



Response to the CMA Proposed Remedies (Public version)

Introduction

As we have stated in our collective responses to the CMA's investigation to date, we see two major problems with the current energy market. The first problem arises as a direct result of the ability of incumbent suppliers to use their stock of disengaged customers to segment the retail energy market. The direct means by which suppliers segment the market is by engaging in both loss leading and excess profit taking. The second problem is the current overly proscriptive and complex regulatory framework. In light of these problems, we welcome the CMA's overarching findings that:

1. Customers are generally disengaged
2. Customers are being overcharged and the Big Six are making excess profits, and
3. The regulatory framework is a barrier to competition and does not benefit customers.

From OVO's perspective, the impact of the two key problems we identified is that the retail energy market is needlessly complex, opaque and in many cases unfair to both customers and smaller independent suppliers. These problems have also been a major contributor to the lack of both trust and innovation levels across the retail market. A direct consequence of the lack of innovation, is that customers are provided with only a limited choice of tariff options. This outcome is not consistent with a fair and competitive market.

The purpose of this response is twofold. In the first section we reiterate some of the remedies we proposed in the remedies paper we submitted to the CMA¹. The latter section is devoted to considering the specific remedies the CMA have proposed.

As a guiding principle throughout this paper, we do not assume that competition should be an objective in and of itself. The goal should not be to attempt to design a perfectly functioning economic model which does not reflect or deliver what is in a customer's best interests. Our primary test of a proposed remedy is that it must demonstrate material

¹ Ovo (2015) *Energy Market Investigation: Proposed Remedies*

benefits to the customer in order to warrant introduction. If we are satisfied this has been established, we then shift our attention to assessing whether the proposed remedy is suitably effective at promoting fair competition for the benefit of customers and the market. We are also guided by our belief that a well functioning retail energy market should be simple, transparent and fair.

SECTION 1: OVO'S PROPOSED REMEDIES

A. INTRODUCTION OF A COST REFLECTIVE PRINCIPLE (CRP)

Outline of a CRP

As per the Ovo Energy, Proposed Remedies paper², we propose that Ofgem introduces a regulatory principle that forces suppliers to price tariffs according to their cost. At the time we proposed this remedy, we were unaware of the CMA's intention to introduce a safeguard tariff. We compare and contrast the two in our response to Remedy 11 below.

A specific cost reflective principle would be introduced in tandem with the overall transition proposed by Ofgem to principles-based regulation (**PBR**), of which we are highly supportive. We are aware that Ofgem is minded to consult on the areas of the energy market that would benefit from a transition to PBR and we detail our broader recommendations in the following section.

We believe that the introduction of a CRP would directly remedy the problem associated with incumbent suppliers using their stock of disengaged customers to segment the retail energy market. Our proposal is simple: a tariff that is not priced fairly in relation to underlying costs should not be allowed. This means that tariff prices that are priced at levels significantly below or above cost would trigger review by the regulator, with stringent penalties if they are found not to adhere to the principle. In this way, the CRP would prevent suppliers from engaging in either loss-leading or overcharging.

² Ovo (2015) *Energy Market Investigation: Proposed Remedies*

As our response to the CMA's Updated Statement of Issues showed, the price differentials between some suppliers' cheapest tariffs and their SVTs are very large. It is not clear that these large differences can be explained by differences in costs to serve or differing hedging strategies. In fact, the CMA have found³ that is only by virtue of the fact that;

"a certain proportion of customers will revert to the SVT (for which there is a bigger margin) that they can offer the cheapest of their non-standard products."

In other words, the lower returns made by suppliers during a fixed period (usually the introductory term of a customer's contract with them) are sustainable only on the expectation of greater returns in a subsequent period when those customers are moved to higher tariffs. We would argue that if it should be proven that these non-standard products appear to be priced below cost, as is our suspicion, then this is by definition a loss leading pricing strategy. The implication of this strategy is that suppliers can undercut lower-cost potential entrants, by subsidising any losses they make by earning excess returns on disengaged customers who are found to have been overpaying for their energy. This strategy serves to insulate incumbent suppliers from competitive pressures, undermining the primary benefit of a fair competitive market; downward pressure on costs.

We feel that the introduction of a CRP, coupled with clear guidelines and a framework for robust enforcement, would significantly reduce the current price difference between fixed and variable tariff offerings in line with the true costs associated with each. This would mean that a supplier's ability to compete would be wholly dependent on how well they deliver efficiency savings and innovative products. The long term gain for the customer is clear; to remain competitive, a supplier would need to be both innovative and efficient, passing on the savings they make to try and acquire new customers whilst retaining existing customers by maintaining a high quality of service. An improvement in the standard of service would also be expected to follow as the potential for cost based innovations are exhausted over time and the marginal benefit to customers becomes reorientated towards greater choice and other non price related values.

³ CMA (2015) Summary of provisional findings report, Paragraph 104

Under the CRP:

a) Suppliers must be able to justify shorter-term, deeply discounted tariffs on a cost basis. After the CMA's extremely detailed analysis of the financial models of the Big Six suppliers, it is still not clear how the large differentials between their SVT and deep-discounted tariffs can be justified.

b) Ofgem should be able to seek evidence from suppliers that any tariff they offer is priced according to the costs imposed on the supplier. Suppliers that are unable to adequately substantiate a tariff must immediately withdraw them. Potential penalties could include; bans from marketing activities or the repayment of excess profits to customers where justified. Persistent abuse would merit the suspension or loss of their supply licence.

Additional benefits of a CRP

While, we would envisage that the primary benefit of a CRP would be a reduction in the price differential between fixed and variable tariff prices in line with costs, the adaptable nature of a principles based regulatory approach would also prohibit other forms of unfair pricing.

SECTION REMOVED

B. ADOPTION OF PBR BY OFGEM

Good regulation is a prerequisite for a fair and transparent energy market. As we set out in our Remedies paper⁴, we consider that the current volume and complexity of regulation in the energy retail market acts as a significant barrier to entry and expansion in the market by independent suppliers. In turn this has limited innovation and development of competitive business models which would benefit consumers and drive the evolution of the market as a whole.

