of the Technical Document but does not go beyond sweeping generalisations, weakly supported by its Consumer Engagement Survey. It offers a few more characteristics in passing at 4.3, concluding with no evidence whatsoever that *"it could be the case that measures to improve engagement will never be effective."*

<sup>2</sup> Technical document, p3

<sup>3</sup> Technical document 2.11

disengaged customers, and Ofgem itself distinguishes between customers on the same basis in its retail market indicators.<sup>4</sup>

Even if being on a default tariff might be taken to indicate current - possibly temporary - disengagement, it does not amount to evidence of inability to engage. This reflects the fact that customers who have only been on a default tariff for a relatively short period will have been engaged in the recent past.

- **Given that some customers are less able than others to engage in all markets, it needs to set out the threshold for least able to engage.**

Vulnerability does not automatically imply inability to engage. Given that the remedy Ofgem proposes is essentially a means of channelling financial assistance rather than overcoming barriers to engagement, it may be that vulnerability and difficulty engaging are only preliminary filters. If, in fact, the underlying issue is the affordability of an essential service for certain vulnerable customers due to their financial circumstances, that is an altogether different rationale for intervention than the one Ofgem has put forward.

Ofgem denies that it is primarily seeking to address fuel poverty, yet nevertheless reaches for a proxy that has more to do with fuel poverty than it does with difficulty engaging. The logic of its position is that even if WHD receipt is taken to connote vulnerability, this is a necessary but not sufficient condition for further intervention. The mere fact that a WHD customer may be on a default tariff says nothing about that customer's ability to engage and how this relates to their vulnerability.

A well targeted intervention based on inability to engage would have to grapple with the underlying characteristics that explain, with compelling evidence, why particular WHD customers have difficulty engaging. Ofgem makes no serious attempt to do this, however.

- **In identifying those vulnerable customers who most need of additional financial support, Ofgem should not undermine its own vulnerability strategy**

Ofgem's vulnerability strategy is founded on empowerment as well as protection, and Ofgem acknowledges the risk that its proposed intervention could adversely affect engagement:

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<sup>4</sup> <https://www.ofgem.gov.uk/data-portal/retail-market-indicators>

*“Although vulnerable consumers are currently less engaged on average, our preferred option could further reduce engagement and make it more difficult for these consumers to benefit from competition in the future.”<sup>5</sup>*

This risk arises from the ‘safe haven’ perception a safeguard tariff creates, and will be further compounded in this case by use of the flawed prepayment meter price cap methodology resulting in an unsustainably low cap.

Such concerns might arguably carry less weight if Ofgem could be certain that the protection it proposed was closely targeted on customers facing substantial and enduring difficulties that preclude engagement. But there is no basis for such certainty under Ofgem's current proposals.

## 6. Ofgem's current remedy is currently poorly-targeted.

- **WHD is a poor proxy for inability to engage in the market.**

Ofgem accepts that there are difficulties associated with the various proxies for vulnerability it has considered. But it opts for WHD on the basis that, given its self-imposed timetable, for any measure to be introduced quickly eligibility must rely on consistent data suppliers already have access to.

We appreciate that Ofgem's immediate timetable creates practical difficulties. We also recognise that WHD may be superior in some respects to other candidate proxies such as Priority Services Register (PSR). As Ofgem notes, PSR requires the customer's express agreement which suggests some element of supplier engagement. And as Ofgem further notes, the CMA's survey found that customers on PSR were *less likely than average* to be on SVT. This surely underlines the need for caution in the use of sweeping statements about the likelihood of vulnerable customers to be engaged or disengaged.

But the fact that PSR is a bad proxy does not make WHD a good proxy for inability to engage in the market - the aspect of vulnerability Ofgem uses to justify intervention via a safeguard tariff.

Ofgem mentions some of the features that make WHD a poor proxy for fuel poverty

- pensioners who qualify for WHD are less likely to be in the lowest income deciles than members of the broader group
- the broader group is budget capped and subject to a first-come first served application process.

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<sup>5</sup> Technical document p5 – key assumptions/sensitivities/risks

However, Ofgem states elsewhere that it is not primarily concerned with fuel poverty as lead responsibility for policy in that area rests with government.<sup>6</sup>

The present question, therefore, is how well any proposed vulnerability proxy identifies those customers who have difficulty engaging in the market – or in certain cases may be unable to engage with the market altogether.<sup>7</sup> In relation to broader group WHD recipients, the application process itself requires engagement with the supplier. For the same reasons Ofgem advances in relation to PSR, proven ability to engage in respect of the broader group casts doubt on WHD receipt as a good measure of inability to engage.

