

## Appendix 7.1: Price cap remedies

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### Assumptions and data

1. We discuss below in more detail the assumptions and data relating to the proposed prepayment meter price cap remedy (set out in section 7).
2. In order to estimate the impact of the proposed price cap as set out in section 7 we have used tariff data and customer numbers as at 30 June 2015 and compared these against the price-cap calculated, which would be effective on that date. A number of assumptions have been adopted in performing this comparison. These are outlined below.
3. In determining the impact of the price cap on customers, we have assumed that consumption for all prepayment customers is in line with Ofgem's medium Typical Domestic Consumption Value (TDCV) in effect from January 2014 to August 2015.<sup>1</sup> We have not made a distinction between the single rate meter and Economy 7 consumption levels, and have assumed off-peak consumption for Economy 7 customers of 38%.<sup>2</sup>
4. Assumptions around the calculation of benchmark bills and regional network costs are in line with those used in the detriment calculation discussed at section 3.
5. We have calculated annual prepayment customer bills at medium TDCV as at 30 June 2015 based on the gains from switching data set. These annual bills at medium TDCV are calculated in line with the assumptions in the gains from switching analysis (see Appendix 3.2). Exclusions have been applied to remove, for example, tariffs with incomplete data, time of use and bundled tariffs from this data set.

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<sup>1</sup> Assumed annual gas consumption of 13,500 units, assumed annual electricity consumption of 3,200 units for single rate meter and Economy 7 meter customers.

<sup>2</sup> Off-peak consumption of 38% is based on the average off-peak consumption across all suppliers over the period 1 January 2012 to 30 June 2015, based on the gains from switching data set.

6. We have assumed that any suppliers with tariffs on the market where the annual bills calculated are below the cap, will remain at this level (ie the cap does not introduce a focal point effect on existing competitive tariffs netting off supplier revenue reduction).
7. We have assumed that annual savings under the cap are equivalent to the difference between annualised bills under the cap and annual bills under the customers' existing tariffs as at 30 June 2015.
8. We have assumed cost-to-serve adjustment of £22 and £32 for electricity and gas respectively (i.e. total cost differential of £54 in line with Appendix 3.6).
9. In comparing to the minimum prepayment bill, we have calculated annual bills at medium TDCV based on the gains from switching data for prepayment customers at 30 June 2015 and identified the cheapest in each region. These tariffs are not necessarily those available for new customers and include historic tariffs where customers remain on the tariff as at 30 June 2015.

#### **An alternative design for the price cap**

10. Section 7 describes our proposed design for the prepayment meter Price Cap Remedy. In the process of designing this remedy, we have also considered an alternative design (referred hereafter as the Alternative Price Cap design). As noted in Section 7, we have reached the provisional decision to propose the prepayment meter Price Cap remedy. In this appendix we describe the Alternative Price Cap design. We believe that the proposed prepayment meter Price Cap remedy is a more effective and proportionate remedy compared to the Alternative Price Cap design, based on our assessment against the key criteria of practicability, supplier incentives and accuracy discussed at paragraph 7.74.
11. In a nutshell, we consider that the Alternative Price Cap design presents the following risks:
  - (a) potential accuracy concerns as a result of the lag between the date reference tariffs were brought onto the market and the implementation of the cap informed by these tariffs (see below paragraph 27 to 30);
  - (b) existence of perverse incentives and potential mechanisms for suppliers to game the cap (see below paragraphs 60 to 61);
  - (c) practicality in terms of the significant, regular data required by Ofgem to calculate updated caps; and potential changes in the nature of competition in the reference basket which may result reduce the

effectiveness of the cap (see below paragraphs 26 and 60 to 61) which added to the concerns around perverse incentives.

12. The Alternative Price Cap design which we have considered for the purpose of this assessment is as described below (for the avoidance of doubt, the design elements described in this appendix relate solely to the Alternative Price Cap and do not relate to the proposed prepayment meter Price Cap remedy, which uses a hybrid reference price and cost index approach):
- (a) Every six months all suppliers with more than 500,000 customer accounts would submit to Ofgem details of all customers on each non-default or deemed tariff on the last day of the preceding six month period (the 'reference date').
  - (b) The details provided would need to specify how many customers were on each tariff and what the tariff structure is for each of those tariffs (eg standing charge, unit rate, any other tariff information that determines annual energy cost for the customer). Rebates and discounts would be taken into account to the extent that these are reflected in the cash price paid by a customer for their annual energy consumption.
  - (c) Ofgem would calculate the expected annual cost of each tariff assuming consumption equal to the TDCV published by Ofgem which was in effect on the reference date.
  - (d) The annual cost calculation for online only tariffs would include an additional £5<sup>3</sup> to account for the incremental cost of serving customers who are not online only (eg paper bills). The price cap would apply equally to all tariffs whether they are online only or not.
  - (e) Ofgem would calculate the projected annual cost for all customers on non-default or deemed tariffs.
  - (f) The median of the annual cost figures would be taken as the 'reference price'.
  - (g) Ofgem would add on the amounts specified in the licence in respect of 'headroom' and 'cost to serve'. The price cap level is then calculated as follows:

Price cap<sub>TDCV, region 1, period 1, meter-tariff type 1</sub> =

reference price<sub>TDCV, region 1, period 0, meter-tariff type 1</sub> + headroom

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<sup>3</sup> See paragraph 50

allowance  
+ prepayment meter uplift

The headroom allowance and the prepayment meter uplift would be specified in the licence.

