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Dear Anna

### **uSwitch response to Ofgem's Default Tariff Cap Statutory Consultation**

I am writing on behalf of uSwitch in response to Ofgem's Statutory Consultation on the Default Tariff Cap, published on 6 September 2018.

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

We have provided Ofgem with a significant amount of data throughout this project to help inform its decision-making and are grateful for the engagement from Ofgem's project team with respect to this. However, we remain highly concerned that Ofgem has not found the right balance in how it intends to implement the default tariff cap (the cap).

In this response we reiterate some of our concerns and highlight some practical steps Ofgem should now take to better protect against the potential for consumer detriment.

#### **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. We continue to hold this view.

uSwitch accepts that Ofgem has a duty to implement a default tariff cap under Domestic Gas and Electricity (Tariff Cap) Act 2018 (the Act). However, we remain highly concerned that Ofgem has not achieved the correct balance under its duties and the four matters it must have regard to. Ofgem's draft impact assessment suggests it is prepared to accept severe damage to the growing part of the market that is functioning well, including to the approx. 10 million customers that have done the right thing and actively engaged, moving away from default tariffs. We remain concerned that Ofgem's assessment of potential benefit arising from the price cap does not focus on the net impact across all consumers in the market.

uSwitch is concerned that Ofgem's desire to hit a self-imposed deadline for the introduction of the default tariff cap has meant it has not given full consideration to the significant complexity of the potential effects of the intervention. The requirement to introduce the default tariff cap in the Act "*as soon as practicable*" should not forego appropriate regulatory process. In light of the significant risks this intervention poses to consumer outcomes in the current and future market, Ofgem should ensure that it is prepared to revisit key levers in the cap model while the cap is in place, beyond just smart meter costs, as it learns about the effects in practice.

We are also concerned that Ofgem has failed to fully consider practical steps that might mitigate the entirely probable unintended consumer behavioural consequences. Ofgem cannot rely on supplier incentives to communicate the cap in a way that maximises market engagement. Incumbent suppliers have an economic incentive for customer engagement to decline amongst their own customers.

#### **Four matters to have regard to and the draft impact assessment**

The Act 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*". In our response to Ofgem's Policy Consultation, we noted that Ofgem appeared to have significantly deprioritised switching incentives. This approach has been confirmed in Ofgem's statutory consultation. As

we have previously stated, Ofgem has not presented a single scenario in which switching levels would continue growing at the historical rates we have seen, or even one which would maintain prevailing levels.

Ofgem's draft impact assessment highlights its willingness to tolerate reductions in switching in the region of 5-35% as part of this intervention. Notwithstanding the concerns we have previously raised with Ofgem regarding its calculations on this point, reductions in switching at the level of its 30% central estimate have the potential for lasting impacts on consumer propensity to engage with decisions on energy (in the broadest sense) both while the cap is in place, and even after its removal.

We consider it critical Ofgem allows itself to revisit these issues while the cap is in place. We note that Ofgem states it can reconsider the efficient level of costs allowed for in the cap if it finds it has systemically and materially departed from reality. However, Ofgem should go beyond this and commit to review its policy decisions on its methodology at least annually and act should the market impact be more detrimental than its impact assessment expects with respect to any of the four matters.

### **The role of headroom**

uSwitch is disappointed that Ofgem has not considered it appropriate to add a level of headroom specifically to ensure market competition is supported between all sizes of suppliers. It appears that Ofgem has merely used headroom as a variable to ensure it arrives at a price cap figure it considers may be politically acceptable, rather than one that is firmly grounded in analysis.

Ofgem should be prepared to revisit the role of headroom while the cap is in place. It may for example be worthwhile to use competitive headroom to build a workable transition out of the temporary cap; gradually increasing the level of headroom over time for non-vulnerable customer accounts to build up competition and consumer response.

### **Customer communications**

We note that Ofgem has not set any requirements on how the default tariff cap should be communicated to customers by suppliers. We also note Ofgem's intention to change the customer communication rules from early 2019.

We are concerned that Ofgem appears to have given no detailed consideration on how to mitigate the undesired consumer behavioural effects likely to be caused by the introduction of the cap. Ensuring the cap is communicated in a way which still encourages consumers to consider their options should be seen as critical. This should be of particular priority given the expectation of a rising market where consumers remaining on a variable, albeit capped, tariff would lead to many consumers seeing their bills increasing and paying more than necessary.

We continue to believe that the design of the default tariff cap needs to be accompanied by strong supplier licence conditions that ensures a capped default tariff is communicated carefully, avoiding suppliers taking advantage of an incentive to engender a false sense of security among their customers.