- **SVT is a poor proxy for identifying WHD customers who are unable to engage**

In relation to engagement, Ofgem states:

*" . . . our concern around disengagement is that the consumer is likely to be on a high-priced SVT. We therefore consider being on a default tariff as a strong indicator of a lack of engagement in practice by the consumer."<sup>8</sup>*

This is circular reasoning. Effectively, it amounts to saying: "If you're on a default tariff, you must be disengaged. Therefore, we take the fact that you're on a default tariff as evidence of your disengagement." Critically, however, *it does nothing to distinguish vulnerable customers who may be on a default tariff from any other customer on a default tariff.* Nor does it provide any insight into a vulnerable customer's ability to engage, and how this is linked to their vulnerability.

The CMA took a more nuanced approach to engagement in relation to its proposed database remedy. It decided that only customers who had been on a default tariff for more than three years should be included.

- **WHD contributes to apparent disengagement which a price cap will further entrench**

It should also be recognised that the eligibility criteria for WHD customers may, of itself, have contributed to customer disengagement. This is both because customers may be concerned that they will lose their entitlement to the WHD if they change supplier and because some smaller suppliers do not participate in the WHD scheme.

It is worth reflecting on what this means from the perspective of a WHD customer who can engage. They might find a tariff offered by a small supplier that is cheaper than their current tariff. But if the small supplier in question does not participate in WHD, the customer would lose their £140 WHD rebate if they switched. Their potential gains from switching are therefore reduced by this amount, making them less likely to switch. It

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<sup>6</sup> Technical document at 2.17 referencing Ofgem regulatory stances (2016)

<sup>7</sup> Technical document at 2.17 and associated footnote 23

<sup>8</sup> Technical document at 4.12



would clearly be wrong in such a case to equate a conscious decision not to switch with an inability to engage.

At £1101 based on current typical domestic consumption values<sup>9</sup>, British Gas's dual fuel SVT is competitive with other suppliers who support WHD. But for core group WHD recipients this is reduced by a £76<sup>10</sup>, on top of which they get £140 WHD rebate. So, the net cost to the customer after rebates is £885.

A £216 saving against one of the most competitive default tariffs offered by an established supplier with a deserved reputation for looking after vulnerable customers puts the 'customer detriment' Ofgem alleges in perspective. This is not 'poor value' and nor is it evidence that vulnerable customers are unable to engage. A cap set at £1031<sup>11</sup> as Ofgem proposes together with a WHD rebate of £140 brings net cost to £891 before any further rebate from British Gas. At this level, the risk of entrenching apparent lack of engagement by customers benefiting from a price cap with a rebate applied on top is unmistakable.

- **Fuel poverty is a policy for which Government is responsible, and does not directly correlate with Ofgem's duty to have regard to vulnerable customers.**

Neither Ofgem's statutory duties nor its vulnerability strategy provide strong support for the form of intervention it now contemplates.

Ofgem presents the case for action in terms of reducing harm experienced by vulnerable customers but fights shy of stating that it is seeking to address fuel poverty.

*"We are seeking to reduce the impact of the current two-tier market on those most affected and most likely to be harmed by it. The government has the primary role in addressing fuel poverty, particularly for policy aimed at redistributing substantial costs between energy consumers. Our objective is to reduce consumer harm, rather than to redistribute costs."<sup>12</sup>*

Ofgem is correct when it states that primary responsibility for addressing fuel poverty rests with government and not Ofgem, notwithstanding Ofgem's role in helping to administer government schemes such as WHD.<sup>13</sup>

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<sup>9</sup> This and subsequent figures are based on TDCVs applicable from 1 October 2017. If usage is below what these TDCVs assume, the actual costs faced by customers will be lower.

