



(by email)

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Dear Jemma,

Statutory consultation for a vulnerable safeguard tariff

Thank you for providing SSE with the opportunity to respond to Ofgem's statutory consultation consulting on proposals to introduce a temporary safeguard tariff for vulnerable consumers. SSE firmly supports all measures that seek to improve the outcomes for vulnerable consumers within the energy market. However, we continue to strongly support competition as the best route to deliver for consumers. We will engage constructively with Ofgem, government and other stakeholders to identify solutions that contribute towards positive, sustainable outcomes for customers and in particular, vulnerable consumers.

Our primary position: competition, not caps

We have recently confirmed that we will be utilising Ofgem's new rules for customers rolling off fixed term tariffs, by ensuring these customers are rolled onto another fixed product¹. This will build in an additional annual prompt to engage for this group of customers as well as providing price protection for the course of the year, whilst ensuring the customer is paying a fair price. We are also currently exploring the possibility of no longer selling SVTs at all unless a customer specifically requests it. This would mean that no new customer would become subject to SVT going forward. This would be subject to working through issues associated with Deemed Contracts and Dead Tariffs.

¹ See our letter to the Secretary of State enclosed

As regards existing customers, customer engagement will remain the challenge. Intervention on pricing will not solve this issue. In fact, it is likely to exacerbate it. We remain committed to working with Ofgem on making the necessary improvements in this area outside of the cap arrangements. In this way, we strongly believe that the issues in the market can be worked through in the way intended by the CMA following its extensive review of the market. The CMA has already concluded that further price regulation would not be in the best interest of the market or, ultimately, consumers.

In addition, the ECJ has recently noted in the case of ANODE² that price regulation of this nature will affect the freedom of suppliers to act in the market and therefore the competitive process. Thus, the Court found that the imposition of regulated tariffs constitute “by its very nature an obstacle to the achievement of a competitive market”.³

In light of the recent conclusions made by the CMA and ECJ, our view remains that there is no credible case for pursuing further price intervention.

In the case of the presently proposed interim cap, whilst we disagree that there is a sufficient case to support further price intervention, we are nevertheless willing to accept the intervention proposed by Ofgem on the basis that it provides time limited protection for a clearly defined group of vulnerable customers.

Process

We strongly believe that intervention in the retail energy market should be subject to a full and proper process of open and transparent consultation to minimise the risk of unintended consequences. In most cases, we believe that a robust process demands a full assessment of the policy options through full and detailed policy consultations prior to the issuing of a Statutory Consultation. We would also expect a fuller impact assessment, based on evidence obtained from affected licensees as well as from other sources. However, in this case, SSE recognises Ofgem’s rationale for expediting the implementation of a temporary vulnerable safeguard tariff. We would highlight that, whilst we accept Ofgem’s approach to the licence amendment process relating to this specific policy change, we will fully expect that a full and fair process is followed for all future licence changes.

In addition, we would highlight that the challenges associated with implementing the cap, particularly given some of the implementation period falls over the Christmas period, are significant. Some of these implementation issues are discussed in Section 3 below. This project demands resource and attention at the same time as a number of other regulatory

² Case C-121/15

³ See paragraph 33

implementation projects, including Smart. The timescales for such a significant regulatory change are far shorter than we would ordinarily reasonably expect. Whilst we understand the rationale for Ofgem's decision to fast-track this process and implementation timescales, we do not expect this approach to be one that will be taken in respect of future regulatory change of this nature.

Given the challenges associated with adopting this fast track process, we would expect Ofgem will take a pragmatic and proportionate view in its approach to monitoring compliance with this licence condition.

Ofgem's proposed Interim Cap and future price regulation

SSE's response to Ofgem's statutory consultation on the proposed cap covers the following areas:

1. **The impact of extending the existing safeguard prepayment methodology to a wider group of consumers:** SSE has a number of concerns about the existing approach used to regulate charges for those consumers that use prepayment meters, and whether costs incurred by suppliers are appropriately reflected.
2. **The wider impact on the retail energy market:** SSE has explored the wider impact of the vulnerable safeguard tariff on customer engagement, innovation and customer service. We raised several similar issues during the Competition and Markets Authority (CMA) Energy Market Investigation in relation to the Prepayment Charge Restriction.
3. **Implementation:** Finally, we have a few outstanding questions regarding the proposed licence drafting and the approach to implementation. We would welcome clarity from Ofgem on the points raised.