⁴ Ovo (2015) *Energy Market Investigation: Proposed Remedies*

In recent years, these rules have become ever-more detailed and proscriptive. A move towards PBR, focused on an overall priority of 'treating customers fairly and avoiding customer harm', would force suppliers to consider the best interests of customers in any decision they make - rather than figuring out how to implement the complex rules about what information should go on which specific part of an energy bill, for example.

We therefore strongly support Ofgem's review and consideration of moving towards PBR, which we believe is essential to meeting the CMA's goal of engaging inactive consumers and protecting their interests. Ofgem's current Standards of Conduct provide a good starting place. Enforcement decisions in recent years also provide a strong body of case-law which could guide enforcement action in the future.

The success of such a principles-based approach is dependent on a regulator who is willing and able to take swift and meaningful action to address non-adherence.

A review of the current regulatory regime must also include a review of how Industry Code changes are decided upon. Pro-competitive measures such as cash-out reform, Project Nexus, half-hourly settlement and faster switching are often mired in committees that take years to come to decisions. This cumbersome process is also damaging to competition, as the sheer volume and obscurity of the code process effectively excludes independent suppliers from the regulatory development process without huge investment in expertise, meaning the committees of decision makers are largely comprised of incumbents with little vested interest in changing the status quo.

We therefore propose:

- a. A rigorous, wholesale review of all regulation including removing the four tariff restriction under RMR, restrictions around cash discounts and overly-complicated information to consumers which inhibit innovation and ultimately fail to benefit consumers.
- b. Move towards PBR based on the Standards of Conduct.
- c. A review of how Industry Codes are formulated and implemented, making the process as open, transparent and fair as possible.

C. PROPOSAL FOR A SOCIAL TARIFF FOR THE MOST VULNERABLE CUSTOMERS

The primary remedy we proposed as a solution to the problem associated with inactivity in the market was the introduction of a social tariff⁵. The CMA's willingness to consult on the introduction of a safeguard tariff demonstrates that it is willing to prioritise customer protection over strict adherence to economic principles, a view we wholeheartedly support. On the evidence of this approach we would be confident that it is within the scope of the CMA to introduce a social tariff. The social tariff we propose, would be designed to achieve both customer protection and improve market outcomes. It would seek to alleviate fuel poverty, a key social issue which is estimated to be affected in excess of 2 million households. It would offer the most vulnerable in society a means to re-engage themselves in the energy market, safe in the knowledge that they will always secure a better outcome than the current status quo for many. Finally, it would reduce the extent to which vulnerable customers could be taken advantage of by incumbent suppliers, curtailing the latter's ability to engage in unfair pricing tactics such as loss leading and overcharging.

The full details of what we proposed are contained within our the remedies paper that we submitted to the CMA⁶.

We compare and contrast OVO's proposed social tariff and CMA's safeguard tariff below in our response to Remedy 11. In summary we are of the opinion that our social tariff has merits that go beyond the safeguard tariff proposed.

⁵ For a full analysis on OVO's social tariff, please see OVO Remedies etc etc.

⁶ Ovo (2015) Proposed Remedies

D. A NOTE ON CHANGE OF TENANCY

In the remedies paper that we submitted to the CMA⁷ we did not propose a remedy that sought to address the issues relating to the cost to suppliers associated with tenancy changes. The issue came to our attention while reading the responses of several members of the Big Six to the CMA's Updated Issues Statement. One particular member⁸ of the Big Six explained to the CMA that;

"Our deemed tariff is a temporary price for customers who have moved into premises that we supply. It is generally higher than our negotiated prices as a result of ...the higher price and volume risks to which we are exposed because these customers do not have fixed term contracts and can switch at any time."

To mitigate against these risks we are proposing that energy accounts should only be tied to customers and not to properties.

The idea for this proposal is borrowed from the Texas retail energy market where there is no obligation for a customer to stay with their energy supplier when changing their residence. Suppliers are also not allowed to charge these customers exit fees if, for example they are on a fixed contract, once the customer provides evidence that they are indeed changing residence. When a customer leaves a residence a "move-out transaction" is sent from the supplier to the distributor and the supplier loses all relationship with the premises. The distributor will then arrange to have the supply to the house disconnected.

It is important to note that the Texas retail energy market is different to the UK market in that it has a higher penetration of smart meters and distributors have access to an advanced data management system. This means that in some instances a distributor can disconnect a property remotely. Despite this added level of technical sophistication in the Texas retail market however, there is still a cost associated with disconnecting the supply of energy to the premises. This cost creates an incentive for all parties to find a means of

⁷ Ovo (2015) Proposed Remedies

⁸ Centrica Response to the Updated issues statement (2015)

maintaining the supply of energy to the premises by ensuring that the new resident opens a new energy account as soon as possible.

There are some clear benefits of the Texas model which could address the issues identified by the CMA. It removes "deemed" or out of contract tariffs which in turn reduces the price of certain energy tariffs and the likelihood of customers falling into bad debt. Also it forces customers to engage by actively having to select a supplier and tariff when moving into a new home. If implemented in conjunction with the safeguard tariff as proposed in Remedy 11, the transitional period of the safeguard tariff could end when there are no longer customers on out of contract tariffs. Also, we understand that the Texas energy market has quite a high rate of switching which may result of the change of tenancy model they have adopted which forces customers to actively choose their suppliers and tariffs on change of tenancy. Unfortunately we do not have access to accurate data which would allow us to examine what proportion of all switches are change of tenancy switches but we would encourage the CMA to investigate this further.

In the time afforded to us to consider this proposal we have not been able to examine the detail of how tying energy bills only to customers would work in practice in the UK energy market. It remains unclear to us whether there is potential for this policy to be delivered without a significant increase in the number of smart meters, in addition to other technical changes. For this reason we are only recommending that the CMA consider how such a remedy to the energy market might work in conjunction with other measures to address, in essence, the risks faced by suppliers which leads to high tariffs.

