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Providing financial protection to more vulnerable consumers

Summary of Consultation Responses

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Overview of Stakeholder Responses

On 20 December 2017 we issued a consultation on our proposals and rationale for financial protections for vulnerable customers. The deadline for response was 31 January 2018. In this consultation, and at the accompanying workshop events, we outlined our proposals to refine the design of the existing safeguard tariff protection for recipients of the Warm Home Discount and to extend the coverage to a broader group of vulnerable consumers. However, we stated that if the Government's legislation to put in place a temporary price cap on all standard variable tariffs and fixed-term default deals is in place before winter 2018-19, it will protect vulnerable consumers and we will not implement our extended vulnerable safeguard tariff.

We received 33 written responses to this consultation. The majority of respondents provided views and considerations on our proposed extension of the WHD safeguard tariff. Many also offered views on our wider policies around vulnerability, SVTs and future plans for price protection.

In this document we provide an acknowledgement and summary of those responses. We will also publish all non-confidential responses.

Document Structure

- Section one explores key theme around the Overarching policy intent
- Section two delves into key themes around the Scope
- Section three & four covers key themes around the design of the safeguard tariff

1. Overarching Policy Intent

In our consultation document, we highlighted concerns on consumer engagement, with evidence which suggested that vulnerable consumers are less likely to engage with the market and therefore, more likely to suffer detriment as a result. We explained that the safeguard tariff in place at present does not cover all of the vulnerable consumers we want to protect, so we set out our reasons for why we consider that a greater number of disengaged vulnerable consumers require safeguard tariff protection. We also set out our objectives for the safeguard tariff. This chapter provides a high level summary of the responses we received on these issues.

Vulnerable Consumer Objectives

Our proposals

In our consultation on extending financial protections to more vulnerable customers, we outlined the evidence which highlights that a spectrum of vulnerable consumers are more likely to be disengaged and at risk of paying more than they need to, leading to consumer detriment. We therefore outlined our proposals to extend our existing protection for customers in receipt of the Warm Home Discount ('WHD safeguard tariff') to a wider group of vulnerable customers. These customers would be identified through either our favoured option, a data matching exercise between the suppliers and the Department of Work and Pensions (DWP) to identify who qualify for certain government benefits, or our backstop option where the suppliers identify the eligible customers. We stated that the objective of our proposal is to reduce the consumer detriment incurred by vulnerable consumers in the existing market, and that these proposals are in line with our duties to have regard to the interests of certain consumer groups who are vulnerable, and to consider protecting the interests of these consumers via means in addition to the promotion of competition.

Stakeholder Views: Vulnerable consumer objectives

We received a number of responses focussing on our objectives for protecting vulnerable consumers, and their consistency with our proposals. The majority of respondents generally supported our proposals as being consistent with the objective of protecting vulnerable customers. However, a limited number of responses from suppliers commented on whether the policy intent of our protections was consistent with our objectives.

Several consumer groups and suppliers responded to the consultation stating that more should be done to define vulnerability because of a lack of clarity associated to the definition. One supplier argued that the current proposal was a step in the right direction, but that Ofgem should do further work to define how vulnerability and disengagement interact and to identify the target group for protection.

However, one supplier argued that the two different approaches to identifying potentially vulnerable customers suggested a lack of precision in how Ofgem considers vulnerability should be identified. They argued that this was evidence of a weak link between the underlying rationale for price protection and the targeted consumer groups. Two other responses also proposed that Ofgem should revise the policy intent so that it targeted and aligned with protections for fuel poor customers.

Impacts on Consumer Engagement and Competition

Our proposals

In our consultation we noted that it is too early to say whether our proposed protection would have a significant impact on consumer engagement. The number of consumers in scope would be greater than for the existing vulnerable protection. However, since we also plan to refine the safeguard tariff methodology, such changes could affect the potential

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financial gains consumers are able to obtain by switching to a new tariff and/or supplier, by increasing or decreasing the difference between the safeguard tariff and the cheapest deals in the market.