[https://www.ofgem.gov.uk/system/files/docs/2017/08/tdcvs\\_2017\\_decision.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/08/tdcvs_2017_decision.pdf)

<sup>10</sup> <https://www.centrica.com/news/centrica-plc-british-gas-standard-tariff-increase-Aug17>

<sup>11</sup> PPM level from 1 October 2017 at current TDCVs

<sup>12</sup> Technical document at 2.17

<sup>13</sup> See for example

[https://www.ofgem.gov.uk/system/files/docs/2016/12/whd\\_annual\\_report\\_sy5\\_final\\_for\\_publication2.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/12/whd_annual_report_sy5_final_for_publication2.pdf)

This is clear on the face of primary legislation, which provides for the Secretary of State to require adjustment of charges to help disadvantaged groups of customers.<sup>14</sup> There is no similar provision for Ofgem itself to propose such adjustments.

Ofgem's general duties, many of which it shares with the Secretary of State, are not expressed in terms of having regard to the interests of vulnerable customers – an informal umbrella term.

The general duties refer to the interests of individuals who are chronically sick or disabled, of pensionable age, on low incomes customers, or living in rural areas. The duty to have regard to these interests is expressly "*not to be taken as implying that regard may not be had to the interests of other descriptions of consumer*".<sup>15</sup>

In any event, the duty to have regard to particular customer interests exists to inform the primary objective to *protect the interest of consumers, wherever appropriate by promoting competition*.<sup>16</sup>

In carrying out their respective functions, Ofgem and the Secretary of State must each have regard to "*the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed*" as well as other principles of regulatory best practice.<sup>17</sup>

The statutory notice accompanying the proposed licence modification is strangely silent in relation to Ofgem's primary objective and general duties, referring only to the statutory provisions for licence modification with no reference to underlying purpose.<sup>18</sup>

The statutory consultation letter refers repeatedly to Ofgem's own consumer vulnerability strategy. However, that strategy underlines the that fuel poverty is as much about energy efficiency and income as energy prices, and that primary responsibility for addressing fuel poverty rests with government, not Ofgem.

*"Fuel poverty is a result of the efficiency of a home, energy prices and income. Government is responsible for tackling fuel poverty. Ofgem contributes to tackling fuel poverty by working to ensure value for money for consumers overall. Other areas of our work that can help consumers in fuel poverty are the gas network extension scheme and the Energy Best Deal advice campaign."*<sup>19</sup>

The same document highlights standards of conduct as the principal instrument for embedding consideration of vulnerability within principles based regulation. However, in the statutory consultation confirming the introduction of a new vulnerability principle into

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<sup>14</sup> See for example Electricity Act 1989 Section 43A; Gas Act 1986 Section 41A

<sup>15</sup> See for example Electricity Act 1989 Section 3.3

<sup>16</sup> See Electricity Act 1989 Section 3A.1

<sup>17</sup> See Electricity Act 1989 Section 3A.5

<sup>18</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/10/statutory\\_notice\\_-\\_electricity\\_supply\\_licence.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/10/statutory_notice_-_electricity_supply_licence.pdf)

<sup>19</sup> [https://www.ofgem.gov.uk/sites/default/files/docs/2013/07/consumer-vulnerability-strategy\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2013/07/consumer-vulnerability-strategy_0.pdf) at 4.12

the standards of conduct, Ofgem explicitly confirmed that the vulnerability principle does not govern energy pricing.

*"To address queries raised by a minority of suppliers, we wish to reiterate that the pricing of products and services (except for deemed tariffs) will continue to be outside the scope of the domestic Standards."<sup>20</sup> (emphasis added)*

**7. The PPM price cap's applicability as a remedy to assist vulnerable customers who are least able to engage must be urgently reviewed.**

Key elements of the CMA's PPM cap methodology were not subject to proper consultation, the proposed cap being amended heavily ahead of the CMA's Final Report, and the PPM price cap suffers from significant methodological flaws that have led to unsustainably low prices.

It was also the case that the CMA's rationale for the PPM cap was based on the technical limitations of 'dumb' prepayment meters and consequently limited tariff choice available to customers with prepayment meters, pending their replacement by smart meters. The limitation on customers' ability to engage perceived by the CMA was therefore rooted in technical restrictions, not an innate inability to engage due to vulnerability.

The CMA's rationale informed many aspects of the remedy's design. The cap was expressly conceived as a temporary stop gap, limited in scope and duration. These factors informed the CMA's approach to establishing cost benchmarks and the necessary level of competitive headroom under the cap.