Ovo Answers to specific questions

While we welcome the opportunity to respond to both the CMA Proposed Remedies and Provisional Findings papers, a fully considered analysis has been made impossible by the short deadline for response. We are conscious that the Energy Market Investigation must be completed in a timely manner, however we feel that there is a danger that industry participants, with direct experience of operating in the market, will not have sufficient time to consider the CMA's proposed remedies in the detail required.

REMEDY 1

Introduction of a new standard condition to electricity generators', suppliers', interconnectors', transmission, and distribution licences to require that variable transmission losses are priced on the basis of location in order to achieve technical efficiency.

Remedy 1 Ovo condensed answer

We would support in principle any proposal that reduces losses which would in turn would benefit consumers.

All costs associated with transmission losses are eventually paid by the consumer, hence any proposal that would seek to reduce such losses would be benefit consumers. We did not have sufficient time in the consultation period afforded to us to examine the implications of this issue in greater depth.

REMEDY 2A

DECC to undertake and consult on a clear and thorough impact assessment before awarding any CfD outside the CfD auction mechanism

REMEDY 2B

DECC to undertake and consult on a clear and thorough assessment before allocating technologies between pots and the CfD budget to the different pots

Remedy 2A & 2B OVO condensed answer

- We support the introduction of remedies 2a and 2b, on the grounds that they should reduce the policy uncertainty with regard to support for renewables.
- We are deeply concerned that the future strike prices agreed for some CfD contracts will impose substantial costs on the customer.

We welcome the CMA's proposals with regard to Remedy 2a and 2b and have combined our responses to both sections here.

OVO has been highly critical of the current policy environment for low carbon technologies for a number of reasons, chiefly the lack of policy certainty and stability which it exhibits and the detrimental effect this has on cost of capital and therefore customer bills. It is not clear to us that the current policy framework is creating the stable investment environment necessary to deliver energy related infrastructure at least cost. We are particularly concerned that investors will insist on higher risk premia to deliver future projects, an insistence which will ultimately increase the cost to the consumer of delivering the necessary transition of the energy sector.

The secondary concern we have is that so many high price Contracts for Difference have been issued to certain technologies, without any clear competitive process being observed. While we appreciate that some low carbon generation stations provide minor system benefits (such as greater availability and system inertia) it is not apparent to us that the prices being negotiated are in proportion to these minor benefits.

In the case of Hinkley Point, we do not see how a strike price of £92.50 negotiated (largely behind closed doors) for 35 years represents anything resembling a good deal or fair value for customers. Should power prices continue at their current level of approximately £50/MWh in today's money, it is likely that the difference between the strike price for Hinkley and the reference price could be in the order of £42.50. If we assume that Hinkley point has an availability of 91%⁹ and always runs at full output (3,200MW) when it is available, then Hinkley would cost over £1.08 billion in annual CfD support payments.

There remains no definitive answer as to what this figure represents on customer bills, however it is clear that the Government has not applied the same approach and principles to Hinkley (and several other FID and bilaterally negotiated CFD projects, for example Tidal Lagoon Swansea) as it has to low carbon technologies more generally. These contradictions, and the Government's apparently arbitrary approach to the expenditure of billpayers' money, gives us great cause for concern.

For suppliers, the combination of policy uncertainty and the high cost of certain projects, which we would attribute to the lack of a competitive based process for support being

⁹ Consistent with DECC (20103) Electricity Generation Costs

observed, creates difficulties with regard to the future cost of supplier obligations. For these reasons we we are in favour of the CMA's proposed remedies.

REMEDY 3

Remove from domestic retail energy suppliers' licences the 'simpler choices' component of the RMR rules.

Remedy 3 Ovo condensed answer

We strongly support removal of the four tariff cap rule and would encourage further RMR rules to be repealed.

We strongly support the removal of the four tariff cap rule as we feel that it has not demonstrated any noticeable changes to customer behaviour. In OVO's experience, it has served only to stifle innovation by suppliers and resulted in customers having access to a limited range of tariffs, which in turn has reduced the intensity of competition in the market.

We argue however that this remedy needs to go further in repealing more aspects of RMR which are having the same effects in the market and ultimately failing to work to the benefit of consumers. For example:

- The restrictions of cash discounts to dual fuel and online account management only. Discounts are a key tool for any retailer in developing attractive, innovative tariff structures.
- The rules around cheaper tariff messaging and tariff information labels. We understand the need to mandate a minimum level of information that needs to be provided to customers, but retailers should have flexibility to tailor how they communicate to customers and a balance between the two needs to be reached.
- The requirement to send annual communications and annual statements to customers. We do not understand how this requirement has benefited customers

since its introduction. Customers are likely to be further confused by receiving yet more information from their suppliers.

We understand and continue to support the intention underlying this restriction - namely promoting simplification and transparency to customers - but we do not agree that RMR's restrictions around tariff setting and information are the right approach to fulfilling that intention. Indeed, since the introduction of RMR there have been no perceivable benefits to customers - a large portion remain disengaged and confused by the market. We believe therefore that removing such restrictions, in conjunction with moving towards PBR, will enable suppliers to innovate to a greater extent while protecting customers by having simple overarching principles that require clear, transparent information to give to customers to enable them to make informed choices.

REMEDY 4a

Measures to address barriers to switching by domestic customers

Remedy 4a Ovo condensed answer

We see the roll-out of smart meters to domestic customers as critical to enabling faster settlement periods.

OVO is in favour of increasing the roll out speed of smart meters to domestic customers. We believe that this is a key step in providing the infrastructure needed to eventually move to half hourly electricity settlement for domestic customers. We would be in favour of creating an incentive to increase the demand for smart meters amongst energy consumers. Our current thoughts revolve around the idea that smart meter customers should not have the cost of unallocated electricity or gas added to their energy bills. This would mean that customers with smart meters would be billed on the basis of their consumption as recorded on their smart meters. However, we are uncertain of how this process would work without half hourly settlement.