Stakeholder Views: Impacts on consumer engagement and competition

A number of suppliers and other respondents commented on the potential impacts of price protections on competition, switching and engagement, echoing comments they'd raised in previous consultations. Respondents generally thought that the extended protection would impact on customer behaviours and pricing differentials, and therefore decrease the incentive for switching.

However, one MP disagreed with the viability of using switching as an indicator of engagement, because in their view, although switching activity has increased, this is mostly due to churn amongst "bargain hunting" consumers. The respondent also cited evidence of a negative correlation between price differentials and switching.

Default Tariff Cap & Timing

Our proposals

This consultation set out that our proposals would extend tariff protections to an additional 2 million vulnerable consumers in time for winter 2018-19. We also stated that if the Government's proposed SVT and default tariff cap is in place before winter 2018-19 it will protect vulnerable consumers and we would not implement our extended vulnerable safeguard tariff.

Stakeholder Views: Default Tariff Cap & Timing

We received a number of responses around the interaction of our proposed extensions with the governments proposed default tariff cap. These responses primarily focussed on justification for the expansion of price protections for vulnerable customers, as well as practical implementation considerations from transitions across price caps.

A number of respondents commented on the lack of a termination date for our proposals. One supplier noted that while the consultation states the safeguard tariff will come to an end once the market wide cap is in place, there is no sunset provision in place in case the market wide cap is not introduced. It therefore proposed that Ofgem should provide more clarity around a sunset clause to enable the industry and suppliers essential time to work with the policy.

While one supplier stated that Ofgem's positions on duration is inconsistent and contradictory. It considered that it was unclear whether Ofgem's price caps for vulnerable customers are a temporary stop-gap, or whether Ofgem proposes an enduring need for providing price protection to vulnerable consumers.

Consumer groups voiced concerns around the withdrawing of the safeguard tariff in the presence of the market-wide cap, given existing uncertainty about the design and coverage of the market-wide price cap. Respondents sought detail around the design of the market wide cap, seeking assurance that vulnerable customers would not lose out under a market-wide price cap, compared to Ofgem's targeted protection.

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2. Scope

The consultation asked stakeholders to provide their views on Ofgem's proposals to identify consumers for safeguard tariff protection, as well as the tariffs, meter types and suppliers our proposal should cover. This chapter provides a high-level summary of the consultation responses and feedback from the workshops which relate to the scope of the safeguard tariff.

Data Matching

Our proposals

The consultation set out our preferred approach to provide price protection to consumers who qualify for certain income or disability related government benefits automatically. This approach would require a new data-matching exercise between the Department for Work and Pensions (DWP) and suppliers, enabled by changes to the Digital Economy Act (DEA). We stated that ideally all suppliers would use data matching to identify vulnerable consumers for the safeguard tariff.

However, in order to deliver protection in time for winter 2018/19, we considered that only suppliers obligated to participate in the WHD would be able to provide the safeguard tariff via data matching. We proposed that the remaining suppliers would be required to use other existing proxies to target vulnerable consumers.

Stakeholder views: Data matching as preferred option

Responses from consumer groups and the majority of suppliers were supportive of the proposal to use data matching to identify consumers for the safeguard tariff. The consumer and supplier workshops we held echoed a similar response. Advantages of data matching cited included the automatic protection for eligible customers as well as the effectiveness and robustness of this approach.

Stakeholders who commented on the list of benefits (set out in Appendix 1 of the consultation) were supportive of our proposal highlighting the inclusion of both income and disability-related benefits fits with the aims of the safeguard tariff. Three consumer groups and one supplier noted that the list of benefits could be expanded to include child and working tax credits from HMRC.

Specifically, on the legality of the new data matching approach, a number of respondents and participants within consultation responses and at the workshops noted their support for the use of the powers under the DEA to enable data matching, and encouraged Ofgem to continue working with government to make swift progress in this area. We are pleased to note the government's recently published consultation on proposed amendments to the DEA.[1] As regards to data protection requirements, Ofgem received a response from the Information Commissioner. We are very conscious of data protection issues and will engage closely with the ICO as we progress our proposals.

