Anna Rossington,
Consumers and Competition,
Ofgem,
10 South Colonnade,
Canary Wharf,
London,
E14 4PU

20th June 2018

Dear Anna,

Default Tariff Cap: Policy Consultation

Thank you for the invitation to respond to the above consultation. Bristol Energy is an independent supplier of electricity and gas with a business model that has a regional focus on the South West of England, although we supply customers across Great Britain. We have a mission to fight fuel poverty and be a force for social good.

Executive Summary

Bristol Energy is a supporter of the Government's decision to impose a temporary price cap on the market to prevent disengaged customers from the worst excesses of high, unjustified pricing. Nevertheless, if the cap is to be temporary in nature, then competition needs to be able to thrive under the cap, and it should not be used as a vehicle to push down prices across the board in defiance of market forces, and be the cause of multiple suppliers exiting the market unless they are failing to deliver.

Given the diversity of suppliers in the market, we believe it would be better to set a cap in which marginally inefficient suppliers can still strive than set a cap which risks forcing all but the most efficient suppliers out of the market. Ofgem should also note that nearly all suppliers have negative EBIT in the first few years of operation whilst the business grows. Funders support this on the understanding that they will re-coup their money in subsequent years when the business has a positive EBIT. If EBIT margins are too low, then funders will leave the market.

It is also important that Ofgem sets out at the start of the cap, quantifiable objectives that it wants to see met, so that it does not have seek the SoS permission to extend the cap any longer than necessary. This would have two advantages, firstly that the industry is clear as to what it needs to demonstrate to have to cap removed, and secondly it does not leave Ofgem having to make a subjective decision in the political environment that could exist when a decision is required.

Due to the limited time available to respond and number of questions we have only answered specific questions which we believe are important to answer, expanding our response as necessary.

Q1. Which approach for setting a benchmark for efficient costs do you think would be most appropriate?

We agree with Ofgem's analysis that each of the options has its pros and cons and that in reality none are a perfect solution. The key element to us is transparency and the ability of suppliers to have reasonable foresight of what the cap will be by replicating as far as possible Ofgem's calculation. To this end we believe the bottom up cost approach is marginally preferable.

Q2. What are your views on the issues we should consider when setting the overall level of the cap,

including the level of headroom?

Bristol Energy supports the price cap to protect disengaged customers from the worst excesses of overcharging by several unscrupulous suppliers, whilst allowing suppliers to not only make a reasonable return, but to also offer value plus services such as enhanced customer care, and in our case, support a mission to fight fuel poverty. If the cap is correctly applied, then it is likely disengaged customers will still be on the worse tariffs, but not as highly penalised as present, and will still have an incentive to switch tariff and/or supplier.

The continuation of competition is to us the most important issue to consider. If the price cap reduces competition by removing independent suppliers from the market then the only winners in the long run will be the large suppliers who have caused the imposition of the price cap in the first place by their treatment of their inert customer base, and the losers will be all consumers both engaged and disengaged.

This may require a slightly higher headroom than short term political pressure demands, but in the longer run will be beneficial to energy customers, as the market power of larger companies is diminished as the level of disengaged customers is reduced.

Q3. Do you agree with our approach to accounting for different costs, in particular additional costs of serving consumers paying by standard credit?

We do not agree that separate caps should be set for Direct Debit and standard credit customers, as we believe this complicates the cap setting unnecessarily and inhibits competition. Ofgem should set the cap on the basis of standard credit and leave it to suppliers to offer discount for Direct Debit or other payment methods as a method of facilitating competition.

Standard credit customers pay by various means, some by cheque, cash or electronic banking. Direct debit customers can be monthly fixed, or the full amount taken by Direct Debit (or standing order) on receipt of a bill (monthly or quarterly). We therefore see this linear approach to payment methods as a hinderance to efforts to engage customers.

Given the limited time Ofgem has to develop set a cap, not setting caps for different payment methods would seem a way of allowing Ofgem to focus its resources on the main issues around the cap setting process as well as providing a way for suppliers to focus engaging customers with different payment methods.

Q4. Do you agree with our proposals for how we will update the cap?

