Retail Price Regulation Team,
Ofgem,
9 Millbank,
London,
SW1P 3GE

22nd March 2018

Dear Sirs,

Setting the default tariff cap working paper

Thank you for the invitation to respond to the above working paper. Bristol Energy is an independent supplier of electricity and gas with a business model that has a regional focus on the South West of England, although we supply customers across Great Britain. We have a mission to fight fuel poverty and be a force for social good.

Executive Summary

Bristol Energy is a supporter of the decision to impose a price cap on Standard Variable Tariffs (SVT) and welcome Ofgem's working paper setting out its thinking.

It is important that Ofgem recognise that in setting the cap for default and SVT tariffs, it is also setting a pseudo cap for all tariffs in the sense that it will be difficult for suppliers to market fixed tariffs above the cap unless they can demonstrate something tangible to customers to justify this. The original political purpose of the cap was to prevent the "worst excesses", and in setting a cap for an efficient supplier (not that a typical efficient supplier exists), it should not seek to drive down prices to a point where competitive suppliers do not have a headroom to compete.

Whether Ofgem decides to set the cap based on a price or cost benchmark it must consider the breadth and diversity of all the suppliers operating in the market. There is a significant difference in both the prices and costs of an incumbent supplier with a disengaged customer base, and a new entrant attempting to gain market share in the engaged part of the market. Ofgem must also consider the impact that economies of scale have on suppliers' fixed costs.

We also feel it would beneficial for Ofgem to look at the published accounts of all suppliers to better understand the market. Many suppliers in the market are currently loss making, either due to inefficiencies, or because they are investing to grow market share in a highly competitive market. If Ofgem chose to base its benchmark of an efficient supply business using loss making suppliers, then there is a risk that it could damage the competitive market.

We have a number of specific points on your working paper which we have set out below, and for your ease we have referred to the relevant paragraph number in your working paper.

4.2 We support the proposal to have separate caps for each region. All suppliers will have a different proportion of customers in each region, and thus any attempt to reduce the number of caps via a weighted average would create winners and losers in terms of suppliers, and make some regions more profitable to be in than others to the detriment of those customers in less competitive regions.

4.5 Ofgem's approach to setting a cap at nil consumption and at Typical Domestic Consumption Value

(TDCV), seems to work under the current PPM safeguard tariff and we support its replication in the new design. However, we would propose that the standing charge includes the installation of a smart meter and the costs of operating the smart meter infrastructure. Even properties with nil consumption will still need to have a smart meter and regular readings to confirm nil consumption in correct.

4.6 The current Safeguard tariff for PPM excludes Smart meters and thus the number of non-standard multi-register meters was minimal. The proposed price cap includes Smart meters and as such may stifle innovation in multi-rate tariffs. Whilst customers will originally select a smart tariff and will not be subject to the cap assuming it is a fixed term tariff, suppliers will not be able to offer to default these customers onto a similar tariff at the end of their initial contract, nor offer variable multi-rate smart tariffs as they will be subject to the cap, but not specifically have a cap set for their tariff structure. We believe Ofgem will need to issue precise guidance on applying the cap to multi-register smart tariffs.

4.7 We believe that any cap should be set on the basis that a customer pays on receipt of bill. This would allow suppliers to continue to offer Direct Debit discounts to customers who opt for this method. This would be in keeping with the first three of the matters Ofgem has to have a regard for in setting a cap.

5.7 We agree that Ofgem must be careful to exclude reference prices where a supplier is pricing beneath cost to gain market share. Ofgem should also be wary of using tariffs offered by suppliers who have poor customer service or are avoiding costs by neglecting their regulatory obligations.

5.13 There is no such thing as a "typical" supplier. All suppliers deal with wholesale energy costs differently depending on their ability to hedge, often related to their access to long term funds of parental or other guarantees. Their fuel mix is also relevant, as a supplier with a high proportion of renewables is likely to face higher costs. Environmental and social costs are dependent on whether a supplier is obligated, voluntarily participating or exempt from certain costs. Indirect costs also vary depending on the level of customer care, or like Bristol Energy have a mission to fight fuel poverty. We therefore believe that Ofgem needs to reflect the diversity of suppliers in selecting benchmark suppliers.

5.23 Whilst we understand the benefits of using existing CSS of the largest suppliers, it is important that this does not create a bias to larger suppliers and their economies of scale and access to long term funding at the expense of other suppliers in the market. Ofgem will need to seek data from a wide range of parties.

5.28 On the matter of suppliers converging their approaches to purchasing wholesale energy for default tariffs we agree there may be some convergence by suppliers with high default tariffs, but if a majority of suppliers need to converge as has been the case under the PPM safeguard tariff then this could be detrimental to independent suppliers who may not be able to purchase energy long term like larger well financed suppliers. If Ofgem sets the cap appropriately, then most supplier should be able to continue their current strategy apart from those suppliers with excessive default tariff charges.

5.33 One area where direct fuel costs are likely to diverge between larger and smaller suppliers is the cost of credit and collateral. The largest suppliers can rely on their credit rating to access credit, or avoid posting collateral, whereas many smaller parties are required to post cash collateral on a mark to market basis. Ofgem's previous work on secure and promote should provide evidence of this.

5.46 As stated, the CMA investigation into operating costs only looked at the operating costs of larger suppliers, and given they all provided similar levels of service, the CMA's conclusion that differentials were down to the level of efficiency may have been valid. However, in the wider market, Ofgem is fully aware that levels of service vary significantly across suppliers, in particular that there is a degree of correlation between low prices and poor service standards of some new market entrants. As the proposed cap applies across all suppliers then any assessment of efficiency must be based on an appropriate level of service with sufficient headroom to allow suppliers to offer a higher level of service if they wish to do so. If the cap is set based on the operating costs of suppliers who deliver poor levels of customer service, then inevitably, suppliers will need to engage in a "race to the bottom" in terms of service to the detriment of customers.

5.47 In terms of marketing costs, we would also highlight that marketing spend of smaller suppliers is likely to be higher on a cost per customer as they are engaging in growing market share compared to incumbents who are defending market share, there are also fixed costs such as marketing campaign designs which do not reflect the breadth of a campaign. (e.g. The design costs of a poster remain static whether for one billboard, or a thousand)

5.49 In the case of benchmarking, we would propose that Ofgem seek to use a mix of incumbents defending their market share, established Independent suppliers and new entrants aggressively seeking to gain market share. This does not mean the Ofgem would need to average the costs for a bottom up approach, but in understanding the variance it would be in a better position to set a cap that continues to facilitate competition.

I hope you find this response useful. If you have any queries, please do not hesitate to contact me.

Kind regards,

Chris Welby

Chris Welby
Head of Regulation