We do not agree that suppliers that fail to switch customers within 17 days should be penalised. We consider it more proportionate to have suppliers refund the customer the costs associated with the switch having not taken place, in addition to a compensation to the customer similar in principle to existing Guaranteed Standard payments for missed or late appointments. This could be further streamlined by standardising the rate at which customers are compensated (again similar to Guaranteed Standards). This approach would act as an incentive to suppliers to switch customers promptly, while having consequences that are simple to administer and for customers to understand.

We are in favour of the cooling off period being either reduced or removed altogether. The purpose of the cooling off period was largely to provide customers with an added level of confidence to transact online¹⁰. However as many suppliers no longer charge exit fees the customer is free to end their contracts at any time at no cost, thereby making the cooling off period largely redundant in our opinion.

SECTION REMOVED

REMEDY 4B

Removal of exemption for Centrica on two-year inspection of gas meters

We have no comments on this proposal.

REMEDY 5

Requirement that energy firms prioritise the roll-out of smart meters to domestic customers who currently have a prepayment meter

Remedy 5 Ovo condensed answer

We support this proposal.

Ovo is in favour of prioritising the roll-out of smart meters to domestic customers who currently have a prepayment meter. We feel that this is a key step in providing the

¹⁰ Directive on Consumer Rights (2011/83/EC)

infrastructure needed to eventually move to half hourly electricity settlement for domestic customers. We would be in favour of creating an incentive to increase the demand for smart meters amongst energy consumers. Our current thinking is that smart meter customers should not have the cost of unallocated electricity or gas added to their energy bills. This would mean that customers with smart meters would be billed directly on the basis of their consumption as recorded on their smart meters. This would be predicated on suppliers being afforded the means to submit the consumption data to Elexon.

REMEDY 6

Ofgem to provide an independent price comparison service for domestic (and microbusiness) customers

Remedy 6 Ovo condensed answer

We welcome this proposal, yet do not foresee that a future Ofgem site would act as a major competitor to existing PCW sites.

SECTION REMOVED

The commercial realities of digital marketing mean that it is unlikely that Ofgem's price comparison site would be capable of competing with existing comparison sites which earn revenue streams and have greater experience with attracting and advertising to customers. For this reason we would foresee the main benefit of an Ofgem price comparison service as providing consumers with the comfort of being "endorsed by the Government" and having no commercial interests driving its operation. This could be extremely helpful in engaging customers who currently suffer from a lack of trust in the market as a whole which disincentivises them from shopping around. We have seen from Ofgem and CMA analysis that a higher proportion of these customers are vulnerable, especially the elderly, and we would expect them to respond especially well to a free service provided by a trusted public body.

SECTION REMOVED

REMEDY 7a

Introduction of a new requirement in the licences of retail energy suppliers to provide price lists for microbusinesses on their own websites and to make this information available to PCWs

Remedy 7a Ovo condensed answer

We support this proposal in the hope that it will improve transparency and fairness in the Microbusiness sector.

We agree with this remedy proposed by the CMA. Our experience of the Microbusiness retail energy market is that it is less transparent than the domestic market. Requiring energy suppliers to publish price lists should improve the level of transparency in this section of the market and as such should improve market outcomes. We currently publish price lists for Microbusiness customers on our website.

REMEDY 7b

Introduction of rules governing the information that TPIs are required to provide to microbusiness customers.

Remedy 7b Ovo condensed answer

We support this proposal and would be in favour of having the confidence code applied to TPI's in addition to having to disclose their commission levels with their commercial partners.

We agree with this remedy proposed by the CMA. As we have mentioned in our answer to 7a, our experience of the microbusiness retail energy market is that it is less transparent than the domestic market.

SECTION REMOVED

We would propose that the confidence code that is applied to PCW sites in the domestic market be considered as the model that dictates what information TPI's should be required to provide.

REMEDY 8

Introduction of a new requirement into the licences of retail energy suppliers that prohibits the inclusion of terms that permit the auto-rollover of microbusiness customers on to new contracts with a narrow window for switching supplier and/or tariff

Remedy 8 Ovo condensed answer

- We are in favour of this remedy.
- We propose that the microbusiness sector should be scrutinised further by Ofgem

Once again we are in favour of this remedy. We feel that auto-rollover terms in contracts are unfair and restrict the ability of customers to engage in the market. We are also in favour of suppliers having to notify that a contract is coming to an end. The measures the CMA has proposed in remedy 7 should also improve engagement of these customers. We would also like to see an increase in the level of protection afforded to microbusinesses by Ofgem. We accept that these sectors are businesses rather than domestic customers however given the nature of the CMA's findings with regard to the microbusiness sector overall, there is a clear need for greater scrutiny by the regulator of practices in this market sector.

REMEDY 9

Measures to provide either domestic and/or microbusiness customers with different or additional information to reduce actual or perceived barriers to accessing and assessing information

Remedy 9 Ovo condensed answer

We are in favour of increasing the information available to microbusiness customers but would caution against the level of information being mandated by proscriptive rules

We think there is an important distinction to be made between quality and quantity with regard to the level of information that customers require. The regulations applying to energy bills are far too focused on mandating the quantity of information with little regard to the quality, its accessibility and its ability to engage customers. We believe this quantity based focus is a major obstacle to increasing consumer engagement and must be re-considered.

As we have stated in Ovo's response to the CMA Updated Issues Statement¹¹ and earlier in this paper, we believe the sheer volume of proscriptive legislation serves as a barrier to improving customer engagement levels. We think that a transition to (PBR) would be especially effective at addressing these issues.

We also believe that PBR would allow suppliers to work with Ofgem to come up with novel and innovative ways to inform customers that would promote greater engagement in the energy market.

REMEDY 10

Measures to prompt customers on default tariffs to engage in the market

Remedy 10 Ovo condensed answer

We support this remedy in principle provided that the level to which communications are regulated and the content of communications are kept to a minimum.

We consider it important when designing measures to prompt customers to engage in the energy market, to note the delicate balance between the quality and quantity of the information provided. Historically we have argued that Ofgem has tended to favour an approach more focused on quantity. Our opinion, as a trusted retail brand with a proven

¹¹ Ovo (2015) Response to the CMA's Updated Statement of Issues

track record of customer engagement, is that this approach may have simply disengaged customers further. We have cited the specific example of the impact of information related regulation on customers energy bills in previous CMA submissions.