In addition to Ofgem's statutory consultation, the points raised within this response are done so with view to assisting Ofgem's policy development following the government's Draft Domestic Gas and Electricity (Tariff Cap) Bill⁴, or extension of the safeguard tariff under Ofgem's own initiative.

1. **Extending the existing safeguard tariff for customer using the prepayment methodology**

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/651268/CCS207_CCS1017179938-1_Draft_Domestic_Gas_and_Electricity.pdf

Ofgem's Technical Document⁵ (and Impact Assessment) is predicated on the assumption that the 'prepayment methodology for calculating the benchmark represents the costs of an efficient supplier'.⁶ We strongly believe that prepayment methodology is not representative of the actual costs of an efficient supplier and therefore the CMA methodology is fundamentally flawed. During the Competition and Markets Authority (CMA) Energy Market Investigation, SSE provided substantial input throughout the various stages of the investigation⁷. Having now had experience of the CMA cap in practice, we have found that many of the anticipated drawbacks of the model, highlighted in our original responses, are being borne out in practice. We have highlighted some of these in more detail below.

The points we raise below focus on Ofgem's assumption that the 'prepayment methodology for calculating the benchmark represents the costs of an efficient supplier' and our concerns that the definition of 'efficient', taken from the conclusions of the CMA, is not grounded in realistic terms. It is also worth noting that the issues highlighted below, experienced in connection with the prepayment safeguard tariff, will be significantly exacerbated by an extension of the prepayment model to a wider group of customers:

- SSE does not agree that the current prepayment methodology accurately reflects the costs of an 'efficient supplier'. Our analysis of our own costs versus that assumed in the methodology indicates a gap between the assumed costs and actual costs, which substantially eats into the available headroom. In our view, the CMA failed to adequately define what an 'efficient supplier' is during the Energy Market Investigation and failed to designate an appropriate competitive benchmark. If applied to a wider group of customers, the methodology will risk suppliers being unable to finance their activities. We consider that this will have significant impact on the competitive market and be harmful to the best interests of customers. For this reason, we believe that the premise upon which Ofgem's Impact Assessment is based is flawed, and key assumptions/sensitives/risks are not properly accounted for. We will be looking to share some more detailed observations on this topic with Ofgem in its subsequent policy consultations on any longer term cap proposal.
- The CMA's prepayment model does not take adequate or realistic consideration of smart metering which is not included as a specific cost item in either the policy costs or indirect costs benchmarks. Smart costs are managed in different ways by different suppliers, notably due to different suppliers funding arrangements which will impact on how and when costs come through. A supplier with a significantly smaller customer base may take a different approach to funding their smart obligations and

⁵ https://www.ofgem.gov.uk/system/files/docs/2017/10/financial_protections_for_vulnerable_consumers_-_technical_document.pdf

⁶ Technical Document, 'Key Assumptions/sensitivities/risks', Page 5

⁷ Public responses can be found here: <https://www.gov.uk/cma-cases/energy-market-investigation>

will not incur the same costs as others. There could be a risk to the delivery of smart if this CMA methodology on costs is applied wider to a wider customer base. If the costs of smart rollout are not fully accounted for within a wider market cap, this could have unintended consequences on the smart rollout.