Stakeholder views: Data matching supplier coverage

The majority of suppliers and three consumer groups considered that all suppliers should be required to undertake data matching. Respondents noted that having an all-inclusive approach would allow for a consistent treatment of vulnerable consumers, avoid consumer confusion, and reduce any competitive distortions. Concerns were also raised over the unsuitability of the backstop approach (see stakeholder views on backstop approach below). In addition, a number of suppliers stated the implementation requirements and

[1] BEIS and Cabinet Office, 2018, Data sharing regulations for a safeguard energy tariff. Consultation closed 26 February 2018.

costs of administration for the data matching would not be significant or particularly demanding for smaller suppliers.

However, mindful of costs and operational implications for smaller suppliers, respondents and workshop participants also proposed a number of options to ease small suppliers into new data matching arrangements. Proposals included: providing an implementation delay to small suppliers; rebilling customers that are later identified as vulnerable once data matching is in place for all; excluding suppliers who have been in operating for less than two years; or only obligating suppliers with over 50,000 customers.

Backstop Option

Our proposals

In our consultation we said that there could be challenges to implement the data matching approach in the time available, so we considered a backstop approach that would rely on suppliers identifying eligible customers using information they hold which can indicate vulnerability (such as being on the Priority Services Register (PSR) or being in debt). We also proposed this alternative approach for smaller suppliers where it would not be practical to have data matching in place for winter 2018/19 (see data matching supplier coverage above). We noted that these two approaches need not be mutually exclusive.

Stakeholder views: Backstop option

A majority of respondents did not support the proposed backstop option. Specific concerns with the use of the PSR as a proxy for identifying consumers for the safeguard tariff were raised. These included unsuitability of the proxy given the PSR's objectives of identifying those in need of non-financial assistance; the fact that vulnerable customers would not automatically receive the tariff, as consumers have to register on the PSR; exiting inconsistencies across suppliers; lack of awareness of the PSR by certain groups of vulnerable consumers; and perverse incentives for suppliers to neglect their PSR obligations. However, a few suppliers and consumer groups did note that the application of the PSR would be easier to use in practice for smaller suppliers, as the data is readily available.

Limited views were provided in the consultation responses for the use of debt as a proxy. At the supplier workshop, it was discussed that debt would be an imperfect representation of vulnerability whereas at the consumer workshop, participants generally supported the idea of debt being used as a proxy.

Stakeholder views: Combination of data matching and/or other proxies

Four consumer groups suggested that data matching should be used alongside supplier-held information. They were concerned that relying solely on benefits data through data matching could mean that some vulnerable consumers in need would not receive the price protection.

While the majority of respondents did not believe other approaches would be viable, a number of alternative proxies were suggested. These included the use of more specific supplier-held information that would indicate consumer vulnerability, local authorities' data, General Practice's data, Winter Fuel Payment data and Gas networks' Fuel Poor Network Extension Scheme data.

Supplier, Tariff and Meter Inclusion

Our proposals

In the consultation, we proposed to apply the vulnerable safeguard tariff to all suppliers.

Consistent with the existing vulnerable safeguard tariff, we proposed that the extended safeguard protection would apply to consumers on standard variable or fixed-term default tariffs and regardless of meter type, with the exception of PPM customers who already have protection measures in place.

Stakeholder views: Supplier, Tariff and Meter inclusion

All respondents strongly agreed that the safeguard tariff should include all suppliers. In relation to meter types, where views were provided, all respondents stated that all meter types should be covered by the safeguard tariff.

A vast majority of respondents agreed with the proposals for SVTs and default fixed tariffs to be covered. However, some specific concerns were raised. Two suppliers noted that the safeguard tariff should only apply to consumers who have been on a default tariff for a certain period, with one respondent specifically suggesting a period of at least 6 to 12 months. One supplier suggested green tariffs should be excluded from any cap. A number of suppliers raised concerns with the definition of SVTs and default tariffs which may be used by active customers.

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3. Tariff Cap Design

The consultation sought views on two methodology options; a basket of market tariffs ('Market Basket') or an amended version of the existing Prepayment Meter Safeguard Tariff (designed by the CMA). Below we have summarised all points raised on methodology within consultation responses, workshops and other bilateral engagements with stakeholders. In addition to the points raised from our recent consultation, we have included relevant points previously raised as part of the "Phase 1" WHD Safeguard Tariff consultation process.

