Developing a framework for assessing whether conditions are in place for effective competition in domestic supply contracts

Executive Summary

We agree broadly with Ofgem's proposed framework for assessing whether conditions are in place for effective competition in the domestic market. However, we do have a number of specific comments which, if addressed, could provide more confidence to all stakeholders.

Firstly, we would be concerned if Ofgem chose to assess a large number of indicators to help inform its decision. This would risk making it extremely challenging to conclude whether, in the round, the conditions are in place or not, therefore creating the impressing that the process will be a "black box". Instead, we would encourage Ofgem to focus on a smaller number of relevant indicators.

Secondly, the framework does not explain how a baseline will be set. This is important, so that everyone can see how the metrics have moved over time.

Thirdly, we believe the framework should include a comparative assessment with other sectors such as telecoms and banking. This can help provide a greater context to see whether the performance of the energy sector is comparable to other sectors, with regards to the chosen metrics.

Fourthly, we have concerns that Ofgem's discussion paper is very high level, and there is currently no clear idea of how the final framework will look. Ofgem needs to show that it has taken account of supplier responses to this paper, and provide them with an additional opportunity to comment on the framework before it is finalised.

Finally, we believe there should be a further consultation next year, before Ofgem submits its recommendations to the Secretary of State on whether to remove the default tariff cap. Suppliers should have the right to comment on any errors it perceives in Ofgem's findings, so that any recommendation is made on accurate and complete information.

We firmly believe that the imposition of the default tariff cap has constrained the improvements that were already being seen in effective competition, for example by restraining suppliers' ability to finance their businesses and innovate in the market. We believe that removing the cap would result in improvements in switching and also in consumer engagement (although some time may be necessary to allow the market to recover). For this reason, Ofgem should recommend removal of the default tariff cap to the Secretary of State at the earliest possible opportunity.

We recognise that there are customers who find the switching process difficult, largely due to vulnerability. There are solutions, other than a price cap, that could help these customers, some of which we have listed in our response to Question 3.

While such solutions are being developed, we accept that it may be necessary to extend the price cap for vulnerable customers for a short period beyond the end of 2020. We do not agree that an enduring cap would be an appropriate solution.

We have provided our responses to Ofgem's questions later in this response, but first, we would like to provide a few general comments about the price cap and why we believe it should be removed.

Default tariffs versus fixed term tariffs

Due to the volatility of wholesale energy prices, most larger suppliers will have a hedging strategy to smooth out wholesale purchasing risks and minimise the frequency of price changes. For fixed tariffs, there is an element of certainty that customers will remain with their supplier for the term of the contract and therefore there is stability in the margin for that tariff; however, a customer on a default tariff may leave at any time without notice or penalty, resulting in the risk of having to sell energy back to the market, potentially at a loss. It is therefore necessary to factor in to the prices an amount to insure against that risk.

However, it should also be noted that customers who are on default tariffs generally have a higher cost to serve due to their characteristics, and an imbalance in the level of those costs for different suppliers. We discuss this below.

The unlevel playing field

There has long been an unlevel playing field in the energy market, with an imbalance between larger and smaller suppliers. One of the main reasons for this is that smaller suppliers are not subject to the WHD and Energy Company Obligation (**"ECO"**). Our current assessment of this benefit is approximately £35 per customer per year for non-obligated suppliers. When these schemes were first introduced, smaller suppliers had a much lower percentage of market share, and it would have been impractical to expect new entrants with few customers to participate. Our preference is for these obligations to be funded under general taxation. However, it is worth noting that, WHD and ECO having now been in place for a number of years, those suppliers who are more experienced in managing schemes are willing and able to manage obligations on behalf of smaller suppliers. There is no reason, therefore, for any supplier to be excluded from the scheme. The benefits to consumers would not just be in more effective competition (larger suppliers would be in a better position to compete with smaller ones), but there would be greater choice of supplier for WHD applicants. Another possible solution would be for a few companies (suppliers or otherwise) to provide ECO and WHD services and for suppliers to pay for those services according to market share. We have and will continue to lobby for WHD and ECO to be extended to cover all suppliers.