In essence, we are supportive of Ofgem's proposal on how they will update the cap, but are concerned by how Ofgem intends to manage unforeseen changes in wholesale costs. Currently suppliers account for forecasting risks by two mechanisms. Firstly, by implementing a small uncertainty risk premium when setting their tariffs. The second mechanism for SVT is the ability to change the tariff with 30 days' notice, and for fixed is to withdraw the fixed tariff from the market for new customers and replace it with a new tariff.

With a cap in place, then the second mechanism falls away. For SVT customers prices could only be increased up to the cap, and in a competitive market, whilst a fixed tariff can be withdrawn for new customers and a new one issued above the cap in theory, in practice why would customers opt for a fixed tariff over a cheaper capped SVT?

The nightmare scenario for Independent suppliers without access to infinite cash flow is that costs increase significantly above the cap due to unexpected world events affecting wholesale prices such that their capped SVT tariff becomes loss making and its fixed price customers opt for it at the end of their current fixed term as it will be the suppliers' cheapest tariff.

Ofgem must have a mechanism which allows suppliers to increase SVT prices in exceptional circumstances between the 6-month cap setting process, or risk a mass exodus from the market and multiple Supplier of Last Resort actions needed, potential causing more suppliers to exit.

Q5. Do you agree with our assessments of whether an exemption for tariffs that appear to support renewable energy is necessary and workable?

Bristol Energy currently offers a Green electricity and gas fixed tariff to customers which would not be subject to the cap, although it will mean that we will not be able to offer customers on our green tariff the option to rollover onto another green fixed tariff at the end of their current fixed term by "default", and they will have to positively opt for a green tariff every year. We believe this is a poor customer outcome, but is an unintended consequence of a price cap regime.

We support Ofgem's approach to grant derogations rather than a blanket exemption, thus ensuring disengaged green tariff customers on SVT do not become unprotected. However, given the decision to go via derogation rather than exemption we believe Ofgem should be willing to allow suppliers to seek derogations for green gas tariffs with the onus on suppliers to satisfy Ofgem concerns around compliance monitoring. As Ofgem states renewable gas tariffs are not widely available and if anything, need more support than more established electricity tariffs.

Q6. Do you have any views on what information we should use to assess the conditions for competition?

We are pleased that Ofgem recognises that, by implementing a price cap to protect the disengaged, it may reduce the opportunity for engaged customers to get a better deal as competition will reduce, in both deals available and the number of suppliers.

We believe Ofgem should set out quantifiable milestones as to what effective competition is, and be transparent about them. For example, the number of properties supplied by the incumbent supplier falls below X%. It should not wait until the 2020 before setting out Its criteria which will be subjective to the political environment of the day.

The advantage of this will be that the industry will see what it needs to achieve to have the price cap lifted and can work with all stakeholders to achieve it.

QA1.1 Do you agree that we should not further consider the use of a market basket to set the initial level of the cap?
QA1.2 Do you agree that we should not further consider the use of a market basket to update the cap over time?

Yes. We agree that Ofgem should not consider further the market basket approach for the initial or subsequent caps.

QA5.1 Do you agree with our proposal to update the cap in line with trends in exogenous cost drivers?

We are supportive of this approach, in particular the need to update the cap based on forward looking cost drivers rather than historical data, or market prices given they will have been influenced by the existing cap.

QA5.3 Do you consider that further provision is required for us to re-open aspects of the design of the cap, beyond our licence modification powers – and if so, why?

As set out in our response to Question 4. We believe Ofgem must have powers to adjust the cap in between the 6-monthly adjustment where significantly unforeseen events means that suppliers are not recovering costs and are thus making a loss. Whilst larger suppliers maybe able to withstand a period of loss making tariffs, some independent suppliers with high numbers of engaged customers may fall by the wayside as a result of Ofgem's inaction.

Hopefully, Ofgem will never need to exercise this option, but it would be unwise for it not to have this insurance policy rather than risk market competition.

QA9.1 Do you agree with our proposed approach to setting the EBIT margin?