Amendments to CMA Prepayment Meter Methodology

Our proposals

In our consultation, we requested stakeholders to provide their views on our option of amending the CMA's prepayment meter methodology. The methodology uses a benchmark which is based on the prices of two mid-tier suppliers observed by the CMA in 2015 (with adjustments), with the cap being updated every six months using an index of external costs over which suppliers have no influence. We noted we could consider suggestions for methodological changes where they could improve the benchmark or other aspects of the design, within the time available.

Stakeholder views: Alterations to prepayment meter safeguard tariff methodology

Most respondents commented on these proposals, including the majority of suppliers, three charities, one consumer group and one price comparison website. The majority of respondents supported applying alterations to the prepayment meter safeguard tariff methodology, highlighting their preference for this approach over that of a market basket approach. Respondents stated that this methodology would be the easiest methodology to implement because suppliers were familiar with its application.

However, although alterations to the prepayment methodology were the preferred approach, most respondents also highlighted a number of concerns with the accuracy of the existing benchmark. Most respondents, including the vast majority of suppliers, highlighted that it was essential to consider whether the methodology should be at least modified, and ideally recalculated, to ensure it is cost-reflective. These echoed points made by respondents to our previous consultations.

We have grouped responses on this issue into seven common themes:

- Benchmark;
- Benchmark at nil consumption;
- Wholesale & hedging costs;
- Headroom;
- Policy costs;
- Smart metering costs; and
- Payment method uplifts.

a) Benchmark

The accuracy of the initial CMA benchmark was one of the primary concerns for many of the respondents. Respondents generally stated that the use of the two mid-tier benchmark suppliers (OVO and First Utility) in June 2015, does not accurately represent an effective 'catch all' benchmark for the wider industry.

One of the main concerns highlighted by suppliers relates to the differences in the underlying customer base of the benchmark suppliers, who they identify as being generally cheaper to serve online based customers with differing consumptions, tendencies and levels of bad debt. A number of primarily larger suppliers noted that this has led to an inaccurate benchmark for prepayment meter customers.

In addition, the following comments were made about the benchmark:

- The benchmark is based on two challenger firms with systematic differences in their cost profiles, and despite the subsequent alterations to account for this from the CMA, this has led to a benchmark which does not accurately reflect the long run costs of all suppliers.
- Basing the benchmark on only two suppliers is an inadequate sample for a representation of an industry wide price cap.
- Basing the benchmark on only a single point in time does not account for seasonal variations which would influence any benchmark.
- The benchmark uses data which will be more than three years out of date by the time the proposed new vulnerable safeguard tariff would come into effect.
- Subsequent alterations to the benchmark to ensure it was comparable to the prices of other suppliers, including larger suppliers, were not transparent and fairly represented.
- Some companies may have additional underlying exogenous costs, such as pension costs that result from legal obligations but which are unlikely to reflected in the benchmark.
- Suggestions that the costs in relation to the management of industry codes (CUSC, DCUSA, MRASCo, SEC, Xoserve etc), which are currently largely borne by the larger suppliers on a voluntary basis, needed to be taken into careful consideration.

b) Benchmark at nil consumption

The benchmark at nil consumption for the prepayment meter safeguard tariff methodology, is based on the average standing charges of prepayment customers for the six largest suppliers. Respondents generally supported this approach, and the continued need for a standing charge within any altered methodology in order to ensure efficient recovery of fixed costs.

Some respondents considered that the use of the prepayment standing charges was a reasonable proxy in the context of protecting vulnerable customers. Respondents highlighted that there may be difficulties associated with using direct debit standing charges to calculated the benchmark at nil consumption, as the application of specific direct debit discounts are often applied as a pro-rated discount on the standing charge. Respondents noted that this would result in the direct debit standing charge not accurately reflecting the underlying fixed costs of serving customers.