It is worth noting that the costs of ECO are greater now than they were when the obligation was first introduced, due to the fact that the 'low lying fruit' was exploited in the early days, leaving suppliers under the current version of the scheme to find additional funds to deal with those premises with difficult technical issues to resolve, and customers who do not want to engage.

Also, under the default tariff cap there are even further costs to larger suppliers, who are required to put WHD customers who pay by standard credit on the Direct Debit level of the cap; a cost that is not covered under the cap and therefore eats into larger suppliers' headroom.

Another reason for the unlevel playing field is that new entrants have been allowed to enter the energy market, ill-prepared to manage its risks and meet its regulatory requirements. For example, new entrants:

- have often taken advantage of the 'supplier in a box' model, which allows them to enter the energy market with very little understanding of regulatory obligations. Many of these suppliers had failed to fully cost their tariffs to ensure they could provide the required level of customer service;

- sometimes have business models that required payment in advance and use consumer credits to fund their businesses;
- in some cases do not properly manage their risks, such that when wholesale prices are rising they are in danger of becoming insolvent – indeed many suppliers have exited the market, in large part due to this, during 2018;
- sometimes do not accrue for expected future financial commitments, so that they are unable to pay their bills when they became due (e.g. the Renewables Obligation (**"RO"**)). Where companies subsequently fail, these unpaid bills are mutualised across the remaining suppliers, resulting in higher prices for consumers.

Consequently, the prices charged by many new entrants are not sustainable, but do attract significant numbers of customers away from obligated, well-managed suppliers who, in order to attempt to maintain the size of their portfolios, need to offer similar prices at very low or negative margins.

Larger suppliers who also hold a generation licence also face other exception costs, for example the largest six suppliers are obliged to prepare annual financial statements (Consolidated Segmental Statements), participate in trials to engage 'disengaged' customers, and suffer having their customers plundered by activities such as the collective switching trials (paying for the cost of the trial, to add insult to injury).

Shortcomings of the default tariff cap methodology

We have consistently argued that, while the default tariff cap closely reflects actual costs for wholesale energy, networks, and policies, it does not take full account of the additional operating costs for a portfolio that has a greater number of vulnerable consumers, nor does it completely account for all smart costs; it does not allow suppliers to earn a sufficient rate of return nor allow sufficient headroom for unaccounted for costs (including those we are now seeing for mutualisations due to supplier failures); finally, it does not provide any room for competition below the level of the caps, despite the fact that multiple surveys have indicated that customer switching falls off significantly where savings are less than around £70 per annum.

In our opinion, therefore, the level of the default tariff cap has been set at an unsustainably low level. We maintain that default tariff prices were not, on the whole, unreasonable prior to the introduction of the default tariff price cap, and that the cap itself will reduce competition in the market:

- while increased switching has been seen since the introduction of the cap, it is our belief that this will be short-lived and results more from the amount of media interest in energy prices than from the imposition of the cap itself;
- if it is allowed to continue for any length of time, the cap is likely to result in customers becoming complacent, believing that, because they are on a capped tariff, there is no need to actively participate in the energy market.

Lack of competition in the default tariff market

Competition is already vigorous in the fixed term market. The number of switches in April 2019 was the highest ever recorded in any month[1] and the number of customers on default tariffs has reduced to 54%[2] in 2018 compared to 70% at the time of the Energy Market Investigation[3]. It is also worth noting that a recent survey indicated that 74% of customers are satisfied with their energy supplier[4]. In the Appendix to this response we show the decrease in market concentration since 2011. An extrapolation of this decline shows that according to the European Union definition, residential electricity is likely to become 'unconcentrated' later in 2019 and residential gas in early 2021.

The improved competition, however, is largely in the fixed term market. This begs the question as to why competition is lacking in the default tariff market, as we have pointed out in our response to Question 1.

