OVO Energy
1 Rivergate
Temple Quay
Bristol BS1 6ED

policy@ovoenergy.com
www.ovoenergy.com

8 October 2018
retailpriceregulation@ofgem.gov.uk
By Email Only

Dear Anna,

OVO Energy is the largest independent energy supplier in Britain. Founded in 2009 by entrepreneur Stephen Fitzpatrick, OVO Energy redesigned the energy experience to be fair, effortless, green and simple for all customers. Today, OVO Energy is a progressive energy company that serves more than 890,000 retail energy customers, striving to deliver clean, affordable energy for everyone. Our core values encompass fair pricing, top customer service, clear and simple information, and innovative technology to make managing energy easier.

OVO Energy welcomes the introduction of a price cap for customers on variable tariffs, which provides protection to disengaged customers who are often on some of the worst deals in the market. We are supportive of introducing the cap this year to ensure customer are protected ahead of the winter.

OVO Energy recognises Ofgem's efforts in completing thorough cost analysis given the short timeframe for delivery. We believe the cost reflective methodology has resulted in the cap being set at a reasonable level which protects customers from being overcharged whilst allowing space for supplier competition.

That being said, OVO Energy feels there are some elements of the methodology which may need to be addressed to ensure the cap continues to be cost reflective in the future. We have addressed these in detail below.

Cost Adjustment Mechanism

OVO Energy welcomes Ofgem's proposals to include some risk mitigation mechanisms but believes there is still more work to be done in this area to ensure the cap continues to be cost reflective in the future. Given industry experience with the Safeguard Cap we would encourage Ofgem to pay particular attention to costs associated with:

- **Policy Development** - OVO Energy would like to propose that Ofgem looks at creating a mechanism which reacts to increased costs faced by suppliers associated with development of existing policy and introduction of new policies. We are aware of various upcoming changes such as Guaranteed Standards on switching, outputs from Ofgem's Switching Programme, move to PAR1 imbalance pricing and the potential suspension of the Market Making Obligation - all of which may lead to a material increase in the costs faced by suppliers. As a result, we propose that Ofgem reassesses existing and new policy costs in line with each cap period to ensure the cap moves in line with actual costs.

- **Wholesale Costs** - Wholesale UK Power and Gas prices have been extremely volatile over the past three months. While OVO Energy is comfortable the indexation methodology proposed will result in the cap moving in line with the forward wholesale market, we are concerned that the 1% additional allowance may prove insufficient. Market tightness and reduced security of supplies in the Power Market - due to more intermittent renewables - and the Gas Market - due to reduced storage and increased reliance on Liquified Natural Gas imports - mean that there is the potential for material increases in the cost of Wholesale for a domestic supplier. We see a very real risk that the costs of shaping (converting standard traded products into retail load shapes), balancing (adjusting short term positions due to forecast weather) and imbalance (the penalties for demand forecast error) could increase significantly, and the level of the cap should reflect such increases. In addition, the introduction of a Default Tariff Price Cap significantly increases the wholesale risk due to the likely correlation between customers selecting a Price Capped tariff and wholesale market movements. In a rising wholesale market, capped variable tariffs will look attractive and may result in more customers choosing to roll onto variable tariffs leaving suppliers under-hedged and therefore exposed to the higher wholesale prices. Therefore, we encourage Ofgem to include mechanisms within the methodology to either update the 1% additional allowance for wholesale in future price cap periods or to allow suppliers to recover excessive costs incurred in previous price cap periods. We believe that such a mechanism is essential to ensure the price cap reflects the realities of costs and risks suppliers face.

- **Unidentified Gas (UIG)** - The 0.96% assumed for unidentified gas (UIG) does not align with outturn volumes or the industry consensus that this is likely to settle at around 4%. This 3% difference equates to c. £9 per customer per year, which is extremely significant given headroom of just £12 per year. With the notable uncertainty currently surrounding UIG and the work being undertaken by the XoServe taskforce, as well as suppliers, we encourage Ofgem to retain the ability to amend the 0.96% assumption for future cap periods to ensure this allowance reflects the actual costs incurred.