However, one consumer group noted that using the prepayment methodology could result in consumers incurring higher costs. The creation of a new benchmark was proposed by subtracting the CMA calculated prepayment meter uplift value from its prepayment meter safeguard tariff benchmark at nil consumption as the recommended approach.

c) Wholesale & Hedging

A number of suppliers raised concerns around both the calculation and updating of wholesale energy costs within the prepayment meter safeguard tariff methodology, and the subsequent impact these could have on their required hedging strategies.

Larger suppliers were generally of the view that the methodology used to define the initial wholesale cost bucket, and the subsequent hedging and updating of this value, was flawed, and did not represent an accurate portrayal of the wholesale costs for an efficient supplier. While some smaller suppliers highlighted that the use of the forward wholesale prices for calculation of wholesale energy costs was challenging to suppliers who are growing their customer numbers.

- One supplier outlined that due to the nature of the cap, it makes it less attractive for suppliers to offer long-term fixed tariffs due to the risk of being forced to reduce the prices mid-term.
- One supplier commented that the prepayment methodology does not accurately model efficient wholesale energy costs. It argued that the current benchmark was unrepresentative of efficient wholesale costs because it is based on a single snapshot date, does not consider long-term average wholesale costs, and because the suppliers in the benchmark benefitted from a fortunate hedging strategy.
- Another supplier commented that in order to match the wholesale cost element of the safeguard tariff in each applicable charging period, wholesale purchasing needs to commence at least six months before each cap period. However, with regards to energy purchased for SVT customers, it is typically purchased over a much longer period in order to reduce price volatility. The supplier recommended that suppliers should be given sufficient time to understand hedging requirements and hedge accordingly in alignment with their customer numbers. Otherwise, there is a risk that outturn wholesale costs will not match the allowance within the cap.
- One smaller supplier mentioned that when during a phase of growth and customer acquisition, there is uncertainty about how many customers will be acquired in future periods, and this makes it difficult to determine how much energy to hedge and at what price to maintain economic feasibility.
- One supplier commented that the market for some products is not liquid (e.g. quarterly gas) and that this made it almost impossible to purchase energy at the assumed rates. The same supplier also argued that there is a clear disconnect between the 12-month delivery window used for setting the annualised price and the actual period of six months over costs are to be recovered. Finally, the same supplier argued that suppliers have to have a sufficiently large customer base in order to manage trades in such a way to match the wholesale index.
- One supplier highlighted that the CMA's methodology applies an electricity wholesale cost index that is calculated using a weighted average of peak and baseload products to roll forward the price cap over time. It was noted that this baseload is weighted 70% and peak is weighted 30%. This supplier noted that is likely to understate wholesale cost growth over time by placing too low a weighting on the peak component of electricity wholesale costs.

d) Headroom

Most respondents commented on the degree of headroom provided for by the cap and raised it as an issue that needed to be carefully considered in order to encourage competition whilst the cap is in place. Suppliers were generally supportive of including

headroom in any revised prepayment meter safeguard tariff methodology, with the majority of those commenting proposing increases to the headroom allowance.

One large supplier suggested that there should be more headroom than under the prepayment safeguard tariff because there are fewer technical constraints which inhibit competition in this segment of the market.

One supplier argued that the amount of headroom provided for in the prepayment methodology was insufficient and that this was reducing competition, because a smaller amount of headroom reduces the incentives on customers to switch. However, the supplier was supportive of setting headroom as a percentage, as a fixed headroom would result in higher margins on customers who consume less. This same supplier proposed a headroom percentage of 10% per fuel.

A number of suppliers of all sizes stated that the implementation of the prepayment price cap had led to a reduction in switching rates. One supplier made a similar comment and cited evidence from New South Wales, Australia, where a looser price control coincided with a period in which price dispersion and switching increased whilst the number of customers on regulated tariffs fell.

e) Policy Costs

We received a significant number of responses on the issue of policy costs, primarily from suppliers. The majority of suppliers generally disputed the accuracy of the policy costs included in the prepayment meter safeguard tariff methodology, with respondents proposing a number of amendments. One of the primary issues raised was on the treatment of smart meter costs, which we discuss separately below.

