Statutory Consultation for a vulnerable safeguard tariff – E.ON response

Technical Document - Impact Assessment Form – Preferred option – Hard to Monetise Impacts (Describe any hard to monetise impacts, including mid-term strategic and long-term sustainability factors following Ofgem IA guidance)

1. We do not believe that the negative impacts of Ofgem's preferred option on switching are marginal. Those consumers who are engaged may consider that they no longer need to shop around as the cap will ensure they are not on an expensive tariff. It may be hard to re-engage these customers when the cap is removed. In addition, customers who are currently disengaged are more likely to remain so. We accept that some vulnerable customers are likely always to remain less engaged; however there are a significant number of vulnerable customers who are capable of participating in the market but for whom the effort is greater than the perceived benefit. It may just need the right innovative tariff to engage those customers, but they are less likely to perceive the benefit if they are on a capped tariff.

2. Ofgem maintains that the headroom within the cap design will allow suppliers to compete for these customers. Consumer research[1] indicates that customers need to save an average of just below £300 a year to change supplier or tariff; the headroom for the prepayment price cap is in the region of £15 a year for a prepayment customer – for standard credit customers, suppliers are likely to make a loss (see paragraph 3 below). Since the introduction of the prepayment price cap, E.ON has experienced a 30% reduction in switching in the prepayment market (see Appendix 1). It is difficult to see, therefore, how competition within the headroom could encourage engagement.

Technical Document - Impact Assessment Form – Preferred option – Hard to Monetise Impacts (Key Assumptions/sensitivities/risks) AND Technical Document, paragraph 3.30

3. Ofgem admits that risks are involved if its assumptions prove to be inaccurate. We believe there are two significant inaccuracies:

   (a) Ofgem's assessment of policy costs is inaccurate, particular in regard to the cost of delivering smart meters. The table below shows E.ON's calculation. We are happy to provide further detail behind this, as requested in our meeting with Ofgem on 6 November 2017, but that has not been possible in the three days since that meeting.

[1] "What are the drivers, barriers and enablers of consumer engagement?", Page 7, **Consumer engagement In the energy market since the Retail Market Review, 2016 Survey Findings**, TNS BMRB on behalf of Ofgem August 2016 (

TABLE REDACTED

(b) Ofgem intends to use the same methodology for the safeguard tariff as for the prepayment tariff cap using the same absolute values (paragraph 4.8), despite the fact that conclusions reached in the CMA investigation[2] shows that the uplift costs for a standard credit customer (a customer paying on demand) need to be greater than for a prepayment customer. The table below demonstrates how, if the prepayment uplift value is used, suppliers are likely to make a loss on standard credit customers. (This is, of course, on top of the inadequate policy cost allowance referred to above).

	Prepayment £*	**Standard credit £**
Wholesale energy	162.9	162.9
Network	124.6	124.6
Policy	96.2	96.2
Other	77.1	77.1
Uplift	24.7**	49.5***
Headroom	15.3	-9.5
October 2017 price cap (excl. VAT)*	**500.9**	**500.9**

*East Midlands (11) Prepayment price cap charge (adjusted for CPI), restriction period 2017-18 Winter calculations v1.5, Ofgem, 1 October 2017
**Paragraph 7, Appendix 9.8, Energy market investigation, final report, Competition and Markets Authority, 24 June 2016 (DD-PPM differential)
***Paragraph 8, Appendix 9.8, Energy market investigation, final report, Competition and Markets Authority, 24 June 2016 (SC-DD differential)

4. Ofgem's Social Obligation report for 2016[3] indicates that a significant proportion of customers are on standard credit. It is likely, therefore, that Direct Debit or other customers will need to subsidise standard credit customers in order that suppliers can maintain overall profitability. It cannot be expected that suppliers would be forced to supply at a loss.

5. We therefore recommend that Ofgem adjusts the methodology by taking into account the higher uplift cost for standard credit customers. This should ensure suppliers can at least break even on standard credit customers, and therefore should enable them to continue to apply a payment method differential for customers paying by Direct Debit.

