Octopus Energy
20-24 Broadwick St,
London, W1F 8HT
w: octopus.energy
e: hello@octopus.energy
p: 0330 808 1080
f: 084 3558 9972

To: Jemma Baker and team

Via: CDconsultations@ofgem.gov.uk

31st January 2018

Dear Jemma -

Response to providing financial protection to more vulnerable customers

Octopus Energy is a growing challenger energy supplier that supplies gas and electricity to domestic homes and businesses in Great Britain. Our largest investor is the Octopus Investments Group, who over the last decade has become the third largest investor into UK renewable generation in the UK and the largest in solar generation.

Octopus Energy are the only energy supplier recommended by Which?!, based on their analysis of industry metrics including complaints, pricing and customer surveys.

We believe:

- That the consumer should be given clearer communication about pricing over a longer period: so that they can choose a tariff that is good for them over the long term, not just the fixed term.
- That long-term good pricing and service can be enabled by some of the same approaches as the eCommerce sector – in the same way that Amazon and budget airlines have done in other sectors.
- That the barriers to switching due to the slow and complex nature of the switch process should be systematically eliminated to make switching quicker and easier (as online shopping and services have provided in other sectors)
- That customer service should be measured by how happy customers are with the service they receive, not a set of defined metrics which often fail to recognise what really matters to consumers

Overall

We agree that the eligible group needs to be widened in order to successfully implement a safeguard price cap for vulnerable customers. We support the need to move at speed for implementation in autumn 2018, and agree with the objectives laid out in section 1.10 of the consultation.
We think that the types of vulnerable customers in need of support (as shown in figure 1) is a fair view against which the scope should be reviewed.

We are strongly against the creation of two different sets of criteria for qualification by supplier. Like other suppliers at the workshop, we believe that it is a manageable workload for all suppliers to do the data-matching process and avoid the confusion and inadequate coverage of the back-stop option. If suppliers are not capable of simple data-matching, we would worry that they are not capable of the systems requirements of running an energy supply business properly.

We support the approach of using a basket of tariffs to define the level of a cap. With so many different business models, trading strategies and customer propositions, it is no longer possible to define generic cost models. Instead a cap based on a basket could reflect the reality of the range of efficiencies, trading and other strategies that this broad-based competitive market now displays.
Of course, a basket is based on the activity of market participants, so concerns have been raised (by companies likely to be affected by a cap) about the possibility of gaming, or loss-leaders reflecting unrealistic cost levels. We believe such concerns do not stand up to scrutiny. With so many competing suppliers, basic design aspects can ensure that gaming is unfeasible. The fact that a basket is based on the prices companies actually charge real customers, means it would not be viable for companies to set

Octopus Energy
20-24 Broadwick St,
London, W1F 8HT
w: octopus.energy
e: hello@octopus.energy
p: 0330 808 1080
f: 084 3558 9972

prices in order simply to influence the level of the cap (as long as the window is long enough and frequent enough) – because these prices are the ones which determine the profit or loss they make on their actual business – making it a much more meaningful measure than any abstract measure.

Scope questions

Question 1 – *What are your views on our preferred approach of identifying consumers for safeguard tariff protection by primarily relying on data-matching?*

We think that data-matching with the Department of Work & Pensions (DWP) Benefits database is the only fair way of identifying those customers who need this price cap protection. We welcome the approach of using all those income and disability benefits that appear to be the best assessment of those likely to be in fuel poverty (as detailed in appendix B in the consultation), and agree that this needs to go beyond the current Warm Home Discount (WHD) 'broad' criteria.

In terms of implementation, we are confident that we would manage this data-matching exercise and believe based on our due diligence that it should be possible (and therefore mandatory) for all suppliers. We also believe the burden on the supplier to be small. However, we do acknowledge that it may take a small amount of extra resource on the DWP side to make this number of data-matching processes happen on-time and in-time. We would suggest that scoping of the work (as discussed in section 2.29 of the consultation) could be completed, based on the experience of those smaller suppliers who have already been through this process when they entered the WHD data process as voluntary members of the WHD scheme.