Some of the specific points mentioned on policy costs include:

- One supplier suggested that Data Communication Company (DCC) charges should be separated from other charges and treated as a pass-through cost which can be updated bi-annually.
- One supplier noted that the exemption of the Energy Intensive Industries (EII) from both the Renewables Obligation and Feed-In Tariffs schemes has resulted in cost inflation which is not reflected in the policy costs index.
- A number of suppliers noted that policy costs, such as Energy Company Obligation (ECO) and WHD Costs, are increasingly being disproportionately borne by a decreasing supplier, customer and total consumption base. These suppliers noted that this is adding significant cost inflation, which is missing from the cap indexation. A number of suppliers also drew attending to issues stemming from the exclusion of EII.
    - To address this point, one respondent suggested Ofgem define a second index that relates to the size of the obligated customer base for ECO and WHD, and use this index as a base to proportionately increase a portion of the policy costs that corresponds to ECO and WHD.
- One supplier recommended there be updates to the base period data used within the OBR forecasts for policy costs. This adjustment was suggested as a result of current issues raised with the base date which feeds in the policy cost index value not being regularly updated to reflect varying costs as these occur.
- One supplier proposed a flaw in the current identification within the Economy 7 benchmark, from holding the assumption that policy costs are the same for an Economy 7 customer and a standard electricity meter customer. It was noted that this assertion is not reflective, due to policy costs being largely variable based on consumption, and Economy 7 customers being high consumers.

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- One supplier highlighted flaws in the CMA's calculations in relation to the split between fixed and variable costs for 'Policy' costs and 'Other' costs for electricity, noting that as a result, the cap for low consuming customers will be up to £20 higher than it ought to be in 2018/19.

- One supplier proposed to include an allowance for some short term trading costs and costs of imbalance within the wholesale cost index.

- One supplier suggested a full valuation of policy costs to be the optimal approach in ensuring all costs are accounted for within the cap. They believe Ofgem's current proposal to adopt the same methodology for ECO and EII as the CMA could only be extended into this cap where the costs fully net one another off. Where this is not the case, it was advised that Ofgem re-open an index mechanism.

- Several suppliers outlined the importance of considering network charges within the price cap methodology, given the considerable increases in transmission costs in previous years. They stated that indicative costs are set at the end of December preceding the effective period commencing the following April, whilst actual costs are set in February, providing a maximum 60-day notice for suppliers to factor these into tariffs. It was proposed that this electricity transmission lag creates a significant risk for suppliers in relation to setting a price cap, with the potential for suppliers to under-recover costs if the allowance assumptions are set too low.

f) Smart Metering

A number of respondents commented on the inclusion of smart metering costs within the benchmark. Most of these responses suggested that the benchmark did not reflect the actual costs of smart metering as smart metering costs had not been included as a specific cost item. These suppliers proposed that some form of adjustment is required to account for this.

More granular points were also raised on smart metering, these included:

- The current benchmark was set without consideration of the differences in First Utility and OVO's smart meter rollout strategy relative to other market participants.

- The benchmark does not recognise the implications of delays in the programme moving from SMETS1 to SMETS2 meters, and fails to acknowledge the importance of smart meter roll out to overall customer economics.

- Concern that there has been no systematic approach undertaken by Ofgem to collect and interpret smart metering cost data from suppliers.

- That different suppliers will have differing underlying customer dynamics, with some containing harder to reach customers, as well as higher installation costs due to delays in the SMETS2 roll-out.

However, one consumer group suggested that the onus should be with the suppliers to evidence how actual delivery costs incurred through the smart meter roll out are higher than those estimated, if they want a greater allowance for smart costs within the price cap.

g) Payment Method Uplifts

In our consultation we cited the CMA analysis which recognised the likelihood of there being a difference in the costs associated with serving prepayment and standard credit customers for an efficient energy retailer, compared with direct debit customers. They noted this to be primarily driven by bad debt and working capital costs associated to serving standard credit customers. The CMA estimated a cost differential of around £100 between direct debit and

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standard credit for a dual fuel customer. We identify there to be various approaches to assessing the cost differential between payment methods which could plausibly provide very different estimates.

A majority of respondents supported the requirement of a bespoke uplift applied to standard credit customers, in order to allow suppliers to efficiently and accurately recover their costs. There was a mixed response in relation to implementing a blended rate, whereby there would be one cap level for both direct debit and standard credit customers. Responses generally noted that this would result in some customers cross-subsidising other payment methods.