Technical Document – paragraph 1.9

6. We agree that the safeguard tariff should apply to both customers on standard variable tariffs and fixed term default tariffs (but that, for those on non-default fixed term tariffs, the safeguard tariff will not apply until the relevant tariff end date). However, there are potential unintended consequences that we would like to draw to Ofgem's attention.

(a) SLC 22C.9 prohibits increases in charges for fixed term tariffs. Where a change to the Relevant Maximum Charge on the safeguard tariff increases customers'

[2] Appendix 9.8: Analysis of indirect costs by payment method, **Energy market investigation, final report,** Competition and Markets Authority, 24 June 2016
[3] **Monitoring social obligations: Q4 2016 data report**, Ofgem, 16 October 2017

prices, suppliers will be unable to apply that price increase for default fixed term customers.

Even where a change to the Relevant Maximum Charge on a safeguard tariff decreases customers' prices, we believe it could be argued that there is disadvantageous change: customers are being moved from a fixed term default tariff where the prices cannot go up (SLC 22C.9) to a safeguard tariff where prices are variable (or, in the case of fixed term default tariffs) indexed (SLC 22C.11) and therefore may go either up or down.

Suggested solution 1:

SLC 22C.9 could be amended so that fixed term default contracts can neither be subject to advantageous changes nor disadvantageous changes. It would therefore not be possible for the safeguard tariff to be applied until a fixed term contract (agreed or default) came to an end. While this is our preferred option, it would be contrary to Ofgem's policy intent.

Suggested solution 2:

SLC 22C.9 could be amended so that it does not apply to fixed term default tariffs where the change relates to switching the customer to a safeguard tariff. Suppliers would then have to apply SLC 23.3 – provision of a notice advising of a price increase or unilateral disadvantageous contract change (an **"SLC 23.3 notice"**) whenever a customer is found to be eligible for the safeguard tariff. While this would meet Ofgem's policy intent, it would result in a poor customer journey, as explained in (c) below. It would also increase suppliers' costs, as a notice under 23.3 would be required for every customer that is eligible for the safeguard tariff, even where their charge for supply will be decreasing. These costs are likely to be exacerbated because eligibility will be assessed on a daily basis, meaning that communications have to be sent spasmodically rather than as a single campaign.

Suggested solution 3:

Disapply SLC 23.3 in respect of disadvantageous changes that relate to application of the safeguard tariff.

(b) An SLC 23.3 notice requires 30 days' advance notice. Ofgem's proposed licence conditions require suppliers to switch an eligible customer to the safeguard tariff within 30 days of identification. We therefore have insufficient time to produce and send a notification that gives customers the required amount of notice.

Suggested solution 1:

Allow suppliers 45 days to switch an eligible customer to the safeguard tariff.

Suggested solution 2:

Reduce the advance notice period for an SLC 23.3 notice (where the change relates to eligibility for the safeguard tariff) to 15 days.

(c) An SLC 23.2 notice is required to advise a customer that they can switch supplier or tariff in order to avoid the changes. There are several issues with this:

i. A Core Group customer may not be identified by a new supplier as being eligible for the safeguard tariff, as the new supplier will not have been obligated to pay it to them.

ii. A Broader Group customer may not benefit by switching to another supplier: the new supplier may not be a Warm Home Discount (**"WHD"**) obligated supplier; the new supplier's eligibility criteria may be different; the new supplier may have closed their WHD scheme for that year.

iii. A customer may be happy with the default tariff they are on, particularly if it offers additional products or services, such as a boiler thermostat or cinema tickets. In usual scenarios where a SLC 23.3 notice is required, suppliers will not allow customers the option to remain as they are: in the scenario where they are being switched to the safeguard tariff, that option is available and should be provided to customers as part of SLC23.4(l).

Suggested solution:

Amend SLC 23.4(l) to give customers the option to remain on their current tariff if they wish, and draw their attention to the fact that switching supplier may mean they lose out on the WHD or the safeguard tariff.