Broadly speaking, the CMA down-weighted concerns about entrenching disengagement because engagement opportunities for prepayment customers were restricted by technology limitations, and because the cap would be lifted once those limitations ceased to apply<sup>21</sup>. In addition, it was less concerned about the risks of setting the cap too low because, as well as being temporary, it only covered a small proportion of the market. While Ofgem is uncertain about the number of additional customers who will fall within its proposed cap initially, it anticipates further extension subsequently. The precise magnitude of any such further extension is currently unknown, even to Ofgem. But as the proportion of customers covered by a cap expands, the basis on which the CMA judged its own cap to be proportionate is progressively eroded.

The risk and extent of competitive distortion expands with the proportion of customers included within the PPM cap. Ofgem cannot rely upon the CMA's view about the proportionality of its own proposal in relation to any extension beyond prepayment. Ofgem asserts that its present proposal is proportionate. But the objective basis for such an assertion is highly questionable given Ofgem's imprecise and largely qualitative

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<sup>20</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/06/statutory\\_consultation\\_-\\_standards\\_of\\_conduct\\_for\\_suppliers\\_in\\_the\\_retail\\_energy\\_market\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/06/statutory_consultation_-_standards_of_conduct_for_suppliers_in_the_retail_energy_market_0.pdf)

<sup>21</sup> There is provision within the CMA's remedy for it to dis-apply the cap progressively to the extent that it judges particular classes of prepayment meter meet the relevant interoperability standards.

analysis. We do not see how Ofgem can form a considered view on proportionality for an intervention whose eventual scope is so ill defined.

In relation to the PPM cap itself, the attached report from Frontier Economics highlights detailing the deficiencies with the methodology that need to be addressed as part of the general review. At headline level, Frontier identifies three underlying reasons for why the methodology results in too low a cap:

- It does not accurately model the wholesale energy costs that an efficiently-run energy supplier can be expected to incur;
  - It is based on only two benchmarks (Ovo and First Utility), neither of which is a good comparator for an efficiently-run large energy retailer serving a diverse set of customers;
  - It does not accurately model the policy related costs that an efficiently-run energy supplier can be expected to incur.
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- **Linking the proposed cap to WHD exacerbates competitive distortions despite Ofgem's acknowledgement that this curtails consumer choice**

The CMA's PPM cap applied, in principle, to all suppliers. The same cannot be said of Ofgem's present proposal. Ofgem states:

*"In principle, we consider that eligibility for the temporary safeguard tariff should not depend on whether a consumer's supplier is in scope, as this would result in similar consumers with different suppliers being protected or not. We want to ensure that eligible consumers do not lose out."*<sup>22</sup>

However, the statutory consultation letter itself makes clear that Ofgem's 'in principle' position will not be met in practice. Instead:

*"Our safeguard tariff will apply to the existing WHD Compulsory Suppliers."*<sup>23</sup>

Ofgem's decision compounds the existing competitive distortion created by the WHD small supplier exemption<sup>24</sup> as well as limiting choice for vulnerable consumers. Small supplier exemptions from policy costs contribute to the price differentials between suppliers that Ofgem mischaracterises as 'detriment'. Combining an unreformed WHD scheme with a price cap threatens to exacerbate existing market distortions considerably. It is vital that supporting vulnerable customers does not become a source of competitive disadvantage to suppliers and entrench apparent 'disengagement' by WHD customers. Yet there is a very real risk that this will be the result.

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<sup>22</sup> Technical document at 4.20

<sup>23</sup> Statutory consultation letter, page 4

<sup>24</sup> Compulsory participation in WHD is limited to suppliers with over 250,000 customers. Additionally, scheme quotas and budgets are set by reference to customer numbers on a lagged basis creating an in-built bias in favour of smaller, rapidly expanding suppliers whose obligations systematically lag their current market size.

The extent of this problem may be expected to grow over time, and will be made worse if the *de facto* scope of the new cap expands significantly without a holistic review that can properly consider the interaction of the cap with the WHD scheme.

Such a review is urgently needed. It should encompass the likely impacts not only on fuel poverty but also on competition, consumer engagement, and the ability of suppliers to finance their operations sustainably.

**8. In reviewing its policy, Ofgem also needs to consider the appropriate duration of any remedy.**

- **Ofgem needs to set out whether it considers those currently least able to engage in the market will be likely to become so.**

Ofgem states that the cap is to provide temporary protection, and leaves open the option of removing the cap before its backstop date of December 2019. But it also suggests the cap may be superseded by the government's proposed wider cap. Separately, Ofgem has suggested that protection for vulnerable customers is likely to be an enduring issue for the next 10-15 years.