Question 2 – *What are your views on our backstop option that requires suppliers to use the information they hold (such as Priority Services Register and debt information) to identify vulnerable consumers?*

We are deeply concerned that there is the potential for customer detriment in the case of the back-stop option because of the differences for the same consumer with different suppliers:
Firstly – many eligible people would currently miss out. Citizens Advice have flagged how few people who should be on the Priority Service Register (PSR) actually are registered (and this risk of low engagement is also covered in the consultation), leading to detriment for those who need it.
Secondly, it will create a confusing 2-tier Supplier market for consumers, where even those consumers who know they are eligible will not be clear whether they have qualified for the cap or not because it depends on the classification of the supplier that they are with.

There is also the challenge of those additional consumers who will be swept up for the smaller suppliers, when they should not actually be eligible. The consultation paper does set out the challenges of those who would register on the PSR or are in debt, but would not be fuel poor. This would include:

- Those who are on the PSR for reasons such as medical equipment (eg sleep apnea), but are not fuel poor.
- Those who are in temporary debt, or even in persistent debt but choose not to pay, rather than cannot pay.

Finally, both PSR and debt approaches also have incentives to game the system that could lead to poor consumer behaviour (ie going into debt or self-declaring PSR that is not the case) and poor supplier behaviour (ie not capturing PSR). These will be hard to monitor and manage.

Octopus Energy
20-24 Broadwick St,
London, W1F 8HT
w: octopus.energy
e: hello@octopus.energy
p: 0330 808 1080
f: 084 3558 9972

Question 3 – *Are there other methods for identifying vulnerable consumers that we should consider, either alongside or as an alternative to, our preferred approach?*

We do appreciate the challenges in identifying fuel poverty (especially where this is driven by high consumption), but believe that DWP data matching is currently the only viable solution.

Question 4 – *What are your views on our proposal for all suppliers to be required to provide safeguard tariff protections to vulnerable consumers? What impact would this have on suppliers? Please provide evidence to support your views.*

We agree that all suppliers should have to provide safeguard tariff protections to consumers that they serve. We feel strongly that the marketplace is already too complex for consumers and asking vulnerable customers to only shop within certain suppliers, or giving different eligibility criteria with different suppliers is not acceptable.
We already see a growing problem of consumer detriment with the Warm Home Discount, where hard-to-reach consumers switch to a new supplier, only to find after the cut-off date that the supplier does not provide Warm Home Discount. We cannot afford to cause more complexity, confusion and detriment for consumers who choose a new supplier.

Question 5 – *What are your views on our proposal regarding the tariff types and meter types our extended safeguard tariff protections would apply to?*

We believe that the tariff should apply to all tariff types and all meter types (including smart pre-payment), because we think that the key is that all qualifying consumers are protected – regardless of supplier, meter or tariff. This would mean changing their tariff to the vulnerable safeguard tariff in the event that their current tariff was above the cap (or leaving them on their current tariff in the event that it remains below). We would suggest that given the stage that we are now at with the SMETS2 roll-out, these customers should also be included in all safeguard tariffs – as we understand that they have been an exclusion up until now. This would clearly be a consumer detriment for those getting a smart meter in the SMETS2 world, and confusing for consumers who should not need to know the difference in SMETS1 vs SMETS2 meters.

Methodology Questions

Question 6: *Which of our two options for setting the benchmark component of the safeguard tariff would be most effective?*

We support the basket of market tariffs. The CMA's methodologies are already challenged by the wide variety of supplier business models and strategies. A calculation-based approach militates against innovation and competition (eg. in different hedging strategies, tariff types etc).

The basket of tariffs could give a very useful method of greater responsiveness to wholesale market movements, and better reflect increasing efficiency from energy suppliers, helping drive down costs for all rather than creating an artificial ceiling. We believe that the use of a regularly updated index (eg monthly) would reduce the chance of the basket being gamed, and could also reduce the lag effect – both in terms of the window for the pricing being more recent and in terms of the implementation window being faster as the data could be published ongoing. Tariffs could be set with an annual cost at or below the cap at the date of renewal (with the increasing adoption of fixed term default tariffs, or as variable tariffs with prices moved monthly, quarterly or annually.