Technical Document – paragraph 2.11

7. We do not believe that the application of a price cap will encourage engagement to grow and cannot see how it will empower consumers in vulnerable situations. Consumers are likely to feel that they no longer need to participate in the market and cease to shop around, therefore potentially missing out on opportunities to switch to tariffs that may be more advantageous to them. This could include innovative tariffs designed to cater for their specific needs.

8. In addition, a customer who is due to receive a Broader Group WHD from their current supplier will be disadvantaged by switching to another supplier, where they would have to re-apply for WHD (assuming the new supplier has the same eligibility criteria). There would be no guarantee of their success: suppliers generally close their WHD schemes before the end of a scheme year. With the added incentive of the safeguard tariff as well as a WHD, we anticipate a higher than usual application rate for WHD, which is likely to result in suppliers closing their schemes earlier.

Technical Document – paragraph 3.31

9. Ofgem states that it wishes to minimise the administrative burden for suppliers. This would best be achieved by applying the safeguard tariff only to those who have been accepted to receive a WHD. We discuss this in more detail below, with respect to the definition of "Relevant 28AA Customer".

Technical Document – paragraph 4.24

10. We appreciate that single fuel gas customers will not benefit from these proposals. We refer to Ofgem's request for suppliers with large numbers of these customers *"to pay particular attention to their treatment of single fuel gas customers"*. The WHD scheme is designed to provide rebates to customers based on their electricity supplier: gas customers are not assessed against the WHD eligibility criteria and therefore, under the current proposals, we are not able to provide any additional support for them.

Technical Document – paragraph 5.20

11. We disagree that the design of the temporary safeguard tariff could help reduce the risks that some eligible customers who would otherwise have engaged are deterred from doing so. As Ofgem points out in paragraph 5.18, *"… the introduction of the temporary safeguard tariff is likely to reduce customers' incentives to engage by creating a sense among eligible customers that they are "protected", and so do not need to take any action (despite the fact that the temporary safeguard tariff is unlikely to be the cheapest offer in the market.)"* This view is, of course, similar to the conclusion reached by the CMA in relation to its own originally proposed safeguard tariff, with which it decided not to proceed.

12. As stated in paragraph 2 above, consumer research has shown that customers are unlikely to switch for savings of less than £300 a year: the headroom for the prepayment cap is equivalent to approximately £15 and, as explained in paragraph 3 above, suppliers would make a loss on standard credit customers. Appendix 2 shows the level of competition for prepayment customers in October 2017. Most suppliers have converged around the cap price, the cheapest price being just £58 per year below the cap: that price is offered by a supplier who is not obligated under the WHD and therefore has a £40 cost advantage, making the gap even narrower. Appendix 1 shows that E.ON has experienced a significant reduction in switching in the prepayment sector. USwitch recently carried out[4] some research which shows that the percentage of prepayment switches via the price comparison website's platform has reduced since the introduction of the cap. Also, it shows that prepayment conversion to switch rates have dropped in recent months and uSwitch has seen a large decrease in savings offered to consumers. uSwitch has indicated to us that they are happy to discuss this analysis with Ofgem.

Technical Document – paragraph 5.32

13. As stated in paragraphs 2, 3 and 12 above, the lack of headroom in the safeguard tariff (and the fact that suppliers will make a loss on standard credit customers) will limit competition for vulnerable customers on the WHD. In order to mitigate this, it is important that application of the safeguard tariff does not discourage consumers who are already engaged in the energy market, or deter others from starting to engage.

[4] **Has the Prepayment Price Cap Impacted on Switching Levels at uSwitch?**, Dr Neil Bailey, uSwitch inSight analyst, uSwitch, October 2017

14. Customers in receipt of WHD may see benefit not just in cheaper tariffs, but in those which offer something additional of value to the consumer - for example, a tariff that offers monthly cinema tickets. Consumers need to continue to be empowered to make decisions on which tariff is best for them. That means that they may choose a tariff that is more expensive than the safeguard tariff but offers them, in their own opinion, a better or more attractive deal.

15. We are therefore concerned about Ofgem's assumption in paragraph 5.32 of the Technical Document that a supplier would be mis-selling by switching a protected customer onto a more expensive tariff. If the customer has chosen that tariff despite having been made aware that the safeguard tariff is cheaper, we do not perceive any detriment to them.

