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Dear Ms Paul,

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

Thank you for the opportunity to comment on this Discussion Paper (DP).

In general, we welcome the approach taken by Ofgem of issuing a discussion paper, especially in conjunction with a workshop, to explore possible ways forward prior to formal consultation. On this occasion, however, this does not appear to be the case. While this document is a DP, we understand that Ofgem proposes to move straight from the DP to publishing the final framework in September/October 2019, without further consultation. Ofgem will then start data collection, with a view to making a recommendation to the Secretary of State on the future path of the cap, based on the framework and data, in August 2020. Subsequent recommendations to the Secretary of State will also be made according to the legislative requirements.

We do not support the approach of going from DP to final framework. The assessment framework is of vital importance to suppliers in the competitive market, as the basis for future recommendations on market structure, and merits a formal consultation. We request that Ofgem consults on the proposed final form of the framework, once it has been able to consider and incorporate responses to the DP. We also believe that suppliers should be consulted on the proposed recommendation to the Secretary of State, in advance of the recommendation being submitted in due course.

While we support the overarching principles guiding the framework, it is important to take a step back and reflect on what the framework is designed to achieve, and the simplest, most cost-effective way of delivery.

If the concern is to protect consumers, but in a way that allows recovery of efficient costs and that encourages competition, then there need only be one cap. The standard credit cap¹, applying to all customers on default tariffs, should allow recovery of efficient costs. It would be robust enough to protect customers from overcharging, as it is specifically designed to do so. The DTC is based on a robust, bottom-up methodology, which will allow efficient suppliers to cover their economic and efficient costs, with a small margin. This would therefore operate as a 'backstop' protection for those customers who did not engage with the market.

The prospect of modest super-normal profit in the short term will also encourage efficient firms to compete for new customers, by offering superior service at the same or lower prices, while remaining profitable. This is not the case at present under the Prepayment Charge Restriction (PCR) - demonstrated by the speed and degree of price convergence in the prepay market since its implementation.

As an aside, Ofgem states several times that *'the retail energy market was not working well for all customers'* (emphasis added). It is impossible that any market will work well for all customers. A market that works well for every customer exists only in theory.

In addition, it is essential that the conditions specified in the framework are capable of being met on a clearly defined basis, otherwise the framework will fail in its objectives. For example, in the proposed section 2 conditions there is a requirement:

'...There should be no unaddressed anti-competitive conduct...'

In our view, this cannot be met unless it is amended to include the word "known" before "unaddressed".

As a final general point, we remain concerned about the approach of using a definition of 'Effective Competition' which is unique to this circumstance. As was discussed at the workshop, there are other uses of the term. It has been highlighted that the Recast Electricity Directive (Directive 2019/944) which replaces the existing Third Package Electricity Directive (Directive 2009/72) may be relevant. Article 5 of the Recast Directive imposes onerous conditions for price caps and limitations on how they may be permitted. We would like to see a full explanation of how these issues have been properly addressed, as part of the formal consultation we request.

In the section below, we address the specific questions from the document.

Question 1: Are there any features of effective competition that are not covered in our definition?

The features defined by Ofgem existed before cap implementation and have actually lessened in some cases as a direct result of the implementation of the price caps (the PCR and DTC).

¹ The Default Tariff Cap (DTC), which would be applied to standard Credit customers who pay for their energy on receipt of a bill.

When reviewing whether the market works effectively, Ofgem should consider carefully key definitions used in the analysis, and whether the proposed measure will lead to the right outcome. At present, the proposals are at a higher DP level, and do not consider crucial details such as definitions underpinning the view of effective competition. As this is the case, we are unable to respond fully to the consultation, and hence our recommendation that this DP should be followed by a formal consultation on the final proposals for the framework. This point also applies to the remainder of the document as appropriate.

We have set out two illustrative examples of the issue below, but this is not a complete list.

Engagement - if referring to 'engaged' customers, the terms used must encompass not only switchers, but also customers who are content with their current supplier, and who choose not to switch. At present, switching rates are too often used as a proxy for engagement.

Tariffs - Equally, the range of tariffs offered by a supplier must be carefully considered. Where a supplier offers only one or two main (variable) tariffs for example, differentiated only by smart/non-smart or payment type, this is not the same as a Standard Variable Tariff, where the supplier offers a larger range of tariffs which might include fixed or acquisition tariffs, leaving the SVT as potentially poor value for the customer. At present, having a single variable tariff is seen as a proxy for poor value for the customer.

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?

As above, when considering the conditions for effective competition, the definition of key terms underpinning those high-level conditions is vital. We have set out examples above, but these are not complete.

With respect to condition 1, it is important not to be too prescriptive. Unforeseen beneficial structural changes may occur in the market, and the assessment carried out using these conditions must be flexible enough to accommodate such changes.

Without some change to the existing price caps, condition 2 may be difficult to achieve, as the existence of caps may impede the competitive process. Either condition 2 is already met, in which case price caps are unnecessary, or it must be enabled through the provision of competitive incentives.

As we have argued above, a single cap, the standard credit cap², applying to all customers with default tariffs, will protect customers from excessive charges but also allow vigorous competition below the cap by efficient firms. This will create the conditions necessary for customers to move from inefficient retailers to efficient retailers. All caps ought to be replaced by the standard credit cap in 2021 or earlier if possible, to allow competitive forces to meet the requirements for cap removal in or before 2023.

² n. 1

Condition 3 will be met if condition 2 is met. However, the point in the introductory section above is also relevant, i.e. it is impossible that any market will work well for all customers. A market that works well for every customer exists only in theory, and 'less-active' does not necessarily mean disengaged.

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?

As above, do not be too prescriptive as unforeseen changes could be beneficial or detrimental and must be accounted for.

In addition, when considering the structural changes, Ofgem must review carefully the change in question and challenge robustly whether or not the actual change may mask the state of the underlying market. This will be especially important when looking at areas such as the implementation of the CMA's remedies - for example, as previously recognised, price caps have a detrimental effect on switching, reducing the value of switching as a metric.

Question 4: Are there any indicators of the competitive process not listed here that you think we should consider in our analysis?

We note the areas on market structure and are in broad agreement. However, we would argue that this section must build in some of the recent work on supplier licensing, and the follow-up activity needed on supplier health. In addition, Ofgem should give greater weight to more orderly exit, rather than SoLR as a measure of a healthy market.

Not directly in answer to the question, but 'default customer accounts' must be appropriately defined and measured. However, this metric must allow for the situation (as noted above) where suppliers offer only one or two variable tariffs. Definitions must not inappropriately capture such competitive tariffs as is currently the case.

Utilita is no longer unique in offering one fair variable price to all its customers. A small number of other new entrant suppliers take a similar approach. Customers of such suppliers tend to be highly engaged and select suppliers offering fair variable tariffs. Selecting a variable tariff is not same as moving to a default tariff (SVT). Even after several years on a customer selected variable tariff, the customer may be engaged and satisfied with the service and price. A customer selecting a variable tariff must not be considered synonymous with a customer being disengaged.

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?

Assessment of price differentials must consider differential operating costs associated with different customer groups and the quality of service provided.

Question 6: Is there any other aspect of effective competition that the framework should consider?

We believe that Ofgem should actively consider the effect of the various price caps on the market and consumers as part of this activity, not just in the period between framework assessments, but over longer periods as well.

Although assessing the cap is not specified under the requirements, we believe it is a clear requirement in the context of Ofgem Primary duty.

We hope this submission has been helpful and we would be happy to discuss any points raised in more detail.

Yours sincerely,

By email

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