The 2019 final report by The Commission for Customers in Vulnerable Circumstances[5] states that *"There were also anecdotal reports of certain newer suppliers allegedly saying that they will not try to attract or serve any customers deemed to be vulnerable, due to their business models – for example, by operating exclusively online or via apps."* The report goes on to quote research by Stephen Littlechild on the tariffs available to customers in February 2019, published by Cambridge Energy Policy Research Group. This research found that *"the highest savings available appeared to be from 14 different suppliers … but on closer examination most of these offers had limitations of some kind, with respect to availability, technology, call centre provision, customer service, risk, reputation, experience and so on."*[6]

Whilst the number of new entrants to the energy market has grown and competition has improved, that competition has been for low-cost to serve customers, who pay by Direct Debit and manage their accounts online. In addition, our response to Question 1 also shows that customers on default tariffs are more likely to be vulnerable than those on fixed term tariffs and, as Ofgem has acknowledged[7], vulnerable customers are likely to have a higher cost to serve than other customers. This may be due not only to the fact that they are also more likely not to pay by Direct Debit or manage their accounts online, suppliers also incur additional costs, for example providing bills in Braille; offering services for the hard of hearing and those who do not speak English when they call in; offering regular gas checks. In addition, financially vulnerable customers are more likely to have debt on their account and require considerable ability to pay assistance.

The price comparison market is well-developed for customers who have internet access, but there are fewer services available for those who need to or prefer to manage their affairs offline. This situation needs to be addressed if switching is to improve for customers on default tariffs.

[1] https://www.ofgem.gov.uk/data-portal/retail-market-indicators
[2] https://www.ofgem.gov.uk/system/files/docs/2018/10/state_of_the_energy_market_report_2018.pdf
[3] https://assets.publishing.service.gov.uk/media/5773de34e5274a0da3000113/final-report-energy-market-investigation.pdf, para 11.53
[4] https://www.ofgem.gov.uk/system/files/docs/2019/06/consumer_perceptions_of_the_energy_market_report_q1_2019.pdf
[5] https://www.energy-uk.org.uk/publication.html?task=file.download&id=7140
[6] Savings available in the retail energy market and the Overall Customer Service score, Littlechild (2019)
[7] https://www.ofgem.gov.uk/system/files/docs/2018/11/appendix_6_-_operating_costs.pdf, para 2.18

In addition, we believe that there should be some means of fairer distribution between suppliers of the costs of supporting vulnerable customers to ensure a more level playing field.

Conditions for effective competition

As we have discussed above, there are a number of factors that could help bring about effective competition, and some of these are outside of the control of suppliers. We summarise these below.

- There need to be changes to the way WHD and ECO schemes are funded. Our preference is for these to be funded out of general taxation; failing that, there should be a level playing field so that all suppliers, regardless of size, contribute equally.
- Changes are required to mutualisation process for the Renewables Obligation, Feed-in-Tariff etc; for example, requiring suppliers to hold credit, or pay into the schemes quarterly. The market entry regime must be much more stringent. From 5 July 2019, the licence application form has been revised to require additional information from new entrants, and Ofgem has stated it will take a more robust attitude to issuing supply licences. Timing of the licensing process has also been amended, so that it is less likely that the 'supplier in a box' model will include a supply licence as standard. Ofgem must ensure that it takes full advantage of these changes and delivers a robust market entry regime, refusing licenses to those applicants who are not adequately funded or do not fully understand the market they are entering.
- Ofgem should continue to monitor suppliers once they are licensed. As part of the Supplier Licensing Review[8], Ofgem is looking to put in place ongoing reporting to ensure new entrants and other suppliers continue to be adequately funded and fit and proper to run an energy supply business. We urge that this be completed as soon as possible.
- The issue of some suppliers funding their business activities through consumer's credit balances must urgently be addressed. If these suppliers fail a Supplier of Last Resort will be appointed and expected to honour these balances, or at least part of them – the remainder being mutualised across all other suppliers. This is being looked at under another part of the Supplier Licensing Review, and again we urge Ofgem to progress this as quickly as possible.
- There needs to be a process whereby the additional costs of supplying vulnerable customers is shared between suppliers on the basis of market share, to ensure these customers are as attractive as a non-vulnerable customer. This should help ensure effective competition for these consumers.