16. Further, we do not believe it would be appropriate to attempt to identify a customer as a WHD recipient at point of sale. For customers in the Broader Group, they will not receive a WHD from a new supplier unless they apply and are accepted, therefore at point of sale will not have been identified as being eligible for WHD.

17. Core Group customers may have received or be due to receive a WHD in the current scheme year or previous scheme year from their current supplier. At point of sale, the new supplier could ask whether they have received a Core Group WHD in the past or whether they are in receipt of certain benefits. However, it is our experience that customers often do not understand which benefits they are in receipt of, and are confused about what a WHD is and may either tell us they are not eligible when in fact they are or tell us they are eligible when they are not. In the latter case, customers may be advised not to sign up to a fixed term tariff and, if they are not eligible, could remain on a default tariff indefinitely. This could potentially be seen as mis-selling and, in any event, would be a poor customer experience.

18. We are considering what alternatives are available to ensure customers who are on fixed term tariff at the time they are accepted by E.ON to receive a WHD can be informed of their rights to be switched to the safeguard tariff. In the meantime we would appreciate recognition that it is not possible for suppliers to attempt to identify WHD customers at point of sale: this should only happen as part of the usual WHD processes carried out by that supplier.

SLC 28AA legal drafting – definition of "Relevant 28AA Customer"

19. The definition for "Relevant 28AA Customer" is drafted so that, in relation to Broader Group customers, the safeguard tariff must be applied where the customer has been identified as meeting at least one of a supplier's eligibility criteria:

   *""**Relevant 28AA Customer**" means …*

   (iii) has, in respect of the current Scheme Year which corresponds with the Charge Restriction Period, already been identified by the Obligated Licensee as meeting at least one of the descriptions of persons in the Obligated Licensee's eligibility criteria as determined by the supplier and approved by the Authority in accordance with Chapter 2 of the Regulations; or

   (iv) was, in respect of the preceding Scheme Year, previously identified by the same Obligated Licensee as meeting at least one of the descriptions of persons in

the Obligated Licensee's eligibility criteria as determined by the supplier and approved by the Authority in accordance with Chapter 2 of the Regulations;"

20. In paragraphs 4.17 – 4.19, Ofgem states that the safeguard tariff will apply to existing WHD customers. Paragraph 5.7 states that *"the temporary safeguard tariff will provide protection to customers that received the rebate in either of the current or other previous scheme year."* We therefore assume that Ofgem's intention is that, in respect of the Broader Group, only customers who receive a WHD in either the current or the previous scheme year should be eligible for the safeguard tariff, but this is not borne out by the drafting above.

21. There is a complication in requiring Broader Group customers to be switched to the safeguard tariff once they have been identified as being eligible, because of the way that suppliers are required to verify eligibility for WHD. Customers are required to sign a declaration that the application they have made is accurate: however a proportion of these applications must be verified in accordance with the Warm Home Discount Regulations 2011. Some will fail verification and therefore cannot be deemed to be eligible. Eligibility can only be concluded at the point where all verification measures have been exhausted and the supplier has passed the customer through to receive a WHD.

22. If suppliers were required to move a customer to the safeguard tariff where they were identified as being eligible but do not subsequently receive a WHD (for example, where the supplier had closed the scheme for that year), this would cause additional administrative burdens. Additional flags would need to be created to recognise these customers separately from those in receipt of WHD. Paragraph 5.29 of the Technical Document states: *"We … believe that our proposals would only lead to a marginal increase in administration costs for these suppliers."*

23. We propose an alternative definition that better meets Ofgem's stated intentions as follows:

    ""Relevant 28AA Customer" *means …*

    (iii) has, in respect of the current Scheme Year which corresponds with the Charge Restriction Period, been accepted by the Obligated Licensee to receive a Warm Home Discount in that Scheme Year, in accordance with Chapter 2 of the Regulations; or

    (iv) was, in respect of the preceding Scheme Year paid a Warm Home Discount by the Obligated Licensee in accordance with Chapter 2 of the Regulations;"