Octopus Energy
20-24 Broadwick St,
London, W1F 8HT
w: octopus.energy
e: hello@octopus.energy
p: 0330 808 1080
f: 084 3558 9972

Question 7: *Do you have any comments on the design issues for either of our two options?*

We would say for the calculation approach that 2 factors have changed since 2015, and therefore need addressing in the calculation:

1) Smart metering has become widespread, so the increased costs need to be factored in:
    a. Meter installation and rental costs
    b. DCC costs
    c. SMETS1 interoperability and compliance costs
2) With the widening of the proportion of customers covered by price cap, there is a need to start to take account of central fixed costs. For example: this is where the costs for the operation of industry codes probably need to start to be accounted for (CUSC, DCUSA, MRASCo, SEC, Xoserve etc). The burden of these is carried by the larger suppliers – with even mid-sized suppliers taking a smaller burden and smaller suppliers taking almost none. Yet the system can only work when these codes work effectively.

We favour the basket approach and recognise that the details of the design are under discussion in the considerations in section 3.67:

- The number of tariffs
- The structure of the basket (and the basis of exclusions)
- The tariff duration
- The number of tariffs per supplier
- The supplier size
- The treatment of single fuel vs dual fuel baskets

Our view was that a larger number of tariffs was better (as long as there is only one per supplier in the basket). But actually when we analysed the last 12 months, beyond the cheapest 5 tariffs, the inclusion of more tariffs showed a similar shaped curve, just at different levels (probably reflecting some of the cost realities for different suppliers in the market):

Chart A shows that the cheapest tariff (blue line) and cheapest 5 tariffs (green line) are not very representative of the costs (the red line of Ofgem dual fuel cost calculation)

Chart A: cheapest 5 tariffs (insufficient for basket)

Octopus Energy
20-24 Broadwick St,
London, W1F 8HT
w: octopus.energy
e: hello@octopus.energy
p: 0330 808 1080
f: 084 3558 9972

Chart B shows that beyond these cheapest 5 tariffs (blue line), larger baskets (with only the cheapest tariff per supplier) follow a consistent curve: cheapest 1 to 10 (green line), cheapest 1 to 20 (red line), cheapest 1 to 30 (purple line) and cheapest 1 to 40 (yellow line).

Chart B: Larger baskets provide excellent consistency suggesting a robust measure of market view on pricing and costs:

We also reviewed the impact of removing the cheapest 5 tariffs (as per the proposal in the paper) and looking at different slices of 10 tariffs. These made little/no difference to the shape of the curve – just the level.
Likewise, only including suppliers over 50,000 customers made little/no difference to the shape of the curve – just the level.

So the question realistically becomes focused on level – which line is the most reflective of the cost position. Naturally there are a number of costs that kick-in with the 50,000 customer threshold and indeed many of the pricing strategies at this early stage of growth are not so cost-reflective, so one approach could be to take a basket of 10-20 of the cheapest tariffs of those suppliers over 50,000 customers. A multiplier, or a £-addition for the levies and obligations at over 250,000 accounts, could then be applied to this base line to get to the cap value.

One question posed is whether level of a basket may be pinned there by specific suppliers. Our analysis (shown in the graphs above and table 1 below) shows that with the 60+ suppliers in the market, the actual supplier taking any specific cheapest price positon is dynamic, but the overall shape is driven by the annual wholesale costs cycle and variations – with the different levels of the curves driven by the fact that lower loss-making tariffs are off-set with the money made from the level and size of the Standard Variable Tariff (SVT) back-book, other revenue streams (eg meter rentals etc) and also that different suppliers have different costs in the areas of structural aspects of cost to supply: obligations, metering, segments served as well as the efficiency and effectiveness areas of cost to serve and hedging strategy. Newer suppliers with no back-book are not able to sustain loss-leading prices for long – so cannot pin the market down alone; whilst there are only a small number of larger suppliers, so any attempt by them to pin the market up or down is outweighed by the sheer number of competitors in the tariff. This is testament to the benefit of having brought so many companies into the market.