There is a fundamental ambiguity here that must be resolved urgently before an apparently temporary and transitional measure becomes permanent and entrenched.

- **Ofgem needs to be clear whether it envisages a temporary or permanent cap**

Ofgem's stated rationale for intervention in the present case is quite different from the CMA's rationale in relation to prepayment meters. Its concerns about ability to engage, though not presently well specified, do not rest on technical constraints which smart meters will overcome.

This raises the question of how temporary the safeguard is intended to be. Superficially, the proposed licence condition appears to contain a sunset date. But Ofgem suggests that the cap might be superseded by a wider government cap – in which case it risks becoming a *de facto* benchmark for something more permanent. Indeed, within days of publishing the consultation Ofgem's Chief Executive told MPs that he saw disengagement among vulnerable customers as an enduring problem, requiring safeguards for perhaps 10-15 years.

Ofgem's stated rationale is based on the premise that some vulnerable customers *can't* engage<sup>25</sup>, not merely that they choose not to do so. If Ofgem now contends that this situation is likely to endure for 10-15 years, and this is the basis for intervening through a price cap, it becomes even more important to distinguish effectively between those vulnerable customers who cannot engage and those who can.

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<sup>25</sup> Or, at least, that they face particular difficulty engaging due to their vulnerability.

- **The risk, as things stand that this intervention becomes an enduring or open-ended one.**

We are particularly concerned that Ofgem may be about to embark on an intervention that becomes self-perpetuating – by fostering and prolonging the very lack of consumer engagement used to justify intervening in the first place.

It may be that there are some vulnerable customers who, for reasons personal to them, will not be able to fully engage in the market indefinitely, irrespective of other measures being pursued to stimulate and facilitate customer engagement generally.

If Ofgem believes that to be the case, it should make that case based on a full and open consultation process founded on analysis and evidence that can withstand profound and rigorous scrutiny.

It has not made such a case to date. Instead, we have a proposal that, in principle, seeks to target vulnerable customers who are unable to engage but risks not doing so effectively in practice. There is plainly a risk that vulnerable customers who can engage will be deterred from doing so – setting back the engagement ambitions in Ofgem's own vulnerability strategy, quite apart from the wider adverse impact on competition that is likely to arise.

Ofgem can and should mitigate this risk by committing to a wide ranging and fundamental review long before the sunset date presently envisaged. We understand that such a review cannot be conducted in time for a measure starting in February 2018. However, we see no reason why it cannot be accomplished by October 2018.

**9. There can be no link between any support for those least able to engage in the market and any wider price cap**

- **We see no rationale for a wider price cap**

We believe the government's proposal for a wider cap is misconceived. The CMA considered and explicitly rejected a wider cap as disproportionate and likely to do more harm than good.

It would be extraordinary to intervene through a wide-ranging price cap at a time when switching is at near record levels, prices are below their 2013 peak, government policy

interventions are the main source of upward pressure on cost and Ofgem is questioning the 'supplier hub' market model.<sup>2627</sup>

- **Even if there was one it would certainly be different to any requirement to support the least able to engage**

Ofgem should be cautious about anticipating a wider cap. At present, we have only a draft bill awaiting pre-legislative scrutiny. The eventual outcome of the parliamentary process remains speculative at this stage.

Nevertheless, even if parliament were to pass legislation substantially the same as envisaged in the draft bill, Ofgem would need to consider the detailed design of any price cap from first principles. In doing so, it would need to ensure consistency with the overarching principles articulated in the draft bill itself, as well as having regard to its primary objective and general duties.

We understand that Ofgem's resort to the existing PPM cap is a product of its ambition to introduce a new safeguard for vulnerable customers in February 2018. However, the methodology underlying the PPM cap is flawed and results in outturn levels that are already dampening competition for prepayment customers. There is a clear risk that these problems will be exacerbated by extending the PPM cap to a greater number of customers.

It is vital that any price cap, even one closely targeted at vulnerable customers who are unable to engage effectively, is set at an appropriate level that at least allows suppliers to recover their efficiently incurred costs and to finance their activities on a sustainable basis. Where the cap also captures customers that can engage, sufficient headroom must be allowed for active competition below the cap. The need to enable effective competition and maintain incentives for customers to switch are expressly referenced as factors to which Ofgem must have regard in relation to the wider cap.