Question 1

Are there any features of effective competition that are not covered in our definition?

1. Ofgem considers competition to be effective if it involves *"rigorous rivalry"*. We question the use of the word 'rigorous': in consulting a dictionary, we note that the definition is harsh, severe or stern. This does not seem an appropriate adjective to use with 'rivalry'. A better adjective may be 'intense'; thus the rivalry that Ofgem would like to see as evidence of effective competition should be energetic, vital.

[8] https://www.ofgem.gov.uk/system/files/docs/2019/05/update_slr_ongoing_and_exit_final.pdf

2. Intense rivalry is evident in that part of the market that attracts 'engaged' consumers: the level of competition for the disengaged is less obvious. It is necessary, therefore, to analyse why this is so in order to achieve better results for this group of customers.

3. We agree that it is important to consider rivalry over a number of features including price, customer service and innovation, and to look at outcomes for customers. We would also encourage the framework to recognise that some customers on default tariffs, sometimes known as 'sticky' customers, have made an informed choice not to engage with the energy market, at least as far as switching is concerned. They may engage in other ways, perhaps by switching tariff but not supplier; taking advantage of other products offered by their supplier; engaging with energy efficiency or other information; discussing vulnerabilities or ability to pay with their supplier; raising a complaint. We have anecdotal evidence of this from a recent customer immersion session we held for our customers who have been with us for 20 years or more, hoping to learn something about what makes a customer loyal. What we discovered was that these customers had no wish to participate in the competitive market, but were nevertheless engaged with their energy usage in other ways. It is more important, therefore, that customers can access information about alternative tariffs, and can switch easily and reliably should they wish to do so.

4. We support the intention to use a broader approach to that adopted when retail price controls were lifted in 2002. Focussing on measures such as switching rates is unlikely to be able to provide any meaningful assessment of the market. For example, auto-switching services, which take the hassle out of the switching process, is highly likely to increase switching rates, but it is questionable whether these consumers could genuinely be considered 'engaged' in the energy market. The service may not be suitable for everyone: those who have had their application for WHD accepted by a supplier are then better off if they remain with that supplier until they have received that discount, which may not be for several months after their application is accepted.

5. The argument has often been made that larger suppliers do not make an effort to engage their default tariff customers as they are making a good profit from them. In our Executive Summary we have summarised why we think default tariff prices are not excessive. Indeed, if default tariff customers were attractive it would follow that smaller suppliers would be anxious to win them. They know, however, that customers on default tariffs are often high cost, given that statistics show that customers of default tariffs are less likely to pay by Direct Debit and manage their account online and are more likely to be vulnerable. Ofgem recognised the likelihood that vulnerable customers were more likely to be on default tariffs in its work on determining the methodology for the default tariff cap[9]. Thus, even though some of the additional cost to serve these customers is recoverable through them not being eligible for Direct Debit and paperless billing discounts, there are residual potential costs that make them unattractive.

[9] https://www.ofgem.gov.uk/system/files/docs/2018/09/appendix_6_-_operating_costs.pdf, para 2.8

Question 2

What are your views on the conditions for effective competition we have proposed? Are they clear and is there anything else you think we should take into account?

6. The three conditions set out – Structural Change, Competitive Process and Good Outcomes – represent a reasonable approach to take when undertaking a future assessment at a theoretical level.

7. There are a number of industry programmes which will have an impact on the market beyond the smart meter roll out including faster switching and half hourly settlement. Progress towards achieving these changes need to be considered under the first condition.

8. With regards to the competitive process, there should be a focus on the sustainability of business models, to ensure customers can rely on their supplier to provide, or continue to provide, good customer service, and that the business will not fail.