- Also, the costs of the smart metering programme are much more than originally estimated by DECC (now BEIS) and therefore the CMA's original assumptions which underpinned its approach in establishing the methodology are flawed. In particular, CPI is not an appropriate measure in which to measure the ramp up of smart costs that is being experienced in practice.
- 'Policy Costs' under the prepayment cap is defined as the sum of the values relating to environmental levies for any forthcoming Charge Restriction Period, as included in the forecast of current receipts presented in the most recent Economic and Fiscal Outlook published by the Office for Budget Responsibility (OBR), before the relevant Charge Restriction Period. We do not believe this approach accurately captures costs relating to the Energy Company Obligation (ECO). We are bearing the risk of OBR forecasts being inaccurate, and therefore costs not being properly reflected within the level of the cap. In addition, the current formulation has not been adjusted to reflect the concessions made by the government to support Energy Intensive Industries which mean that a larger burden of these costs now fall on domestic customers.

Ofgem's statutory consultation notes that 'as the government's legislative timetable firms up we will consider the case for amending the design and coverage of the vulnerable customer safeguard tariff'. SSE would emphasise the requirement to consider the design prior to any proposals to amending the coverage.

2. Wider impact on the retail energy market

SSE is disappointed that Ofgem's proposal is to only apply the safeguard tariff to existing WHD Compulsory Suppliers. Whilst we understand that this is the only realistic option on which to develop a vulnerable safeguard tariff before February 2018, Ofgem's statutory consultation fails to consider the potential distorting effect this will have on competition. It is crucially important that any longer-term policy on price caps or similar intervention applies equally to all suppliers, as a core principle. In this regard, we note that the recent opinion of Advocate General Mengozzi in the ECJ case of ANODE, referred to above,⁸ was that obligations of this nature must be imposed with regard to the principle of non-discrimination and that in particular the requirements "should bind all of the undertakings operating in the sector equally, in order not adversely to affect competition". We expect that

⁸ Case C-121/15, Opinion of Advocate General Mengozzi at paragraph 81-83

any wider cap would be applied in a way that is non-discriminatory – this means it should apply equally to all suppliers and not just to a sub-set of the market.

SSE's response to the CMA's Provisional Decision on Remedies (PDR) raised a number of potential unintended consequences following the CMA's proposal to introduce a safeguard tariff for those customers using prepayment meters. The key points that SSE previously highlighted include:

- (a) **Reducing the scope for suppliers to differentiate and compete on contract structure.** This will lead to a reduction in customer choice and reduced incentives for firms to compete for new PPM customers if wholesale costs rise. We will explore this in more detail in subsequent submissions and in response to consultations.
- (b) **Discouraging engagement of PPM customers.** Customers on the regulated tariff may see themselves as being adequately "protected" by the cap and therefore feel they do not need to engage with the market to find a better deal. More broadly, the cap also risks undermining customer trust in competition to deliver the best outcomes in the energy markets. Our analysis of SSE's prepayment customer churn rates since the PPM cap came into force versus previous figures shows an average reduction of around 30%. This provides a strong indication that SSE's prepayment customers have become less engaged with the competitive market as a direct result of the introduction of regulated pricing.
- (c) **Reducing price competition.** As the CMA's own guidance recognises, the cap may become the focal point of price competition; this risk is particularly acute if there is uncertainty that suppliers would be able to operate profitably within the restrictions imposed by the cap. We have observed from uSwitch data that the differential between the cheapest PPM tariff and the most expensive has narrowed considerably: from £204 to £77 for a typical dual fuel customer. Research findings commissioned by the CMA⁹ found that when customers were asked what minimum amount of savings they required to encourage them to switch supplier, the mean saving required per annum was £158 whilst the median was £114 per annum. In the PPM market, the available saving has now dropped below that found by this research to be required in order to incentivise switching in the market. This helps to explain the drop in PPM churn rates which SSE has observed since the cap was introduced. In addition, it is worth noting that the reduction in incentives to switch will undermine other policy initiatives to stimulate customer engagement.

3. Implementation

⁹ See GfK report at: https://assets.publishing.service.gov.uk/media/54e75c53ed915d0cf700000d/CMA_customer_survey_-_energy_investigation_-_GfK_Report.pdf, see page 74-75

SSE will need to make significant internal investment to implement the vulnerable safeguard tariff. The investment required to effectively manage a potential price adjustment every six months should not be underestimated. In addition, some of the more complicated aspects of the cap – specifically where customers are moving in and out of the scope of the cap – may present IT implementation issues that have not yet fully been worked through. It is unlikely that we will have a “perfect” IT solution in place to account for all the potential practical complexities associated with administering the cap in practice – therefore manual workarounds (such as use of rebates referred to below) are likely to be required in some instances. We are still working through the implications with our IT project team.