That being said, we think there is a need for customers on either deemed tariffs, or the proposed safeguard tariff, to be regularly prompted to engage in the market. Our proposal is that the bills of deemed or safeguard customers must have a prominent section set aside for a direct message from Ofgem. This message would be simple, concise and informative and would set out the following information:

- a. that the customer is on a deemed/safeguard tariff with their supplier
- b. that the customer is likely to save a considerable amount by switching tariffs, and
- c. that Ofgem runs a website by which customers can switch tariffs (assuming remedy 6 is implemented)

We believe that restricting the messaging to these three sentences would convey all the information customers would need to decide whether or not to engage, without risking that they ignore the message and/or misinterpret it.

REMEDY 11

COMPARISON OF A CRP WITH THE PROPOSED SAFEGUARD TARIFF

Remedy 11 Ovo condensed answer

- We support the underlying intention of the safeguard tariff.
- We believe that a mandatory principle of cost reflectivity (as outlined above) would provide a more effective and sustainable remedy than a safeguard tariff.
- If a safeguard tariff is introduced we propose certain controls around how it is calculated and communicated to consumers.
- We have submitted a recommendation as to the price the safeguard tariff should be

At the time we proposed this remedy, we were unaware of the CMA's intention to introduce a safeguard tariff. From our understanding of the CMA's proposal, it would seem that the primary purpose of the safeguard tariff is to protect inactive customers

from being overcharged. Our opinion is that this goal could be better achieved by a CRP which would force suppliers to price in a much fairer and transparent manner. Perhaps most importantly, a CRP is unlikely to impact customer behaviour directly and should therefore not reduce the level of customer engagement in the market. An aspect of the proposed safeguard tariff we find worrying is that a safeguard tariff may promote greater levels of customer inactivity, as customers feel that they are getting the best deal available to them by virtue of being on the safeguard tariff.

In our opinion introducing a CRP would be a far simpler remedy which would not necessitate complex temporary or transitional arrangements. The regulation could be introduced in a much shorter timeframe, with guidance updated on the basis of commodity price movements. This would allow Ofgem to insist that suppliers pass on the savings they make from any wholesale price reductions to customer straight away.

In the short run, a CRP would allow Ofgem the added flexibility to prioritise investigating the truly unfair tariffs without prejudice to those that are fair. Suppliers that offer cost based low prices on the basis of their greater efficiency would fully reap the rewards of their innovation. The flexibility afforded to Ofgem would also allow suppliers to continue to offer tariffs that are legitimately more expensive on the grounds that they offer an additionality element. An example of a legitimate additionality would be green tariffs or a tariff that includes a charitable donation.

In the long run, it is foreseeable that once the principle became suitably well established, suppliers would be capable of distinguishing between fair and unfair prices themselves. In this scenario the retail market would arguably be capable of self regulating. All parties will be aware of what is fair and unfair, therefore potential transgressors would be deterred by the knowledge that they will be reported to Ofgem by other suppliers.

Overall we welcome and fully support the intent behind the proposed safeguard tariff but feel that this solution, even when supported by the suite of other remedies proposed, falls short of a full solution to the problem of incumbent suppliers using their stock of disengaged customers to segment the retail energy market. Nevertheless, if the CMA is minded to introduce a safeguard tariff as the primary solution to removing the

potential for suppliers to engage in unfair pricing tactics, we would support this proposal. Our specific view in relation to the safeguard tariff operation and price is set out later in this section.

While we welcome the fact that the CMA is prepared to propose a remedy that is aimed at removing some of the harmful effects associated with customer inactivity, we are concerned that the CMA's safeguard tariff does not afford any special protection to the most vulnerable and clearly inactive through no choice or fault of their own. It also appears unlikely that the safeguard tariff the CMA is minded to impose will achieve substantial savings that would be material to vulnerable customers.

DEFINING THE DISENGAGED

The viability of the safeguard tariff proposal will be determined by what level of reaction from domestic customers satisfies the threshold of an 'engaged customer'. Our proposal is that only customers on tariffs more expensive than the safeguard tariff price should be contacted to establish whether they are active or not. This seems logical given that customers on tariffs that are cheaper than the safeguard tariff price would not save money by being declared inactive. This proposal would also provide suppliers with an incentive to keep their tariff prices below the safeguard tariff price cap, in order to avoid having to contact their customers (we discuss the price at which the cap should be established later in this section).

In establishing the threshold or level of engagement that would qualify a customer as engaged for the purpose of the safeguard tariff proposal, we are minded to consider the following trade off: if the threshold is too low, then very few customers will be transferred to it and the safeguard tariff will become largely redundant; too high a threshold, and the process may restrict suppliers that offer additionality tariffs that direct some money towards charitable or environmental causes. Given our perception of the scale of the problems in the energy market that the safeguard tariff is intended to address, we are minded to favour a trade off that is closer to being too high than too low.

We propose that a customer would be considered disengaged provided that they fail to respond to a message or communication from their respective supplier (we discuss the content of this message later in this section). The onus would therefore be on the supplier to prove that a customer has responded to a direct communication and is suitably aware of the fact they are on a tariff that is more expensive than the safeguard tariff. This would mean that when queried the supplier would be able to produce a copy of the correspondence.

We would caution the CMA against mandating one form of communication over another as it could impose unnecessary costs and administrative burden, particularly on efficient suppliers with active customers. How suppliers choose to contact their customers should be left up to them. For this reason we are inclined to think that there should be no restriction on the number of times a supplier seeks to prompt the customer to engage. The proof needed should always be the same however, a written correspondence with a signature (digital or in print). The cost of contacting customers varies by both supplier and the means of contacting customers. If a bespoke form of contact was mandated it is also likely that some suppliers would insist on increasing the price of the safeguard tariff to account for the cost of contacting customers.