We are concerned that Ofgem's separate proposals on a principles-based approach to supplier communications has a potential to compound these issues. For example, suppliers will still be required to provide estimated annual costs to customers at key points. In December 2018 those on SVTs may see the newly capped price rolled forward into 12-month projections. This is despite the strong likelihood that the default cap will be known to increase only three months later in February 2019, and again in August 2019 - all in the same 12-month period. In this case, and to a lesser extent in future years of the cap, consumers may receive estimated annual costs that will substantially underestimate what they will actually experience. This in turn would encourage inertia among consumers as the monetary benefits of switching will appear to be lower over the forthcoming 12 months than is likely to be the reality, as associated savings figures offered by fixed plans will be constrained by underestimated SVT projections.

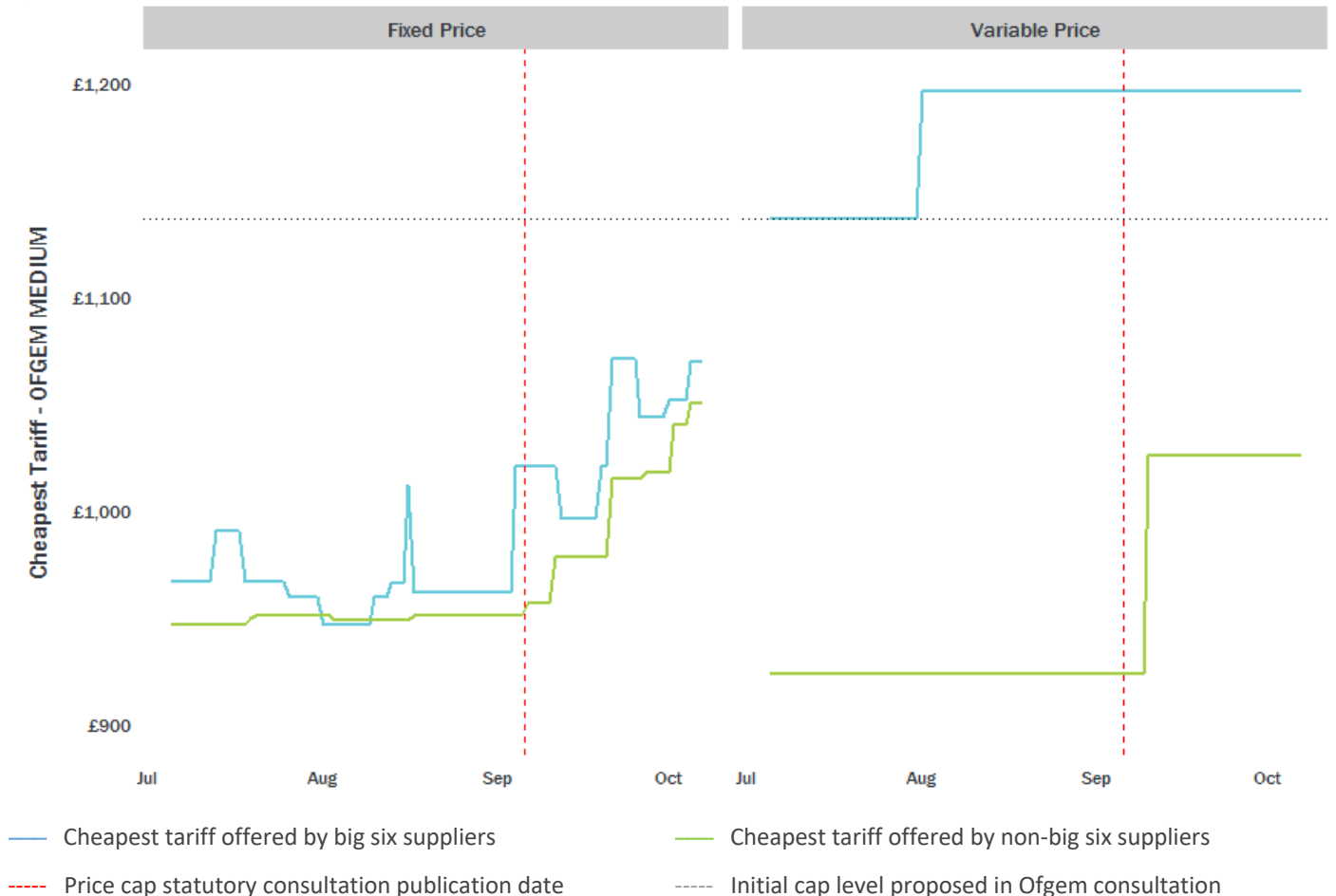
Ofgem must give genuine consideration to how to communicate these risks to consumers. This could for example include requiring suppliers to explicitly highlight the likely six-monthly regularity of price reviews, noting the specific April and October points when customers should expect a price change.