- **Smart Costs** - OVO Energy are supportive of Ofgem's 'minded to' position to review Smart costs ahead of the October 2019 cap period. Furthermore, we think such reviews should continue beyond 2019 to ensure the cap continues to be cost reflective. We suggest Ofgem pays particular attention to costs associated with meter rental cost adjustment, development of SMETS2 costs and the benchmark supplier's progress towards Smart rollout goals.

Ofgem Clarification Required

OVO Energy would welcome further clarification from Ofgem regarding various aspects of the cap to ensure supplier's implementation is compliant. We would be particularly interested to understand how Ofgem expect suppliers to manage the adjusted cap level for standard credit customers.

OVO Energy understands the reasons behind Ofgem's proposals on setting a separate cap level based on payment type. However, as stated in our response to the consultation in May, we believe the cap should be set at a single blended level for all payment methods. We think Ofgem's 'minded to' approach will result in customer confusion and additional operational complexity and therefore costs for suppliers. As such, we suggest Ofgem considers alternative solutions. For example, a fixed uplift of £84 per year for all Standard Credit customers, that could be applied as a monthly charge to bills (£7 a month for dual fuel customers). Such an approach would simplify the cap which would support customers making an informed choice. Additionally, it will reduce operational complexity, helping suppliers implement the cap in a compliant manner while mitigating the risk of inconsistency across the industry.

If Ofgem proceed with their 'minded to' position, it is important suppliers can implement a compliant solution in an efficient manner. This can be facilitated by Ofgem providing clarity on how they expect the process to work operationally. Therefore, we suggest Ofgem explicitly states the ways in which suppliers can move customers from the Direct Debit to Standard credit level of the cap and specifies how suppliers should define customer payment methods. For example, if a customer's Direct Debit is rejected a number of times, can Suppliers class this customer as having a standard credit payment type? If so, will Suppliers be required to run a variable price change process with associated notice periods to move the customer onto the uplifted cap level? Furthermore, if the customer subsequently reinstates their Direct Debit, how quickly will Suppliers be expected to return customers to the DD cap level? Could compliance be achieved through a payment type uplift for non-DD customer that is applied separately to the tariff itself? Without clear guidance there is a risk of inconsistency across the industry which will ultimately result in customer detriment.

Prepayment Cap Review

One of the benefits of a price cap is simplicity for consumers. Therefore, OVO Energy supports Ofgem's proposal to move vulnerable pay monthly customers from the Safeguard Tariff Cap to the Default Tariff Cap. We understand the necessity to cap PPM SMETS2 customer prices to ensure enduring protection, but think including them in the Default cap will add undue complexity operationally. If the Default cap and the PPM cap diverge this would create the risk of different levels of protection depending on which meter type customers have. This will be confusing for customers and could also damage industry efforts to meet smart roll out targets. We propose Ofgem cooperates with the Competitions and Market Authority on their review of the Safeguard Cap in early 2019 to create a simple enduring industry wide cap which uses the cost reflective methodology of the Default Tariff Cap and applies uplifts for varying costs associated with payment type (as opposed to meter type).

Reviewing the Cap

Finally, OVO Energy would welcome Ofgem's consideration on how they will mitigate any unintended consequences resulting from the implementation of the cap. One of the potential consequences could be a significant reduction in switching. Ofgem's impact assessment forecasts that switching rates will decrease by up to 50%[1] once the cap is introduced, but there are no contingency measures outlined should switching rates reduce by more. Therefore, we believe the initial review of the cap and its impact on competition should be brought forward from 2020 to October 2019 (in line with the Smart costs review). Having an early review would provide an opportunity to assess the current market climate and, if necessary, introduce mitigating measures (such as an increase in headroom) should the observed impact of the cap on competition be materially different from expectations. This will ensure the Bill's objective of 'effective competition' can be met.

Kind regards,
Stephen Harris
Energy Director

[1] '*We expect that under a cap, switching levels would have been lower, by up to 50%' (* Statutory Consultation – Default tariff cap – Overview document, Ofgem, 2018,p.7*)*