However, one supplier did propose the socialisation of a portion of the bad debt uplift from standard credit across other payment types. In practise, this would result in a higher direct debit base to account for bad debt portion.

One supplier suggested that the wide range in CMA's estimates for cost to serve difference between direct debit and standard credit could be as a result of the significantly differing customer bases held by the large suppliers. This supplier advised that Ofgem consider whether it would be appropriate to use the 'central' value of the range (which was previously used in the prepayment meter safeguard tariff) or whether it would be more appropriate to use the upper end of the range.

Market Basket Approach

Our proposals

In our consultation, we requested views on the market basket approach. This approach would calculate the benchmark based on a basket of tariffs available in the market at a given point in time. We would collect information on these tariffs at regular intervals to ensure that changing market conditions were reflected in the safeguard tariff.

Stakeholder views: Market basket approach

The majority of respondents did not support the market basket approach, raising concerns around gaming incentives, whether the basket would be representative of an efficient supplier (taking into account loss leaders and other non-cost reflective pricing strategies), and a concern that it would undermine engagement and competition.

Both suppliers and consumer groups generally noted that such an approach would have significant design issues and considerations. For example, various respondents commented that it would be difficult to design a representative basket of tariffs as there are many differences in suppliers' operating models which makes it difficult to compare like-for-like (e.g. pricing strategies, growth strategies, cross-selling strategies and exemptions from certain policy costs). Several respondents commented that the basket could potentially be open to manipulation by individual suppliers, irrespective of how the methodology is developed.

However, a small group of suppliers and one MP offered support to the basket for the following reasons:

- The prepayment meter safeguard tariff methodology and similar benchmarking approaches potentially constrain innovation and competition (for example, by inhibiting the emergence of different hedging strategies and tariff types).
- A market basket would be more responsive to movements in wholesale prices.
- A market basket would help drive costs down for all customers.

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- The risk of gaming behaviours could be reduced through the cap design (for example through the number of tariffs in the basket).

Several suppliers also made suggestions about how the basket could be designed:

- A larger number of tariffs in the basket was better (up to a maximum of one per supplier).
- Suppliers with less than 50,000 customers should be excluded because a number of costs are introduced at this threshold. Pricing strategies at smaller and/or growing suppliers are less likely to be cost-reflective.
- There should be some criteria based on a minimum number of customers on the tariff.
- Tariffs with exit fees should be excluded from the basket as the role of these fees are to reduce the risk of mid-term customer losses on fixed tariffs.
- The basket should be weighted by customer numbers.

Other Methodologies

Our proposals

In our consultation, we listed five methods that could be used to set methodology for any price protections, these were the prepayment methodology based on the CMA benchmark, the prepayment methodology based on a recalculated benchmark, the market basket approach, a bottom-up cost assessment and a regulated default tariff. As noted in our consultation, our assessment led us to further consider our two preferred approaches, a methodology based on the CMA benchmark or a market basket.

Stakeholder views: Other methodologies

A number of responses proposed other methodologies. One respondent proposed that the methodology should set a relative cap for each supplier. This respondent highlighted a number of points previously raised around the potential benefits of a relative cap, including more price competition and a more effective long-term guarantee of low prices.

Several respondents also proposed that the cap methodology should be based on a bottom-up cost assessment, whereby Ofgem would seek specific supplier cost information, developing a 'bottom-up' view of the costs that would be incurred by an efficient supplier. These responses argued that this would be the most effective method for setting a competitive and considered benchmark, and would enable a more accurate reflection of the operating costs involved in serving customers. The same respondents commented that they would welcome Ofgem reconsidering its view on the feasibility of this approach moving forward.

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4. Other responses

The consultation acted as a platform which enabled stakeholders the opportunity to note other matters they felt either directly or indirectly related to the proposal and therefore should be considered. Key themes raised covered implementation, compliance, corrective mechanisms, incentive mechanisms, the Governments Wider SVT cap, timing and terminology presently used. Below we have provided a summary of all these points raised within consultation responses and other engagement avenues.

