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By email: retailpriceregulation@ofgem.gov.uk

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Dear Anna

### **uSwitch response to Ofgem's Default Tariff Cap: Policy Consultation [Non-confidential version]**

I am writing on behalf of uSwitch in response to Ofgem's Default Tariff Cap: Policy Consultation, published on 25 May 2018.

uSwitch, part of ZPG Plc, is the UK's largest energy price comparison and switching service. [X] In 2017 alone uSwitch customers saved £281 million on their energy bills.

We have been engaging constructively with the Ofgem team regarding the default tariff cap over recent months, providing access to our unique data on consumer switching behaviour and responding to your team's queries and consultations. We are keen to continue engaging with Ofgem and would welcome the opportunity to discuss our latest analysis with Ofgem if it is useful.

In this letter we focus our comments on 'Appendix 11 – Headroom' of the Policy Consultation, [X].

#### **Overview**

We have previously highlighted to Ofgem that competition is the most effective and only sustainable long-term solution to drive better consumer outcomes in the retail energy market – in terms of price reductions, innovation and quality of service. Aiming for a default tariff cap that is as low as possible may reduce bills for disengaged consumers in the very short run, but it risks undermining suppliers' ability and willingness to compete for consumers, who would likely become more apathetic in the longer run. To give a true and fair view of the impact of the default tariff cap, Ofgem needs to take into account the harm caused to competition and consumer engagement as the long-term sustainable drivers of good outcomes in the energy market.

While we recognise the requirement in the Draft Bill to protect current default tariff customers, Ofgem also has an obligation to protect future default tariff customers, and, through its statutory duties, all GB energy consumers. There seems to be a degree of tension between the obligation to protect all, or a subset of, consumers in terms of Ofgem following the right process.

#### **The role of headroom**

Ofgem's Consultation appears to distinguish between headroom to enable competition and an 'uncertainty margin' to address the uncertainty, volatility and variability of supplier costs. Both are reasonable components of the default tariff cap: the headroom should be set at a level that supports competition 'below cap' among suppliers, and should be complemented with an uncertainty margin (possibly using a 'glide path') that enables suppliers to gradually adjust. This would enable Ofgem to observe how the competitive dynamics in the market play out, and adjust the cap over time for the maximum benefit to all GB consumers.

#### **Four matters to have regard to**

The Draft Bill states that Ofgem must have regard to 'four matters', including "*the need to maintain incentives for domestic customers to switch to different domestic supply contracts*". However, in the Policy Consultation, Ofgem appears to have significantly deprioritised switching incentives in favour of the other three factors, and has in particular placed much greater emphasis on suppliers' incentives to improve their efficiency.

By way of example, in all four scenarios presented by Ofgem in Appendix 11, switching volumes are shown to fall significantly, by 10-30% and 25-50% in the two 'middle' scenarios set out by Ofgem, and over 50% in its worst case. [X] Even based on Ofgem's own estimates this would effectively undo the successful increases in switching over the past few years, achieved through a combination of Ofgem's initiatives, more engaged customers and much greater competition from a proliferating number of new

suppliers to the market. Moreover, Ofgem has not presented a single scenario in which switching levels would continue growing at the historical rates, or even one where levels would be maintained at the current prevailing levels.

From a process perspective, therefore, it is unclear how Ofgem plans to discharge its obligation with respect to the four matters if it systematically under-represents switching incentives in its analysis.

[X]

[X]

### Overstated benefits, due to harm caused to consumers on fixed tariffs

Ofgem's analysis focuses only on the gross short-term benefits accruing to default tariff consumers from the implementation of the default tariff cap. However, suppliers who experience a reduction in their revenues are likely to seek to recover some of the lost revenue by increasing their fixed tariffs, which would in turn cause harm to fixed tariff customers. Suppliers will be able to do this as a result of the weaker competitive constraint (driven by reduced price differentiation) under a default tariff cap.

The default tariff cap can cause harm to at least 10 million UK households who are currently on fixed tariffs. [X] Additional harm will manifest itself in the market as default tariff customers are less incentivised to achieve savings by switching to a fixed tariff, through the cumulative effect of fixed tariff consumers reverting to default tariffs (which will progressively grow the population of default tariff customers), and through a fall in the *ex-ante* engagement in the market caused by a false sense of comfort felt by SVT customers.

### Other matters raised in the Ofgem Consultation

- **Review and update.** We agree with Ofgem's proposal to review and update the cap every six months. We consider that the review and update should not be a 'mechanical' exercise, but rather require Ofgem to actively engage with the actual performance of the market in terms of long term benefits and harm caused to all GB energy consumers.
- **Removing the cap.** We agree with Ofgem that the conditions for removing the default tariff cap need to be articulated in terms of "conditions for effective competition" rather than actual market outcomes. However, there is a risk that the initial design and implementation of the cap causes irreversible harm to the structure and competition in the market that would, in itself, mean that the "conditions for effective competition" are weaker than would be the case in the absence of the cap. Ofgem needs to ensure that the default tariff cap does not become an enduring feature of the market, which it risks becoming if the presence of the cap itself undermines the conditions for effective competition.
- **Protecting vulnerable customers.** Ofgem has noted in Appendix 11 that low-income households tend to consume less energy than high-income households and this should be reflected in the design of the headroom. We agree with Ofgem's implicit assumption that low-income consumers need to be protected – but would encourage Ofgem to consider a progressive and dynamic assignment of headroom within the cap, with the output being at least two levels of cap: assigning a lower level of headroom for consumers more likely to be vulnerable and significantly greater headroom for all other consumers. This would provide real savings for those who need it most and enable greater savings for those who are able to engage with the market, in turn continuing to drive competition and innovation in the market. This would be a fairer approach and a natural extension of Ofgem's concern for low-income consumers, a concern which we share.
- **Communication.** We continue to believe that the design of the default tariff cap needs to be accompanied by strong SLCs that ensure a capped default tariff is communicated carefully, avoiding suppliers taking advantage of an incentive to engender a false sense of security among customers. We believe Ofgem should consider restriction of a capped tariff's name (avoiding phrases such as 'safeguard') and require in any communication, including price change notices, continuous encouragement to engage with the market through switching. We consider it appropriate for Ofgem to substantively consult on these elements of the proposed price cap in due course.

### Conclusions

To fulfil Ofgem's statutory duty to protect the interests of existing and future consumers (i.e. including those on all types of tariffs), we would expect Ofgem to perform a careful assessment of the harm caused to fixed tariff customers, as well as the net benefit to all GB consumers, as part of its planned Impact Assessment.

We would also expect proper consideration to be given to maintaining switching incentives, to ensure that due process is followed in meeting the requirements of the Draft Bill, including active consideration of, and practical proposals to describe how switching can be maintained and grown in future.

We hope our response is useful to Ofgem. We are happy to provide further detail on any of the points raised, should it be helpful, and continue the active dialogue that we have had with your team to date.

Yours sincerely



Richard Neudegg  
Head of Regulation, ZPG Plc

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