



Default tariff cap: Policy Consultation, 25 May 2018

Dear colleague

Co-op Energy welcomes the opportunity to respond to Ofgem's policy consultation on the Default Tariff Cap.

Introduction to Co-op Energy

One of the biggest differences between Co-op Energy and other energy suppliers is that we're a co-operative, which means we're owned and run by our members. Most big energy suppliers are owned by shareholders, so any profit they make goes back to their shareholders, rather than customers. When we make a profit it's our members, and our community who see the benefits.

Established in 2010, Co-op Energy has over 420,000 domestic customers and is committed to sustainability. We stopped buying electricity from coal in 2016. All our electricity tariffs are now sourced from 100% renewably generated electricity as standard.

We launched our Community Energy Strategy in March 2017 and we are helping to expand community energy in Great Britain and to be recognised as the GB's leading supporter of locally-generated low-carbon energy. Via Power Purchase Agreements (PPAs) we are enabling a fair market access for community energy, with projects including wind, solar-PV and hydroelectric technologies. The number of PPAs with community energy groups now stands at 55 more than sextupling the nine we had at the end of 2014.

We secured Fair Tax Accreditation for the 3rd consecutive year and won the Queens Award for Enterprise 2015 in recognition of our ongoing commitment to social responsibility.

Our views on the price cap

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Co-op Energy supports a temporary, absolute price cap as the best way to address the one of the main sources of consumer price detriment in the market: customers on uncompetitive SVTs for 3 years or more. We advocated the price cap should only apply to customers on SVT for 3 years or more. In our view this strikes the right balance between maintaining the benefits of competition, while protecting those who do not – or cannot – engage with the market.

In parallel, we advocate an enduring Safeguard Tariff for vulnerable customers, available from all suppliers, irrespective of the supplier's size. This will ensure all vulnerable customers are protected by price capping.

To support an enduring Safeguard Tariff, suppliers should be given additional abilities under the Digital Economy Act to access welfare data from the Department for Work and Pensions. This will streamline the Warm Home Discount (WHD).application process for both suppliers and customers (in the Broader Group).

We think it is better for customers if government determines the criteria for who should receive WHD. This determination should be based on social need rather than allowing individual suppliers to determine their own criteria. This will ensure consistency and transparency of the support available for vulnerable customers, remove a potential barrier to switching and, we believe, delivering better outcomes for vulnerable consumers.

Our comments on the consultation questions

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

We agree there is no 'perfect' way to determine a benchmark for efficient supplier costs and agree Ofgem's determination will require judgement and trade-offs.

Our slight preference is for Option 3, the 'Updated competitive reference price'. This is because it is based on the CMA's methodology, which is well understood by industry

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(although not perfect). It also avoids the most obvious criticism of the CMA's methodology, namely that it uses out of date data.

Option 4, bottom up cost assessment could also provide a reasonably robust reference price. There are likely to be a wide range of costs presented to Ofgem, given GB's diverse supply base. It's not clear how Ofgem would determine where in the range of costs it is provided with, the level of efficient cost sits.

It's important Ofgem is able to exclude 'loss leading' tariffs for the updated reference price data. It is not clear how Ofgem will do this, although we appreciate Ofgem has acknowledged this is an issue. Loss leading tariffs do provide those consumers that choose them access to cheap tariffs, however this is at the expense of wider consumer trust in the industry.

We do not feel it is helpful when the difference between the cheapest tariff on the market and SVTs is highlighted. It implies all consumers could access these lower prices, when clearly widespread uptake of loss leading tariffs is not economically sustainable.

'Loss leading tariffs' also increase the likelihood of a Supplier of Last Resort Event (SoLR), the costs of which may be borne by consumers. It's unclear how the cost of a SoLR event would be taken into account when determining the cap.

The Bill requires Ofgem to have regard to holders of supply licences who operate efficiently are able to finance activities authorised by the licensee. There is a risk if the cap is set too tight, this could lead to a 'race to the bottom' with all suppliers seeking to reduce innovation and customer service. Co-op Energy hopes the cap will allow us to continue supporting community energy projects within Great Britain.

Ofgem should also take account of the recently announced changes to the Warm Home Discount (WHD) threshold.

2) What are your views on the issues we should consider when setting the overall level of the cap, including the level of headroom?