Implementation

Our proposals

In our consultation we highlighted our main objectives in relation to implementation to be extending the safeguard tariff protection in the most effective way, so as to enable rapid implementation, whilst also minimising administrative burden and cost of implementation.

Stakeholder views: Implementation

Several suppliers and consumer groups highlighted that extending price protection to a wider group of vulnerable consumers would carry significant implementation and administration costs. One supplier argued that it currently has multiple teams across its business engaged in the delivery of the prepayment and WHD safeguard tariffs, and therefore the cap will carry significant operational costs. Another supplier argued that it had experienced serious implementation issues in delivering the WHD safeguard tariff, which was a consequence of working at great speed.

One supplier proposed a reconciliation provision similar to one that is currently in place for WHD scheme, whereby suppliers are compensated with reconciliation payments at the end of the year. It was suggested the same approach should be taken for the extended safeguard tariff, where suppliers with a larger portion of vulnerable consumers are monetarily compensated. It was proposed that this provision would ensure a fair distribution of the lower revenue generated from safeguard tariff cap customers, as otherwise suppliers with a large vulnerable consumer base would be disproportionately impacted.

One supplier highlighted the risk that removing the protection of the vulnerable safeguard tariff when the government's default tariff cap is introduced could negatively affect consumer satisfaction, as these interim arrangements were not proportional under such a short timeframe. Specifically, the supplier suggested that customers might interpret this as a sign that interim arrangements were rushed through due to their short recourse. It was suggested that this would be an unsatisfactory outcome and the supplier argued that it would prefer the launch of the vulnerable safeguard tariff to be deferred so that it might benefit from further development and refinement.

However, several responses primarily from consumer groups drew attention to the need to continue to develop protections for vulnerable customers. It was noted that if for unforeseen circumstances the government's default tariff cap were not introduced, it is essential that an extended vulnerable safeguard tariff be in place to achieve the best outcomes for vulnerable consumers.

Compliance

Our proposals

In our consultation, we explained our objectives in introducing a safeguard tariff that ensures that costs of administration, monitoring and compliance are proportionate and not overly burdensome.

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Stakeholder views: Compliance

A number of respondents made general comments related to the compliance of any extended vulnerable cap or proposed default tariff cap.

One supplier suggested a supplier could meet the compliance requirements in several ways, for example:

- Suppliers could keep their SVT and default tariffs at a level above the cap, and migrate eligible customers to a safeguard tariff, but only if they are currently on an SVT or default tariff (i.e. not on a fixed term contract).
- Suppliers could price their SVT and default tariffs at a level of the cap or below the cap, recognising that eligible customers may be on a higher fixed term tariffs which they actively signed up to.
- Suppliers could ensure that all their tariffs are below the cap, so there is no need to identify eligible customers or to set a safeguard tariff.

In addition, one supplier response proposed that Ofgem should publish a monitoring and evaluation framework and make it available for public scrutiny, along with any resulting monitoring and evaluation reports.

Additional Areas

a) Correction Mechanisms

A number of suppliers suggested that the methodology should include an "error-correction mechanism", such as that proposed by Professor Helm in the '*Cost of Energy* Review'[2], to adjust for changes in exogenous costs at regular intervals and reduce the risk that suppliers were unable to recover their efficient costs.

b) Incentive Mechanism

One respondent commented on Ofgem's considerations to vary the level of headroom for each supplier based on specific criteria, such as customer service. The respondent highlighted that such an approach would be complex and challenging to design. This supplier highlighted the difficulty in defining criteria with which to vary headroom, such as how would "customer service" be defined, as opposed to "customer satisfaction"? The general point was made that customer satisfaction is subjective and driven by perception rather than objective outputs.

c) Terminology

One consumer organisation expressed a preference to change the terminology being used presently at Ofgem. This response highlighted that within disability working groups, experts were keen to move away from the term 'vulnerable consumers', preferring the terms 'consumer vulnerability' or 'consumers in vulnerable situations'. In response to their advice, we have been using this terminology in our recent standards work.

[2] Professor Dieter Helm, 2017, Cost of Energy Review