We believe that Ofgem needs to revisit the EBIT margin. The market has fundamentally changed since the CMA did its work in 2015 (using 2014 data) with almost twice the number of suppliers in the market, and at the time the CMA's work was based only on the largest eight suppliers and thus skewed towards businesses of scale and maturity. Many new suppliers have significant borrowed capital which needs financing and a EBIT margin of 1.9% is unlikely to be sufficient to keep those businesses profitable in the medium term and provide a return for their funders. We also support the view expressed by others that there were errors in the CMA analysis.

QA11.1 What are your views on headroom being a percentage? Do you think it should be applied to all cost components except network cost? Alternatively, do you think headroom should be applied as a percentage to only controllable costs?

We support the view of applying headroom as a percentage for the reasons specified although we would also Apply an uncertainty element to network costs due to Ofgem's recent decision to re-open the network settlement to allow networks to recover Supplier of Last Resort costs, thus creating an uncertainty on network costs. If Ofgem was to undertake not to open network costs once finalised, then we would be happy to exclude network charges from headroom.

QA11.2 What are your views on whether we should change the level of headroom over time?

One of the key reasons for allowing headroom is to mitigate uncertainty. The industry is going through rapid change with Smart metering, HH settlement, next day switching all of which are for the consumers benefit in the medium term. However, change creates uncertainty, such as how many customers will accept smart meters? how many will be settled Half-Hourly? and what will be the cost impact of moving to next day switching? Layered on top of this are geo-political events such as Brexit or a change of Government, and the progress in the decarbonisation of transport.

Whilst we agree with Ofgem's thinking around not starting high and moving downwards to give inefficient suppliers time to adapt, we do believe the level of uncertainty within the market is kept under review and the headroom adjusted upwards or downwards as necessary to reflect uncertainty.

QA11.3 Bearing in mind the analysis and scenarios presented, what are your views on the appropriate level of headroom to include in the default tariff cap?

In our view we believe the level of headroom should be on the higher side. As stated above we have concerns about the level of uncertainty in the market as it goes through the transformation to a smart energy market. We also believe that it is the interest of the consumer in the long term that there is thriving competitive market especially as the cap is a temporary fix.

Whilst the cap is set on default tariffs alone, it does impact the level of tariffs suppliers can charge for fixed term, non-default tariffs. So even if a supplier has no default tariffs (i.e. In their first year of operation), they will not gain many customers if they price above the cap, but the fixed costs of being a supplier will be spread over fewer customers, so the option to loss-lead is limited unless they have a well-funded backer willing to bear a sustained period of loss.

A low headroom will therefore discourage new entrants, as well as being the cause of market exit, both controlled and via failure and subsequent supplier of last resort processes.

QA13.1 Do you agree with our minded to position not to provide exemptions for renewable electricity or gas tariffs?

We support Ofgem's minded to decision not to offer a blanket exemption to green tariffs. Our principle reason is that it would allow suppliers to charge a price level that could not be justified by the additional costs, and therefore believe a derogation route is more appropriate.

We disagree with Ofgem's minded to decision impose a blanket ban on derogations for green gas tariffs. These tariffs may be small in number at present, but are growing as the amount of certified green gas entering the gas system increases, and there are certification schemes in place. If a supplier wishes to claim a derogation for a green gas tariff, then Ofgem should be willing to hear the suppliers case, and the onus is on the supplier to convince Ofgem that the derogation is both justified and the tariff has suitable certification in place.

AA13.2 What are your views on whether to provide a derogation for renewable electricity tariffs?

We believe Ofgem should provide a derogation route for both renewable electricity and gas tariffs. However, we believe Ofgem is setting the bar too high and being too prescriptive on what a renewable tariff is.

In our view the derogation should be on the basis of the electricity tariff being 100% REGO backed and the onus is on suppliers to justifying why they cannot provide this tariff below the cap. On a green gas tariff, being 100% backed may be difficult to achieve due to the limited availability of certified green gas, so the onus should be more on the supplier proving the provenance of their gas and being clear about the percentage of gas that is renewable. Ofgem may of course set a de minimis figure.

I hope you find this response useful. If you have any queries, please do not hesitate to contact me.

Kind regards,

Chris Welby

Chris Welby
Head of Regulation