Retail Market Policy
Ofgem
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By email to: retailpriceregulation@ofgem.gov.uk

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Dear Sir / Madam

**Default Tariff Cap 5th Working Paper: Competitive Reference Price**

We welcome this opportunity to respond to Ofgem's 5th Working Paper on the Competitive Reference Price.

As discussed in our previous submissions, our preference remains for a full "bottom up" assessment of costs. Given the scale of any market-wide price cap, any proxy risks unacceptable inaccuracies.

**However, should Ofgem decide to continue using a competitive reference price, we agree it is right to refresh the CMA benchmark, given the dramatic market changes since the CMA's inquiry was announced in June 2014**. At the time, new entrant suppliers had a market share of just 7%, there were just 24 suppliers active in the domestic market and the CMA used data from just two suppliers (one of which was First Utility) to create its model. Today new entrants hold a market share of over 20%, the number of active suppliers has almost trebled to 68, and a significant number of new entrants - 9 - have crossed over the full 250,000 policy cost obligation threshold. Given the scale and significance of such market developments, we do not think merely adjusting the existing benchmark is sufficient.

**We agree that Ofgem should "select suppliers with high levels of consumer engagement" and "limit the extent to which the prices charged to less engaged consumers are used in the benchmark, as these prices would be less likely to have been driven to an efficient level through competition"**. Ofgem could select suppliers with a relatively low number of 3 year+ SVT customers, as this provides a good proxy for engagement given the customer will have interacted with their supplier / energy market within the last 3 years. Within this supplier, all tariffs, including defaults, should be considered in the benchmark, given it is the overall portfolio that makes a supplier both competitive and profitable.

We note such tariffs are more likely to be fixed deals at present, but in the future could include variable tariffs where these have clearly been an active choice by the consumer (e.g. some suppliers have only one tariff).

We would caution against only using solely 1 year fixed tariffs as a proxy, given there are often loss-making acquisition products which do not always fully reflect the cost of supply.

Selecting suppliers based on engagement and then including their full suite of tariffs is the most appropriate option.

**We likewise agree that, as well as selecting for customer engagement, Ofgem should select suppliers which "have the lowest prices which are reflective of efficient costs of supply...and are not driven by atypical features"**. Loss-leading tariffs and loss-making suppliers should be excluded, as should suppliers below the policy cost obligation threshold. Likewise we would caution about using rapidly growing suppliers in this baseline, given they will not have incurred many costs to date for e.g. home move, retention, and vulnerability, as they are not yet to steady state and their rapid growth means this will be low as a % of their base. Perhaps a proxy for this could be for Ofgem only to include suppliers that have had at least 250k supply points for 24 months, to ensure suppliers are selected in a "steady state" rather than one of rapid expansion where they may not have faced, or yet understood, the full costs of the market.

**Selected suppliers should also offer the full range of products to all consumers, and sell via a wide variety of channels,** e.g. face to face, telephone, PCWs, to ensure maximum accessibility.

**However, we do not believe that customer mix should be a consideration for Ofgem, provided the selected suppliers offer products to the whole of market.** The incumbents have argued they have a higher percentage of vulnerable customers than average and that this adds costs which needs to be factored in. This should not be relevant, provided the suppliers selected also serve vulnerable customers and make a normal profit margin doing so, i.e. are not loss making, and can therefore serve as a whole of market competitive benchmark.

**In terms of the optimum number of suppliers used to create the benchmark, we agree this should be expanded beyond the original two used in 2014, given the much wider competitive market. However, we also note that too many suppliers risks creating an unwieldy benchmark which might be difficult to audit and track**. In any case, perhaps only four or five suppliers would remain once the above exclusions have been applied.

**We do not believe selected suppliers should be weighted within the benchmark**, as weighting by customer numbers risks biasing the reference price towards one particular business model, as well as creating perverse incentives for the businesses within the Cap.

**We agree the benchmark should be based on direct debit prices,** but with a separate and capped charge for payment on receipt of bill. Additionally, whilst an uplift should be allowed for paper billing, online account management should be seen as the default (unlike under RMR, where paper billing was seen as the default), with paper billing therefore presented as an extra charge.

**Whilst it is mentioned only briefly in the paper as a possible consideration, we do not believe suppliers should receive special dispensation for pre-privatisation costs, e.g. pension liabilities, as in a truly competitive market this would not be relevant.** In aviation, for example, new challengers such as Ryanair and Easyjet have been able to compete against legacy incumbents because of their much lower cost base, and consumers have benefited as a result. This should be the competitive benchmark we are trying to achieve. As a final note, the incumbents have already enjoyed a special dispensation at the consumers' expense, profiting from a huge pre-privatisation inherited customer base for over twenty years.

Yours sincerely

[not signed]

**Natasha Hobday**
**Group Policy and Regulation Director**