For reasons outlined more fully in Frontier Economics' report, the methodology used to derive the PPM cap is flawed in important respects that render it unsuitable for wider application without fundamental review.

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<sup>26</sup> [https://www.ofgem.gov.uk/system/files/docs/2017/10/state\\_of\\_the\\_market\\_report\\_2017\\_web\\_1.pdf](https://www.ofgem.gov.uk/system/files/docs/2017/10/state_of_the_market_report_2017_web_1.pdf)

<sup>27</sup> The government's draft bill would require Ofgem to implement a price cap by modifying supply licences which would, however, become otiose if supply ceased to be a licenced activity.

## **Legal annex**

This annex sets out the drafting changes we consider necessary to give effect to Ofgem's policy intention and enable a consistent interpretation of the licence conditions.

For ease of reference, these amendments are presented with brief explanations in the order they appear in the electricity and gas supply licences.

We wish to highlight two significant policy issues that our proposed amendments address

- Sunset provisions
- Interaction with WHD Regulations

### **Sunset provisions**

We agree that the conditions should be of short duration and contain an express sunset date with provision to end the conditions before that date. But we do not agree that the conditions should apply until December 2019.

Centrica's position is that the policy approach embodied in the conditions requires immediate review. This review should conclude before the PPM charge cap period commencing 1 October 2018 begins.

The amendments we propose below (at Electricity SLC 28AA.17 and Gas SLC 28AA.11) establish a hard deadline for the review to be completed. If the review results in proposals for policy measures to be applied beyond 30 September 2018, these would be subject to their own statutory consultation.

### **Interaction with WHD Regulations**

We agree that the conditions should cross-refer to the WHD regulations as they currently stand. But the present drafting could be misconstrued as allowing subsequent changes to the WHD Regulations to have substantive impact on the operation and scope of the proposed safeguard tariff without further statutory consultation by Ofgem.

This would plainly be inappropriate and cannot be justified as 'future proofing'. Ofgem and stakeholders cannot assess the impact of the proposed licence changes if they are contingent on the eventual outcome of separate policy reviews by government, which are necessarily uncertain in outcome.

The amendments we propose below (to the definition of Regulations in both the Electricity and Gas Supply Licence Conditions) confirm that the regulations are the current regulations as amended at the modification date. If the WHD Regulations themselves are further amended in future, Ofgem will need to consider and consult on any consequential changes it wishes to propose regarding the safeguard tariff.



## **Proposed introduction of standard condition 28AA into the electricity supply licence**

SLC 28AA.1: amend "...during the Charge Restriction Period..." to "...during each Charge Restriction Period applicable at the time". There is more than one period during each calendar year.

SLC 28AA.1: replace "...that customer" with "the Relevant 28AA Customer" to ensure it is only defined customers on an applicable tariff who benefit from the cap.

SLC 28AA.2: replace "This condition will..." with "Paragraph 28AA.1 will apply..." to support consistent interpretation of the condition.

SLC 28AA.7: insert the full wording of 28A.26 and 28A.27 with the revised definitions for 28AA into clause 28AA.7 to support consistent interpretation of the condition.

SLC 28AA.8: insert the full wording of 28A.28 with the revised definitions for 28AA into clause 28AA.8 to make it clearer when interpreting the rules.

SLC 28AA.9: definitions should be included or referred to 28A to support consistent interpretation of the condition.

SLC 28AA.15: 30 days doesn't give sufficient time to identify a customer and notify a customer being moved from a SVT or default fixed tariff to the safeguard tariff. This condition should be amended to enable sufficient time for suppliers to notify customers of a tariff change.

SLC 28AA.17: amend to reflect a shorter period to enable a full review of the policy approach "Condition 28AA will cease to have effect at 23:59 on 30 September 2018 unless the Authority specifies an earlier date by publishing a statement in Writing."

Definition of Charge Restriction Period: amend definition to align with shorter time period "Charge Restriction Period means a period of time, either:

- beginning on the Modification Date and ending on 31 March 2018; or
- beginning on 1 April 2018 and ending on 30 September 2018."

Definition of 28AA Default Fixed Term Contract: remove "...other contractual arrangement" because it is not required and could result in some inconsistent interpretations of what is a default fixed term contract.

Definition of Modification Date: insert the actual date as opposed to requiring users of the licence to cross check with separate notification documents.