Leaving suppliers with more flexibility will allow for innovation and should ensure that suppliers uncover the best means of engaging customers. The likelihood of suppliers contacting their customers should theoretically be linked to:

- a) the price of the safeguard tariff
- b) the likelihood of the customer to switch

If the likelihood of the customer to switch suppliers cannot be known, then the decision of whether or not a supplier decides to contact them in the hope of certifying them as engaged becomes a matter of cost. Following this logic, we would argue that a lower safeguard tariff price cap will increase the propensity of suppliers to engage their customers. That being said, the importance of the threshold for establishing whether a customer is active or disengaged cannot be downplayed. If the method by which suppliers can establish consumer engagement is too lax, then it is likely that consumers will continue to remain disengaged in practice but may be proven to be engaged on

paper. The repercussions of this will be that the safeguard tariff will be circumvented and harmful pricing strategies will continue along with customers continuing to be overcharged.

METHOD OF CALCULATING THE SAFEGUARD TARIFF PRICE

We are in favour of calculating the proposed safeguard tariff on a cost plus basis. Our proposal is that Ofgem would update the cost calculation at six month intervals to coincide with mid-winter and mid-summer dates, (January 1st and July 1st of each year). The reason we are in favour of a 6 month cost review process is that changes in safeguard tariff prices would serve to re-engage customers in much the same way that changes in SVTs currently do. A less frequent review process - e.g. annually - would be less engaging for customers. We chose mid-summer and mid winter dates so that a forward looking hedging strategy of, 6, 12 or 18 months would contain as many summer months as winter months.

As part of our response to this section we made a basic calculation of the estimated costs incurred by an energy supplier in supplying an average variable tariff customer. The model we used for the average customer uses the current Ofgem typical domestic consumption value for a medium user (3,200 MWh of Electricity and 13,500MWh of Gas per annum).

To generate our cost estimate we assumed that the supplier is large enough to meet the thresholds of all current government, social and environmental schemes. This means that our model includes an estimate of the cost of schemes such as the warm home discount scheme in addition to all the wholesale and networks costs that all suppliers face.

The other major assumption we made is that the hedging strategy on which the costs are calculated is based on an 18 month period. While we consider that a safeguard tariff should remain flexible to accommodate wholesale commodity price changes, we acknowledge that a longer time period creates greater price certainty for customers. We feel that an 18 month time period is a fair compromise between these two goals. The

other assumptions we made are detailed in Annex A. For the sake of simplicity we propose that the standing charge element of the bill be the same for all suppliers and priced at cost. Competition could therefore take place over the price of the unit rate. The benefit of this proposal is that disengaged customers would only need to compare one price (the unit rate) to consider whether or not to switch tariffs. The potential downside is that some low usage customers may see their bills increase slightly. We would hope that pricing standing charges at cost would somewhat mitigate this potential downside.

Pricing the standing charge at cost necessitates that suppliers must recover all of their margins on the unit rate. Our current thinking is that an overall gross margin of approximately 17% on top of cost should be the target rate that represents both a fair return, whilst providing suppliers with a level of headroom. This would translate to a tariff price of approximately £1080 based on our cost estimate. In our modelling a gross margin of 25% on the unit rates of both electricity and gas, equates to approximately the £1080 figure we considered as representative of a fair price.

The details of these prices are outlined briefly below and in greater detail in Annex A.

Table 1 Price cap for combined dual fuel bills under a safeguard tariff by region

Dual Fuel (All prices £'s including V.A.T)				
Region	Standing Charge	Unit Rate Elec	Unit Rate Gas	Final Tariff (inc. VAT)
10 - Eastern	154.89	0.14	0.036	1094.87
11 - East Midlands	151.63	0.13	0.036	1053.36
12 - London	157.32	0.13	0.039	1084.71
13 - Manweb	156.27	0.14	0.037	1117.44
14 - West Midlands	154.22	0.13	0.037	1067.31
15 - North Eastern	161.53	0.13	0.037	1077.85
16 - North Western	152.28	0.13	0.037	1080.09

17 - North Scotland	166.06	0.14	0.035	1085.94
18 - South Scotland	159.16	0.13	0.035	1059.93
19 - South East	158.82	0.13	0.037	1087.69
20 - Southern	148.00	0.13	0.039	1102.57
21- South Wales	155.28	0.14	0.036	1080.33
22 - South West	157.10	0.14	0.038	1119.22
23 - Yorkshire	159.29	0.13	0.036	1052.14
Average UK	156.56	0.13	0.037	1083.10

Table 2 Price cap for electricity prices under a safeguard tariff, average UK

Electricity (All prices £'s including V.A.T)			
Region	Standing Charge	Unit Rate	Tariff
Average UK	75.38	0.134	503.87

See ANNEX A TABLE A1 for the regional breakdown

Table 3 Price cap for gas prices under a safeguard tariff, average UK

Gas (All prices £'s including V.A.T)			
Region	Standing Charge	Unit Rate	Tariff
Average UK	81.18	0.04	579.24

See ANNEX A TABLE A2 for the regional breakdown

TRANSITIONAL ARRANGEMENTS

Although we are in favour of the principle of the proposed safeguard tariff, it is likely that the mechanism will prove rather complex if it is to avoid affecting certain suppliers unjustifiably, i.e. those that offer additionality based tariffs. That said we would be in favour of there being an incentive for suppliers to engage their customers, beyond the

risk that failing to disengage them will impact their profitability. We are considering a proposal that suppliers will be released from having to price at the safeguard tariff price once they can demonstrate that over 90% of their customers are fully engaged in the market.

This proposal would of course be supported by the introduction of a CRP to ensure that suppliers with a sufficient number of active customers couldn't suddenly raise prices to their disengaged customers once they cross the 90% threshold. We have also outlined how the tying of energy accounts to individuals and not premises, might remove out of contract tariffs from the market. If this policy was introduced, it would limit the need for a safeguard tariff price. We will continue to consider other ways in which the transitional phase would come to an end but will be guided by the principle that the safeguard tariff should only end once a particular outcome has been achieved. Otherwise there is a danger that many of the problems we have outlined will resurface. We think that it is a naive assumption to consider increased levels of consumer engagement as the long term solution to the problems associated with unfair pricing. As it is likely there will always be a proportion, perhaps not the majority, of customers who choose not to engage fully in the energy market.