9. The cheapest tariffs in the market tend to be aimed at those who pay by Direct Debit, receive paperless billing and operate their accounts online. Consumers who prefer to pay by other methods or receive paper bills tend to have much less choice, and it can be harder to find alternative tariffs – those that allow paper billing, for example, are not easily identifiable on price comparison websites. This may deter some consumers from attempting to switch. Price Comparison Websites (**"PCW"**) need to be encouraged, or required by regulation, to provide more telephone based services to alleviate this, as we discuss in our Executive Summary.

10. We strongly agree with the statement in Condition 2 that a *"well-functioning competitive process in the energy market is also characterised by efficient energy providers being able to finance their operations and make a reasonable profit."* The default tariff cap methodology has a number of shortcomings that make it more difficult for even benchmark suppliers to finance their operations and make a reasonable profit:

    - the £12 headroom provided under the cap has been significantly eroded due to a number of costs that are not accounted for under the cap. Some of these costs, for example the cost of putting standard credit WHD customers on the Direct Debit level of the cap, only apply to larger suppliers; and
    - the cap does not allow sufficient operating costs for efficient suppliers with a greater proportion of vulnerable (high cost to serve) customers;
    - overall, the default tariff cap methodology puts at risk the ability of suppliers to finance their operations and make a reasonable profit, and if the cap is prolonged, the energy market is likely to see further supplier exits, potentially even amongst the largest suppliers.

11. Condition 2 requires that *"there should be no collusion between firms; abuse of market power or other practices that distort competition"*. However, it would be unfair if the poor behaviour of one or two suppliers should prevent the removal of the default tariff cap. This needs to be clearer as part of the framework.

12. In considering good outcomes for customers, Ofgem must consider that for some consumers, a good outcome is one where they can stay with their current supplier and not be pushed into switching.

13. Our main concern is not with the intended approach set out in the discussion paper, but rather how Ofgem will make its assessments. For example, para 3.15 states that Ofgem will *"consider the progress of a range of structural changes intended to improve the functioning of the retail energy market."* It is not clear what 'good' progress would look like; whether there is a baseline from which some undefined degree of improvement is expected; and whether consideration is given to issues outside of suppliers' control (for example, technical solutions being unavailable for smart meters in certain types of property). While we do not want to see definite goals or any form of priority weighting, some indication of how Ofgem will make its assessments is essential for suppliers to have confidence in the process.

14. For this reason, we strongly believe there should be a further round of consultation on the final proposals before the framework is approved by Ofgem.

15. In our Executive Summary we have listed a number of issues that, if addressed, by government or Ofgem, would help improve effective competition.

16. In considering good outcomes for consumers, Ofgem must consider that for many consumers, a good outcome is one where they can stay with their current supplier and not be pushed into switching.

Question 3

What are your views on the structural changes that we propose to include in our framework? Are there any specific changes you think we should consider?

17. We agree with the proposal to focus on a number of structural reforms, such as the progress with the smart meter rollout, effectiveness of CMA remedies, Ofgem led programmes and outcomes from the Future Energy Retail Market Review. It should also consider the effectiveness of the supply licence changes which came into effect on 5 July 2019 to see whether they have provided customers with more confidence over the sustainability of some supplier business models. The assessment must also consider other market developments which could structurally change the market. This should not be limited to innovation around switching, but consider other aspects such as heat as a service and the broader trend towards the digitalisation of energy.

18. We accept that competition will not always deliver the best outcomes for vulnerable customers, which is why we support the need for longer term protection for this customer group; however, this should not be an enduring solution. There are a number of competitive remedies that we believe will negate the need for an indefinite cap for vulnerable customers, such as:

    - greater choice of supplier for vulnerable customers on the Warm Home Discount (**"WHD")** by obligating all suppliers;
    - auto-switching services, which are gaining momentum in the market;
    - encouraging more telephone switching services. This could be achieved by regulating price comparison websites (**"PCW"**), a move which we believe is long overdue and have continually recommended to the government and Ofgem.