Definition of Regulations: amend definition to ensure the policy intention of applying the safeguard tariff to the Warm Home Discount Regulations that apply now as opposed to any changes proposed in the future "Regulations means the Warm Home Discount Regulations 2011 (SI 2011/1033) (as amended) at the Modification Date;".

Definition of Relevant 28AA Customer: amend definition to include definitions of 'Already Been Identified' and 'Previously Identified' where applicable.

Create new definition of: "Already Been Identified means a Domestic Customer who has already been identified by the Obligated Licensee for and subsequently goes on to receive the prescribed rebate in the same Scheme Year. For the purposes of condition 28AA the prescribed rebate is the rebate set out in the Regulations;"

Create new definition of: "Previously Identified means a Domestic Customer who was previously identified by the Obligated Licensee and received the prescribed rebate in the same Scheme Year. For the purposes of condition 28AA the prescribed rebate is the rebate set out in the Regulations;"

### **Proposed introduction of standard condition 28AA into the gas supply licence**

SLC 28AA.1: amend '...during the Charge Restriction Period...' to 'during each Charge Restriction Period applicable at the time'. This is because there is more than one period during each year.

SLC 28AA.1: replace '...that customer' with the 'Relevant 28AA Customer' to ensure it is only defined customers on an applicable tariff who benefit from the cap.

SLC 28AA.2: replace "This condition will..." with "Paragraph 28AA.1 will apply..." to support consistent interpretation of the condition.

SLC 28AA.3: definitions should be included or referred back to 28A.

SLC 28AA.8: insert the full wording of 28A.19 and 28A.20 with the revised definitions for 28AA into clause 28AA.8 to support consistent interpretation of the condition.

SLC 28AA.4 (e)(ii): amend reference to paragraph 28AA.11 to 28AA.5 as follows "...as at the date specified by the Authority pursuant to paragraph 28AA.5 for each subsequent report; and"

SLC 28AA.9: 30 days doesn't give sufficient time to identify a customer and notify a customer being moved from a SVT or default fixed tariff to the safeguard tariff. The condition should be amended to enable sufficient time for suppliers to notify customers of a tariff change.

SLC 28AA.11: amend to reflect a shorter period to enable a full review of the policy approach "Condition 28AA will cease to have effect at 23:59 on 30 September 2018 unless the Authority specifies an earlier date by publishing a statement in Writing"

Definition of Benchmark Maximum Charge: amend definition to include the word 'applicable' to align with the wording proposed in Electricity licence condition to: "Benchmark Maximum Charge means the applicable value published by the..."

Definition of Charge Restriction Period: amend definition to align with shorter period "Charge Restriction Period means a period of time, either:

- beginning on the Modification Date and ending on 31 March 2018; or
- beginning on 1 April 2018 and ending on 30 September 2018."

Definition of 28AA Default Fixed Term Contract: remove "...other contractual arrangement" because it is not required and could result in some inconsistent interpretations of what is a default fixed term contract.

Definition of Modification Date: insert the actual date as opposed to requiring users of the licence to cross check with separate notification documents.

Definition of Modification Date: amend reference to 23(8) of the Gas Act 1986 to 23(10) of the Gas Act 1986 to reference the powers in the Act that enable modifications to the Supply Licence Conditions.

Definition of Obligated Licensee: should include a semi colon and not a full stop at the end of the definition as it forms part of a longer list in condition 28AA.12.

Definition of Regulations: amend definition to ensure the policy intention of applying the safeguard tariff to the Warm Home Discount Regulations that apply now as opposed to any changes proposed in the future and to provide a semi colon at the end rather than a full stop "Regulations means the Warm Home Discount Regulations 2011 (SI 2011/1033) (as amended) at the Modification Date;"

Definition of Relevant 28AA Customer: amend definition to include definitions of 'Already Been Identified' and 'Previously Identified' where applicable.

Create a new definition of: "Already Been Identified means a Domestic Customer who has already been identified by the Obligated Licensee for and subsequently goes on to receive the prescribed rebate in the same Scheme Year. For the purposes of condition 28AA the prescribed rebate is the rebate set out in the Regulations;"

Create a new definition of: "Previously Identified means a Domestic Customer who was previously identified by the Obligated Licensee and received the prescribed rebate in the same Scheme Year. For the purposes of condition 28AA the prescribed rebate is the rebate set out in the Regulations;"