

I wish to comment on your Default Tariff Cap Working Paper 3 – "Our thinking on including a headroom allowance"

I want to argue against the need for a headroom allowance in the price cap mechanism.

The argument for including a headroom allowance is that it is worth penalising those consumers who choose not to or who are unable to switch, so as to subsidise uneconomic suppliers, who might otherwise leave the market, so as to create competition in the marketplace.

Whilst if the vast majority of suppliers were to leave the market, there might be a risk that there would be insufficient competition to drive down prices. This seems extremely unlikely given the number of suppliers in the market, and in any case the price cap mechanism should protect consumers from significant harm.

Such an approach would surely be seen to be against the intentions of the CMA and a major distortion of the role of Ofgem as the protector of consumers.

The reason for the need for the price cap is that a substantial number of consumers were not taking part in the market despite on paper a sizable cost benefit from switching. It seems unlikely that many if any of these will be influenced to take part in the market by the use of a headroom allowance.

At the moment it is arguable that the level of switching is artificially raised because of the structure of current contracts which at the end of term put consumers on a much higher tariff. This means that active consumers are forced to switch to stay on similar priced contracts.

Suppliers presumably calculate that there is more benefit in short term competitive pricing relying on consumer inertia at the end of contract to provide the funding to pay for these initial low prices. If they instead provided consistently lower prices, then its likely that there would be higher levels of loyalty which would remove the customer detriment of having to switch, but would be represented in lower switching levels. Despite the lower switching this could well be argued would be a better position for most consumers. The cost to consumers of making a switch was I believe calculated as part of the more reliable switching program business case.

I think that evidence on the experience of the pre-payment cap will be interesting, particularly looking at switching rates. If there is improved consumer loyalty, then the benefit to consumers of not having to switch should be included in the assessment of the benefit case for the cap. I believe ElectraLink should be able to provide analysis on the electricity market pre-payment switching rates, and xoserve potentially on the gas market.

Another advantage of not including headroom allowance is that with less incentive for competition on price, suppliers will be encouraged to compete in other areas, for instance more innovate tariff structures, or additional services such as Demand Side Response.

I would be happy to discuss further.