19. As part of the work undertaken by Ofgem in response to the Energy Market Investigation, Ofgem has been carrying out a number of trials to engage customers deemed to be disengaged. While some success has been achieved in engaging customers, around three-quarters of customers contacted chose not to take action on the back of information provided to them. This supports our premise that a significant number of customers make an informed choice not to switch; these customers may engage in other ways with their energy supplier, for example in discussing payment difficulties with them, or taking advantage of other products.

20. An example of this was a collective switch trial carried out early in 2018. The trial involved 50,000 customers of a single large supplier, all of whom had been on that supplier's default tariff for three years or more. The customers were split into three groups, with one group receiving letters from Ofgem and the PCW who was conducting the collective switch, another receiving letters from the supplier and the PCW and a control group who received no additional communications. A fourth trial arm was added part way through the trial; this was a proportion of the first group, who received their last communication in a supplier branded envelope. Each customer in the first two groups received three letters: an announcement, which included details of how to opt out of the trial, a savings letter and a reminder letter. Ofgem reported the outcome of the trial in November 2018[10]; no information was provided about the number of customers who opted out, although we are aware of one customer complaining to Ofgem about being written to (we provide more details of this in our response to Question 2). The trial resulted in 22.4% of customers who were contacted subsequently switched through the collective, a strong majority of which were to other suppliers, although many switched to another tariff with their current supplier. This means, however, that 77.6% of these customers did not take advantage of the offer, despite receiving details of the savings they could make and having the reassurance, in some cases, that the information came from the industry regulator and not a supplier. Those involved in the trial had the option of conducting their switch by telephone or online; 71% chose to use the telephone, a much more expensive acquisition route and thus one that many PCWs do not offer.

Question 4

Are there any indicators of the competitive process not listed here that you think we should consider in our analysis?

21. One of the key lessons from previous removals of price controls, not just in energy, but in other sectors such as telecoms, is that it is important not to rely on a single indicator, and instead to make a judgement in the round. Appendix 3 sets out a rather large number of process indicators. We note that this list will evolve over time, and that some may not feature in the final framework. However, we believe it will be extremely challenging, if not impossible, to make a robust assessment when you are assessing a large number of KPI metrics. Instead, we believe there should be a much greater focus on what are the most

[10] https://www.ofgem.gov.uk/system/files/docs/2018/11/cs_results_final_pdf_0.pdf

appropriate and relevant KPI metrics that support the three board themes of market structure, consumer behaviour and supplier performance.

22. We assume the indicators proposed by Ofgem will take into account the overall competitive picture, rather than looking at how one supplier performs against another.

23. We comment below on some of the indicators Ofgem is considering.

Condition	Theme	Indicator	Comments
Market structure indicators	Innovation	Number of initiatives going through Ofgem's regulatory sandbox	This is not a particularly good indicator, as initiatives may be greater or less as a result of government or regulatory changes as well as the general state of the economy or the financial pressures on energy suppliers.
	Innovation	Number of smart meters (SMETS1 and SMETS2) operating in domestic premises	It should be noted that there could be restrictions on this depending on the availability of technical solutions and the readiness of customers to have a smart meter fitted: these issues are outside of the control of suppliers.
	Innovation	Number of in-home displays (**"IHD"**) installed alongside meters	There are regulatory requirements for this, but also technical issues that can prevent suppliers providing an IHD. The benefit of IHDs relates to energy efficiency and bears little relationship to effective competition.
	Rivalry	Market shares	We would recommend splitting this further, between small and medium suppliers. This would enable a view of suppliers who had grown their portfolio as opposed to those who were (relatively) new entrants.
	Supplier entry/exit	Entry and exit of firms	Consideration should be given to the impact of the changes to supplier licensing introduced by Ofgem on 5 July 2019: given that the process will be more stringent, it is to be expected that the number of new entrants will be lower and, consequently, the number of exits fewer.
	Supplier entry/exit	Number of Supplier of Last Resort (SoLR) events	As above.
Consumer behaviour indicators	Price and price differentials	% of accounts by tariff type	Given that customers may make an informed choice to remain on an SVT or default tariff, this is not a good indicator. It may be of value if it included whether those customers had interacted with their supplier, e.g. by signing up to an online account, taking advantage of a bundle or other product, raising a complaint. Care would also need to be taken of the fact that many of the cheapest tariffs are loss-leading and unsustainable, plus the impact of the unlevel playing field, where larger suppliers have higher costs than smaller ones, as discussed in our responses.
	Vulnerability	Customers in debt/blocked switches	On its own, an indicator of customers in debt is not helpful: a customer could pay by Direct Debit and be in debt or credit one month, but over the year their account could balance. There are also other reasons for debt than vulnerability: some customers are disengaged to the extent that they ignore all bills. We assume that 'blocked' switches refers to instances where suppliers legitimately object to a customer switching due to debt. This indicator may be better referred to as 'Supplier objections raised due to debt'. The amount of debt in any market is likely to be impacted by the state of the economy as a whole