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We think the cap should include headroom. This is to account for inevitable errors in calculating the initial efficient level. Such errors merely reflect the imperfect data and tools Ofgem has at its disposal when calculating the initial cap level.

We also think it is important to include headroom in order to maintain a competitive dynamic within the market. Ofgem has found that 91% of consumers are motivated by price¹ and the CMA found the mean saving required for consumers to switch was £158 per annum². Competition has delivered a downward pressure on prices for engaged consumers, including engaged vulnerable consumers. We hope the cap allows room for this to continue.

Switching is one proxy, albeit an imperfect one, for engagement. While there appears to be an acceptance by Ofgem the cap will reduce switching levels, we think it is important the cap maintains incentives to switch to continue to drive competitive supplier behaviour. This includes competition in customer service, product innovation or community benefits ie not just price. Since net switching is from Big 6 to independent suppliers, it is likely the reduction in switching caused by the price cap could disproportionately adversely affect independent suppliers' ability to acquire new customers.

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

We think the method outlined for updating the wholesale price could have unintended consequences in the wholesale market. It will likely cause short term prices to rise as all suppliers' purchasing aligns with the biannual cycle of price cap increases. The impact will be felt more by non-vertically integrated suppliers, who have less balancing tools available to them and may have less capital available to hedge over longer periods.

We think DCC and SEGB costs should be separate line items in the cost stack. This is to ensure consumers have visibility on the components of their bill and help increase trust between consumers and suppliers.

¹ [State of the Energy Market, 2017 Report](#), Ofgem, p.24

² [Energy Market Investigation, A report for the CMA by GfK NOP](#), p,75

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Ofgem should consider how the cap takes into account the significant difference in smart meter rental prices paid by suppliers. Many of these higher costs are outside of a supplier's direct control and a function of an uncompetitive smart meter rental market.

Even when suppliers sign up to Meter Asset Provider ('MAP') cheaper 'contract rates' for smart meter rentals, these rates are often much higher than those paid by the installing supplier. Since independent suppliers are net gainers of churned assets, and more established suppliers are net losers, this market feature disproportionately affects independent suppliers. The difference is much higher than could be explained by any additional credit risk posed by independent suppliers.

'Fair smart meter rentals' is an issue which goes beyond the price cap, but Ofgem should be aware that a decision which ignores this differential will likely bake in higher costs for most independent suppliers when compared with incumbent suppliers. This will make it challenging for Ofgem to have regard for the need to create incentives for holders of supply licences to improve their efficiency (due to the difference in costs bases between suppliers) and the need to ensure holders of licences who operate efficiently are able to finance activities authorised by the licence (as Ofgem will likely assume a single efficient cost and has not clarified what rate it will use for smart meter rentals and how it will determine this value).

We agree there should be different prices for different payment types to reflect their different costs to serve.

4) Do you agree with our proposals for how we will use cost data to update the cap?

It is likely there will be unavoidable errors in calculating both the initial value of efficient costs and its subsequent updating. It's not clear how any errors would be corrected and we would welcome further discussion on possible 'truing up' mechanisms for objectively demonstrable errors.

5) Do you agree with our assessments of whether an exemption for tariffs that appear to support renewable energy is necessary or workable?

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Yes the derogation approach appears workable, however there is an urgent need for more detail on the derogation process so suppliers are able to apply (and gain approval, where they meet the criteria) for a derogation prior to the implementation of the cap.

We do not agree that green gas should be excluded. We think this could stifle innovation and development in green gas products, which would not be in customers' interests. It is unclear the decision to exclude green gas can be reconciled with the government's legally binding target to decarbonise heat.

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

One of the principle impediments to competition is the number of customers on SVT for over 3 years. This is the segment of the market which is not engaged and has not benefited from competition and increased choice of supplier in the market.

We think one metric should be improvements in supplier engagement with customers. This could be demonstrated by customers actively 'opting in' to specific tariffs, including default tariffs. This engagement should be renewed on an annual basis, which seems to strike the right balance between reaching out to customer, but not over burdening them with unwanted communications. Suppliers should be able to evidence this engagement to Ofgem so it may then evaluate engagement success.

We would be pleased to discuss our answers with you if this would be helpful.

Yours faithfully

Duncan Carter
Senior Regulatory Advisor

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