In addition, Ofgem’s intentions in relation to the monitoring of the safeguard tariff compliance by checking against the number of WHD rebates paid will require additional investment. These numbers will not naturally align at this later date but will require manual intervention to reconcile, in order to take account of customers who have left our supply, moved home, deceased customers or moved onto a fixed tariff. This is likely to be a manually intensive task and will take resource away from other areas of customer service.

We note also that that the Scottish Government has devolved powers as regards WHD, though it is not yet clear if it is intending to exercise these. It would be helpful to gain certainty that there will be no changes to the underlying WHD framework which is likely to present issues for implementation.

SSE has several additional questions which we would welcome clarification from Ofgem:

- The safeguard vulnerable tariff is subject to a sunset clause which takes effect on 31 December 2019. However, Scheme Year 8 under the WHD ends on 31 March 2018. The definition of Relevant 28AA Customer refers to the preceding Scheme Year when considering an eligible customer. Should suppliers assume that all those identified during Scheme Year 8 would remain eligible for the safeguard tariff until 31 December 2019?
- The definition of Relevant 28AA Customer will deem a WHD Core or Broader Group customer as eligible assuming a customer received either rebate during a current or preceding scheme year. What is Ofgem’s view on the applicability of SLC 23.3 when a customer is no longer eligible for the vulnerable safeguard tariff?
- When a customer is no longer eligible, we would intend to move the customer to an appropriate “default fixed” tariff, unless the customer chooses an alternative. SSE would welcome further guidance on the timeline for identifying when a customer is no longer eligible for the safeguard tariff and the communication requirements that will apply. We would also flag that IT development is likely to be required for these aspects - we are currently assessing implementation timescales.
- Also, the definition of Relevant 28AA Customer (b)(i) notes that ‘in respect of the current Scheme Year which corresponds with the Charge Restriction Period’. It is

unclear as to whether a customer who is identified part way through a Charge Restriction Period should have the vulnerable safeguard tariff cap retrospectively applied to cover the entire Charge Restriction Period (i.e. in the form of a rebate)?

- SLC 28AA.10 (gas) and 28AA.16 (elec) are clear insofar as a customer already having received a WHD payment is eligible for the safeguard tariff from the Modification Date. However, more customers will undoubtedly become eligible for the vulnerable safeguard tariff cap. We consider that a customer will become a 'Relevant 28AA Customer' at the point on which a Warm Home Discount rebate is applied to the relevant customer account. SSE would then, in accordance with 28AA.9 (gas) and 28AA.15 (elec), be required to comply with 28AA.1 within 30 days of that Relevant 28AA Customer receiving payment. We do not believe the 30-day requirement should begin until such point the customer has received a WHD payment. This is particularly important when considering those Relevant 28AA Customers in accordance with Chapter 2 or the Regulations (or Broader Group). The customer is not deemed as eligible for a Broader Group payment until such point as the supplier has met the minimum verification requirements under the Regulations. In addition, it will be challenging from an IT implementation perspective to migrate the customer to the capped tariff prior to the WHD payment being applied to the customers' account. This is due to the current design of our system markers that will be used to identify eligible customers. We would not be able to implement a solution to this within the timescales allowed. If the migration to the capped tariff is required prior to the payment being made to the customer then we will have to apply rebates to customer accounts to account for the delay in migration. We would welcome further guidance on this aspect.
- Paragraph 5.32 of Ofgem's Technical Document notes that 'our proposals could incentivise suppliers to switch customers on to fixed tariffs'. SSE would welcome further clarification from Ofgem on this point. Taking into account Ofgem's recent implementation of 'informed choices' and requiring that suppliers only recommend tariffs based on a customer's characteristic and preferences, it would be useful to understand what takes precedence.