			and political and regulatory interventions, e.g. changes to benefits.
	Vulnerability	Priority Service Register (PSR)	This is not a good indicator of consumer behaviour. Consumers are vulnerable, they do not behave vulnerably. Customers who are financially vulnerable may be so for a variety of reasons, including downturns in the economy (resulting in redundancies), political interventions (e.g. changes to the benefits system) and increasing costs in other areas, such as housing. If the intention is to consider outcomes for vulnerable customers, this should be made clear.
Supplier performance indicators	Efficiency	Earnings before income & tax (EBIT) margins	Sufficient allowance needs to be made for suppliers to offer discounted tariffs from time to time. Various surveys have indicated that most customers need £70 or more before they will consider switching; if discounts result in negative margins, in order to maintain profitability, suppliers need to be able to raise margins on other tariffs. This problem would be less acute if there were a level playing field between larger and smaller suppliers, as discussed in our Executive Summary.
	Efficiency	Operating costs	Account must be taken of the impact of different suppliers' portfolio mixes; a supplier who serves more vulnerable customers, who have a higher cost to serve, will have higher costs overall.
	Price and price differentials	Average tariff prices (SVT vs fixed tariff)	This may be a difficult measure where a supplier has a single tariff. Also, it is possible that greater switching may occur where the differential is higher, thus the two measures (switching and differentials) may balance each other out.
	Tariff choice	Number of tariffs in the market	The number of tariffs is not a good indicator. There could be 1000 tariffs that are all very similar with similar pricing, and there can be 100 tariffs that are innovative and different, possibly resulting in different charges depending on the times of day a customer uses energy.
	Switching process	Number of erroneous transfers	Many erroneous transfers are out of the control of suppliers; for example, a customer may enter their address in a quote tool that does not match precisely industry data (for example, 1 instead of 1A, or The Brambles instead of Brambles Cottage). This can be the case for quotes on suppliers' websites as well as those on price comparison websites. This is not, therefore, a good measure of supplier performance.

Question 5

What are your views on the consumer outcomes that we propose to assess in determining whether the conditions are in place for effective competition?

24. It is right to consider outcomes for consumers that are associated with trust and confidence, the ease with which customers can change energy tariff or supplier, quality of service and the extent to which customers have choice over tariff offerings. However extreme care should be taken if prices and price differentials are to be analysed.

25. Many of the lower prices seen in the market are unsustainable in the longer term and are either offered by new entrants with poor business models and a lack of appreciation of the

complexities of the market they are operating in, or as loss-leaders by larger suppliers attempting to maintain or grow their market share. This fact does provide evidence, however, of effective competition in the fixed term market.

26. If Ofgem decides to use price as an indicator, it must be in relation to that supplier's efficient costs.

27. Price differentials are equally problematic. Some differential is essential to maintain competition, given that customers have been shown to be less likely to switch unless the savings are substantial. Various analyses have pointed to the fact that many customers will not consider switching unless savings are significant – at least £70 per year. Comparison between default tariffs and fixed tariffs that may be unsustainable is not a reasonable comparison, and assessment of differentials in a price capped default market is, we believe, only an indication that the cap is set too low.