POTENTIAL CIRCUMVENTION ISSUES

Once again we wish to reiterate that our proposed remedies, outlined earlier, are designed in such a way as to prevent suppliers from circumventing their intentions. The lack of a defined consumer group (such as vulnerable customers), in particular makes it inevitable that certain suppliers will succeed in circumventing the intentions of the safeguard tariff to the detriment of a number of customers. With regard to the issue of suppliers being able to circumvent the safeguard tariff we acknowledge that there is a fine balancing point to achieve between ensuring compliance without stifling innovation.

In the current retail market there are several suppliers whose tariff prices will always be more expensive than our proposed safeguard tariff price due to the additionalities they seek to achieve. The proposed safeguard tariff eligibility criteria should therefore be

designed to allow suppliers to continue to offer tariffs which support charities or environmental goals.

We also acknowledge that there is a potential for suppliers to attempt to mislead or dupe customers into choosing to remain on a high priced SVT and thus circumvent the intention of the safeguard tariff as currently proposed. It would appear to us that a well designed communication system should ensure that both goals can be achieved.

Customers that chose higher priced tariffs on the basis that they deliver additional societal or environmental benefits will have done so by choice. Hence they should be willing to continue paying for their energy in this form and will be unswayed by tariff messages suggesting that they are on a tariff that is more expensive than the regulated safeguard tariff. In contrast, customers who are inactive are presumably unaware of the tariff they are on or perhaps the price they are paying for their energy.

REMEDY 12a

Requirement to implement Project Nexus in a timely manner

Remedy 12a Ovo condensed answer

- We are in favour of any solution that increases the speed at which Project Nexus can be implemented.
- It is unclear whether this proposed remedy would make a material difference to the timescale

While we recognise that the latest delays to Project Nexus come on foot of a report from PWC, stating that suppliers would be incapable of meeting the October go live date, it is our understanding that many parties consider XoServe's lack of readiness the more substantial issue. A proposal¹² has come to our attention which suggests that Price Waterhouse Coopers (PWC) be commissioned to extend the scope of their work to scrutinising XoServe's readiness to implement Nexus in a timely manner. We would be in favour of this proposal if this appears to be the major obstacle to introducing Nexus sooner rather than later. We are unsure however, whether this proposal would be within the scope of the CMA to implement.

¹² Industrial & Commercial Shippers and Suppliers (ICoSS) Group letter to Ofgem

REMEDY 12b

Introduction of a new licence condition on gas shippers to make monthly submissions of Annual Quantity updates mandatory

Remedy 12b Ovo condensed answer

- We are in favour of this remedy being implemented.
- We would also be in favour of extending the use of monthly AQs to gas transportation charges.

Ovo is in favour of this proposal as it will hopefully improve fairness and transparency in the gas settlement process and reduce the ability of certain market actors to game the system. The current system creates the potential for shippers to engage in gaming to reduce their costs whilst effectively increasing those of their competitors. Such behaviour clearly adds additional cost to suppliers who do not engage in gaming. There is also an increased risk for customers that more of the price they pay represents unallocated gas, which is beyond their control to reduce.

In light of these costs we are confident that the efficiency savings gained from having a fairer market will exceed the increase in operational cost that may occur as a result of shippers having to report their AQs on a more frequent basis.

In addition to this proposal we would also be in favour of extending the use of monthly AQs to gas transportation charges. This would seem the logical next step to align the entire gas settlement process and would remove any potential for gaming further upstream. If there is a timing mismatch between these processes it is likely that an arbitrage or gaming opportunity will arise.

An additional benefit of a more frequently updated gas settlement process is that customers who install energy efficiency measures (that are effective in reducing gas consumption) will realise the benefits sooner and make more immediate savings on both the capacity and usage element of the final gas price they pay.

REMEDY 13

Requirement that domestic and SME electricity suppliers and relevant network firms agree a binding plan for the introduction of a cost effective option to use half-hourly consumption data in the settlement of domestic electricity meters

Remedy 13 Ovo condensed answer

- We strongly agree with the intent of this proposal but have no specific comments as to how effective this remedy would be.

We are very much in favour of this proposal but due to the time constraints we have faced in responding to this paper cannot provide any evidence of the benefits to customers of this proposal being adopted. We would advocate that a non industry party such as DECC should lead this process.

REMEDY 14

Remedy to improve the current regulatory framework for financial reporting

Remedy 14 Ovo condensed answer

- We are in favour of the current regulatory framework being improved using the consolidated segmental statements as the starting point.
- We think all suppliers that have in excess of 250,000 accounts should have to submit these accounts.

We would be in favour of this proposal provided that it was designed to build on the current framework of the consolidated segmental statements and not propose to replace it. We would also be in favour of extending the obligation to disclose consolidated segmental statements to suppliers that exceed 250,000 accounts. Ovo currently produces a segmental statement account modeled on those issued by the Big Six suppliers on a voluntary basis.

We would assume that the most valuable element of requiring suppliers to submit granular financial reports is the insight it gives regulators into supplier's margins,

especially their indirect costs and profitability. This would help more efficient suppliers demonstrate to customers, regulators and investors that they are better managed than the Big 6 - and hence would increase pressure on the industry to become more efficient.

We would be in favour of introducing an obligation for suppliers to report their customer numbers on a quarterly basis. This quarterly obligation would include a breakdown of the percentage of customers that a supplier has on each of the tariffs they offer.

REMEDY 15

More effective assessment of trade-offs between policy objectives and communication of impact of policies on prices and bills

Remedy 15 Ovo condensed answer

We are in favour of this proposal as energy supply requires long term certainty to deliver the lowest possible prices to customers.