Octopus Energy
20-24 Broadwick St,
London, W1F 8HT
w: octopus.energy
e: hello@octopus.energy
p: 0330 808 1080
f: 084 3558 9972

Table 1: Cheapest 25 tariffs (one per supplier) at 3 time-points across the past year (Feb, July & Nov 2017)
Position 1 is the cheapest in the market, 2 is the second cheapest

date	2017-02-01	2017-07-01	2017-11-01
rank			
1.0	IRESA Limited	One Select	Economy Energy
2.0	Toto Energy	Green Network Energy	IRESA Limited
3.0	Tonik Energy	Breeze Energy	Toto Energy
4.0	Economy Energy	Tonik Energy	Usio Energy Supply Limited
5.0	Avro Energy	Bristol Energy	Breeze Energy
6.0	Affect Energy	So Energy	Igloo Energy
7.0	Bristol Energy	Bulb	Bulb
8.0	PFP Energy	PFP Energy	Green Network Energy
9.0	So Energy	Together Energy	Tonik Energy
10.0	ScottishPower	Engie	One Select
11.0	Octopus Energy	Avro Energy	So Energy
12.0	Bulb	Toto Energy	Zebra Power
13.0	iSupplyEnergy	npower	Together Energy
14.0	Robin Hood Energy	Affect Energy	Nabuh Energy
15.0	Telecom Plus	Nabuh Energy	Affect Energy
16.0	GnERGY	Igloo Energy	E.ON
17.0	npower	Octopus Energy	Extra Energy
18.0	Flow Energy	Sainsbury's Energy	Pure Planet
19.0	Co-operative Energy	Co-operative Energy	Octopus Energy
20.0	LoCO2 Energy	GB Energy Supply	EBICo
21.0	Green Star Energy	iSupplyEnergy	iSupplyEnergy
22.0	Brighter World Energy	Flow Energy	Avro Energy
23.0	Go Effortless Energy	Robin Hood Energy	Bristol Energy
24.0	First Utility	Green Star Energy	Engie
25.0	SSE Southern Electric	First Utility	First Utility

Finally, at a practical level for this basket approach, we note that it is key that there is a trusted source of the cheapest tariff by supplier across the market. This may require a licence condition to supply all tariffs to someone like Citizens Advice, so that the various exclusives and Price Comparison Website (PCW) tariffs are captured.

Additional Questions:

Should it be split between pre-payment and direct debit customers, or one blended rate?
We would say that it needs to be two tariffs - given the significant cost difference (due to debt and working capital) of direct debit vs pre-payment customers (the figure of over £100 due to working capital and debt was flagged by the CMA analysis). We appreciate that this adds complexity, but it is significant.

Calculating the Payment Uplift Value
We would say that the changes to smart metering (wider roll-out and increased costs in a number of areas including meters, DCC and managing SMETS1 interoperability and compliance issues) and also the greater use of 'utility in a box' billing systems (which move the costs more to variable cost per customer than fixed costs to be spread) has changed the payment uplift value significantly since the CMA work up to 2015, and therefore these costs need to be recalculated with the current context. Maybe the way to reduce the complexity is to blend a rate of the smart meter costs of SMETS1 and SMETS2 costs, plus the related DCC costs.

Octopus Energy
20-24 Broadwick St,
London, W1F 8HT
w: octopus.energy
e: hello@octopus.energy
p: 0330 808 1080
f: 084 3558 9972

Calculating the headroom
We agree with the approach of headroom and the approximate level, but note that it would need to include the whole cost stack, as discussed elsewhere in this document.

Compliance Monitoring:
In section 3.85, you ask whether compliance tracking creates a significant burden for smaller suppliers. It is fair to say that the volume of detail RFIs is a significant burden, and greater proportionately for smaller suppliers. That said, the level of the burden is in the complexity and amount of detail. If the response was that all of our tariffs were below the cap and no further response was needed, this is not a significant burden!

We are happy for this response to be published in full and also to answer any follow-up questions or discussions that may come from this response.

Kind regards

Jenny Ashmore
Octopus Energy