28. Other difficulties lie in the fact that a tariff may be cheap or expensive at typical domestic consumption levels, but may be designed to appeal to those with very low or very high consumption, at which levels they are highly competitive. Differentials need to be assessed at a variety of consumption levels.

29. There are a number of restrictions (regulatory and otherwise) preventing suppliers from offering as wide a variety of tariffs as customers might desire. Ofgem has recognised this in the development of its regulatory sandbox.

30. In our view, the most convincing customer outcomes are trust and confidence. Energy suppliers have long been tarred with the brush of being fat cats, giving poor service and charging excessive prices. Nevertheless, consumer surveys suggest a rather different picture. The findings of the most recent Household Consumer Perceptions of the energy market[11], a tracking survey commissioned jointly by Ofgem and Citizens Advice, showed that 74% of customers are satisfied with their supplier.

31. We believe it is important not just to assess outcomes from a narrow energy market perspective, but also to compare the performance of energy with other sectors such as banking, insurance and telecoms. For example, Ofcom employs a customer satisfaction tracker survey which looks at other sectors outside of broadband, mobile and landline, and includes energy and banking. What is striking is that the level of satisfaction in energy is very comparable to these other sectors[12].

Question 6

Is there any other aspect of effective competition that the framework should consider?

32. We are not aware of any other aspects.

[11]https://www.ofgem.gov.uk/system/files/docs/2019/06/consumer_perceptions_of_the_energy_market_report_q1_2019.pdf

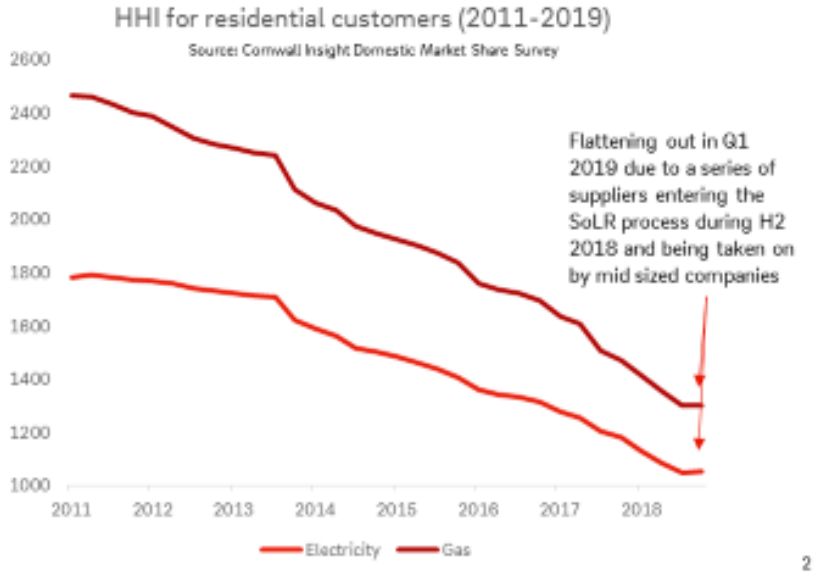
[12] https://www.ofcom.org.uk/__data/assets/pdf_file/0023/145814/customer-satisfaction-tracker-2019.pdf

Appendix

Herfindahl-Hirschman Index (HHI) for residential electricity and gas

Residential energy supply has seen a steady decline in market concentration over the last 8 years

- The Herfindahl-Hirschman Index (HHI) is a measure of market concentration
- Values range from 0 (a large number of competitors all with small market shares) to 10,000 (one monopoly player)
- The US Govt considers a market with a HHI of <1500 as being 'unconcentrated'[1]
- The UK Govt considers a market with a HHI of <1000 as being 'unconcentrated'[2]



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[1] US Department of Justice https://www.justice.gov/atr/horizontal-merger-guidelines-08192010#5c
2 European Commission guidelines 2004/C31/03 http://www.amf.co.uk/wp-content/uploads/2017/10/Concentration-not-competition.pdf