A significant number of cost elements in the energy industry are forecasted quite far in advance, typically between 1-2 years ahead. It is therefore quite difficult for suppliers to adapt to policy changes that are sudden or unforeseen given that all of the commercial decisions we're made on the basis of forecasts of what future costs will be.

REMEDY 16

Revision of Ofgem's statutory objectives and duties in order to increase its ability to promote effective competition

Remedy 16 Ovo condensed answer

- We are unclear whether a change in Ofgem's statutory objective will materially impact its ability to promote competition.
- We are in favour of Ofgem continuing to prioritise customers.
- We consider competition to be in the interests of customers in most cases, therefore Ofgem should have all the powers it needs to promote competition provided it leads to benefits on the customers behalf.

As our collective responses to the CMA enquiry have detailed there are two major problems with the current energy market. The first is the legacy of inactive customers with Big Six suppliers. The second issue is of overly-proscriptive legislation. The solutions we proposed to these problems both required action on the part of Ofgem to be carried out effectively.

Undoubtedly there are some elements of Ofgem's role that can be impacted by a very literal interpretation of their statutory role. The current focus on customers is we believe the correct one, which coupled with Ofgem's ability to: "*carry out its functions in the manner it considers is best calculated to further the principal objective*¹³" should provide Ofgem with sufficient powers to investigate general competition matters that are in the customers interest, which could be interpreted as all competition related matters.

Our opinion is therefore that Ofgem has all the statutory powers it requires to promote effective competition. What we would like to see is a greater focus on competition matters from a principle based approach. As we have argued in our remedies paper the Energy Market is rife for a principles based approach to general retail regulation. We have argued that the use of principles based regulation allows Ofgem the flexibility it requires to really pursue the most detrimental aspects of supplier behaviour that is counter to fair competition.

A proposal we put before the CMA is that Ofgem should impose a principle that all suppliers must charge their customers in a manner that is cost reflective to the individual customer at the given time. Practices such as loss leading or discrimination across different regional markets would therefore come under the scrutiny of Ofgem and if proven would result in the supplier having to abandon the sales policy in question.

REMEDY 17

Introduction of a formal mechanism through which disagreements between DECC and Ofgem over policy decision-making can be addressed transparently

¹³ <https://www.ofgem.gov.uk/publications-and-updates/powers-and-duties-gema>

Remedy 17 Ovo condensed answer

- We are in favour of anything that promotes greater regulatory and policy certainty.
- We have no specific thoughts as to what this process should involve.

REMEDY 18a

Recommendation to DECC to make code administration and/or implementation of code changes a licensable activity

We have no comments on this proposal.

REMEDY 18b

Granting Ofgem more powers to project-manage and/or control timetable of the process of developing and/or implementing code changes

Remedy 18b Ovo condensed answer

We are in favour of this proposal but have no specific comments.

Given the time constraints of this consultation period we have not been capable of looking at this proposal in detail. We are in favour of the proposal, yet are unclear as to whether this remedy would act as an extension of the current significant code review powers afforded to Ofgem, or grant Ofgem a different set of powers.

REMEDY 18c

Appointment of an independent code adjudicator to determine which code changes should be adopted in the case of dispute

Remedy 18c Ovo condensed answer

We are in favour of this proposal and suggest that a member of Citizens Advice Bureau be appointed to each code review group, funded by market participants.

We are in favour of this remedy. We have discussed at length in our collective submissions to the CMA the difficulties that small suppliers face with engaging in the

code governance process. Our proposal is that the independent code adjudicator would be a representative of the consumer advice bureau.

- Help ensure that in the case of a dispute the consumer's interest are always placed first
- Potential for a consumer representative to be present at all stages of the code governance process. This would require more resources on the part of the CAB. The cost associated with having a permanent member of the CAB on each code group could be split according to market share by all parties.

Annex A

Safeguard Tariff Modelling assumptions

- Costs are based on generic modelling of demand profiles, line losses, transmission losses and gcf
- All costs are shown as a generic average across regions in the month applicable
- For gas network costs, a reasonable assumption of exit zone is selected before costs are averaged over Idz region
- Commodity costs are based on the forward curve as of 27/07/2015 with an uplift for HH shaping
- Costs exclude some contractual costs and any additional IGT costs
- No risk premium is applied to any costs, but the additional risks of gas (e.g. AQ settlement risks such as weather volatility) is reflected in proposed margin

TABLE A1

Electricity (All prices £'s including V.A.T)			
Region	Standing Charge	Unit Rate (including 25% GM)	Tariff
10 - Eastern	73.83	0.141	523.58
11 - East Midlands	70.58	0.131	488.82
12 - London	76.27	0.126	478.11
13 - Manweb	75.21	0.143	534.16
14 - West Midlands	73.16	0.130	490.16
15 - North Eastern	80.40	0.129	491.82
16 - North Western	71.23	0.133	496.81
17 - North Scotland	84.67	0.139	528.99

18 - South Scotland	77.78	0.133	502.98
19 - South East	77.66	0.132	501.00
20 - Southern	66.85	0.134	496.74
21- South Wales	73.82	0.136	509.26
22 - South West	75.64	0.141	525.28
23 - Yorkshire	78.16	0.128	486.44
Average UK	75.38	0.134	503.87

TABLE A2

Gas (All prices £'s including V.A.T)			
Region	Standing Charge	Unit Rate (including 25% GM)	Tariff
10 - Eastern	81.05	0.036	571.29
11 - East Midlands	81.05	0.036	564.53
12 - London	81.05	0.039	606.60
13 - Manweb	81.05	0.037	583.28
14 - West Midlands	81.05	0.037	577.15
15 - North Eastern	81.12	0.037	586.03
16 - North Western	81.05	0.037	583.28
17 - North Scotland	81.38	0.035	556.95
18 - South Scotland	81.38	0.035	556.95
19 - South East	81.16	0.037	586.69

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20 - Southern	81.16	0.039	605.83
21- South Wales	81.46	0.036	571.07
22 - South West	81.46	0.038	593.94
23 - Yorkshire	81.12	0.036	565.70
Average UK	81.18	0.04	579.24

ANNEX B REMOVED