### **Market pricing impact on consumers**

We note that Ofgem calculates that 96% of SVT customers would have paid less under the proposed cap if it ever in place in 2017. Ofgem must be careful in how it considers customer impact. Ofgem's intervention is highly likely to drive up the cost of fixed tariffs at a time when an increasing number of consumers are choosing fixed price energy plans. The cap is also likely to drive more customers to revert to a default tariff when they would have otherwise taken another, cheaper fixed plan. This intervention is not a win-win. Millions of customers will have less favourable energy arrangements.

As shown in Figure 1 below, uSwitch has already seen significant movements in the fixed plan market since the publication of the statutory consultation. Even before the implementation of the cap, we are seeing fixed price convergence towards the proposed level of the default tariff cap.

**Figure 1 – Cheapest plans available on uSwitch by category, Ofgem average consumption, June - October 2018**



In our response to the Policy Consultation, we agreed with Ofgem’s proposal to review and update the cap every six months. We considered 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. We are disappointed that Ofgem does not appear to be planning to apply such an approach to its reviews of the cap.

We note Ofgem is proposing a 6-2-12 semi-annual approach to the wholesale energy costs allowed for under the cap. We agree that smoothing out seasonal changes in energy prices is desirable. We also note there are risks that, given the changes in wholesale prices, suppliers may under-recover the costs they legitimately incur given the two-month lag between the announcement of the new cap level and when it comes into effect. We are concerned that this approach, coupled with setting such a limited level of headroom, may make the risk of under-recovery more material.

**Customer service level impact on consumers**

In addition to pricing impacts on consumers, we are highly concerned that Ofgem’s approach on supplier efficiency will force suppliers to significantly reduce customer service experience to levels lower than would be expected from an efficient large supplier in a fully competitive market. We see this risk particularly among the incumbent suppliers with a greater number of vulnerable customers representing a higher cost to serve. While we entirely accept that energy suppliers should be more efficient, if Ofgem errs on this point, it will deliver service levels below that which customers would be demanding.

As we noted in our response to the Policy Consultation, we do accept that need for price protection for customers in a genuinely vulnerable situation. We remain disappointed that Ofgem has not considered our suggestion of a progressive and dynamic approach that could have provided deeper protection to those who are genuinely vulnerable. 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. In reality, in trying to implement a one-size-fits-all cap there is a major risk that vulnerable consumers will not realise savings which make a material difference to their particular situation yet may suffer the consequences of suppliers cutting any discretionary schemes and customer service functions.

### Conditions for effective competition

We note that Ofgem intends to engage on what it considers to be the conditions for effective competition in 2019. We consider this a critically important piece of work that uSwitch looks forward to engaging with.

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. 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. We believe that Ofgem must pay close attention to the impact of the cap to ensure that the conditions for effective competition are reached as soon as possible. uSwitch intends to carefully track this.

Noting its importance, we consider it incorrect in terms of process for Ofgem not to reach a conclusion on conditions for effective competition before finalising its methodology for the cap. It is clear that the cap itself is likely to have a detrimental impact on the conditions for effective competition in market and therefore should be considered holistically. For a cap that could be in place for up to five years it is not correct to simply assume that on its removal the prior consumer behaviours conducive to active decision making, that have taken years to build to the current point, would return to current levels.

In line with this, we note that Ofgem is implementing the default tariff cap based on the findings of its impact assessment. We firmly believe that Ofgem should commit to reviewing its impact assessment annually. If Ofgem subsequently found that its assessment of the benefits of the cap no longer outweighed the cost, it would be right for Ofgem to propose removing the cap regardless of whether certain regulatory projects identified as part of the conditions for effective competition had or had not yet been completed.

### Conclusions

We have raised genuine concerns that Ofgem’s approach to the default tariff cap carries the potential for immediate and long-term customer harm through the unintended consequences that are likely to result from a remedy such as this. It is critical that Ofgem considers the impact on all consumers in the market, as well as that on particular customer groups, in order to reduce the negative unintended consequences of the cap.

While we note Ofgem’s other projects designed to improve consumer engagement, there are immediate controls it could build into the cap model to ensure it has the ability to avoid the most detrimental of impacts. Ofgem should give careful thought to how the cap itself will be communicated by suppliers and ensure the risks of remaining on variable default tariffs are fully understood by consumers. Further, Ofgem should build in greater ability to swiftly review the levers of the cap while it is in place, for example the level of headroom and its broader cost assessment, should the negative impact of the cap be beyond that of Ofgem’s impact assessment.

uSwitch continues to be committed to supporting evidence-based decision making on these matters and to that end remains willing to provide Ofgem with relevant data should it want to review market impact.

Yours sincerely,



Richard Neudegg  
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