- (h) The price cap would be calculated separately for each of the 14 Distribution Network Operator (DNO) regions. Only prices offered in a particular region would feed into the reference price for that region. The headroom allowance and prepayment meter uplift would be the same across all regions.
- (i) The price cap would apply for a period of six months (the 'price cap effective period') from a date three months after the reference date. This exercise would be conducted for each of the 14 DNO regions and for each of the three different meter-fuel type combinations:
  - (i) Single rate meter, gas.
  - (ii) Single rate meter, electricity.
  - (iii) Economy 7, electricity.
- (j) The price cap for each dual fuel tariff would then be constructed from the price caps applying to the component meter-fuel type combinations:

$$\text{Price cap}_{\text{Dual fuel (gas tariff 1, electricity tariff 1)}} = \text{price cap}_{\text{gas tariff 1}} + \text{price cap}_{\text{electricity tariff 1}}$$

- (k) The price cap level would also be calculated in the same way for high and low levels of consumption using the high and low consumption values stated by Ofgem.
- (l) Suppliers would be responsible for ensuring their own compliance ex ante in the same way as for the proposed prepayment meter Price Cap remedy design.

### ***Key elements of the Alternative Price Cap design***

*We describe below key elements of the possible design of the Alternative Price Cap. Structure of the Alternative Price Cap*

13. Under the Alternative Price Cap design, the price cap would take the form of a cap on annual bills and would be set for a period of six months before being

reset. The price cap would be set for all consumption levels and annual bills would have to be no higher than the cap for any level of consumption. The price cap would be calculated at three specific consumption levels and the level of the price cap for consumption between those levels would be determined by linear interpolation. The choice of a six month period is discussed further in paragraphs 27 - 31.

*Would there be separate caps for single fuel and dual fuel customers?*

14. Under the Alternative Price Cap design, separate price caps would apply for dual fuel and single fuel customers. The price cap for dual fuel customers would be calculated as the sum of the price caps that apply to each of the component tariffs. The calculation for each single fuel price cap would draw on the prices paid for under each of the underlying gas and electricity tariffs for dual fuel customers as well as single fuel tariffs. This differs from the proposed prepayment meter Price Cap remedy whereby the single fuel and dual fuel price caps are based on separate benchmark bills, with the dual fuel price cap not being calculated as the sum of the single fuel price caps.

*Would there be separate caps for single rate meter and Economy 7 customers?*

15. In line with the proposed prepayment meter Price Cap remedy, under the Alternative Price Cap design, separate price caps would apply for standard and Economy 7 meter types. The price cap for single rate meter customers would include a reference price based on single rate meter direct debit tariff customer numbers. The price cap for Economy 7 meter customers would include a reference price based on Economy 7 direct debit tariff customer numbers. This approach of using observed customer numbers to determine reference prices differs from the proposed prepayment meter Price Cap remedy which is calculated on the basis of the benchmark bills constructed as outlined at Section 3.
16. We have observed that independent suppliers currently compete most strongly for direct debit customers. We consider that this competition encompasses both single rate meter and Economy 7 acquisitions. We therefore consider that these tariffs form an appropriate reference basket for the single meter price cap and Economy 7 meter price cap respectively.
17. There is a risk that changes in the nature or extent of competition reduce the effectiveness of the cap. For example, if such changes result in fewer Economy 7 tariffs being offered then the reference basket may not reflect competitive prices. This risk may be mitigated by the limited duration and scope of the price cap, reducing the likelihood of significant changes in the competitive market over this period.

*Would there be a separate cap for each supplier?*

18. We considered the risk that suppliers would be able to manipulate the level of this Alternative Price Cap design by adjusting the prices of their own tariffs in the market. One way to mitigate this risk through the design of the price cap could be to set a cap for each supplier that is based solely on the prices of *other* suppliers. We refer to this principle as the Vickrey principle.<sup>4</sup> We have decided not to apply the Vickrey principle in the Alternative Price Cap design.
19. The Vickrey principle would introduce a separate cap for each supplier. We believe the extra complexity may make the operation and implication of the cap less clear to stakeholders. The Vickrey principle would also require increased monitoring and may be seen as unfair if one supplier or customer group is considered to be disadvantaged (eg due to significant variation in the level of the respective caps).
20. Applying the Vickrey principle would reduce suppliers' ability to game the price cap (ie through manipulation of the reference price). By limiting the risk of gaming we expect that application of the Vickrey principle would also reduce the potential perverse incentives and unintended consequences arising as a result of the cap.
21. The risk of suppliers manipulating prices may, in part, be mitigated through the size of the population that determines the reference price, relative to the protected population. At 30 June 2015 there were more customers on tariffs that would be included in the reference price calculation than there were customers who would be subject to the cap, however the risk of suppliers manipulating the cap may continue to exist. As an example suppliers may seek to change the nature of competition to artificially inflate the reference prices, as discussed in paragraphs 60 - 31.

*Number of price caps under the Alternative Price Cap design?*

22. Just as with the proposed prepayment meter Price Cap remedy, there would be a total of 70 price caps as described in paragraph 7.137.

*Relevant consumption levels*

23. The level of the price cap under the Alternative Price Cap design would be specified in the same way as for the hybrid reference price approach which

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<sup>4</sup> We use the term Vickrey as the approach has parallels with the Vickrey, or second price, auction in which the price paid by the winning bidder is determined by the second highest bidder.

we provisionally propose to implement. That is to say that the price cap would be specified for all consumption levels as described in paragraph 7.142.

*Calculation of the reference price?*

24. Under the Alternative Price Cap design, the reference price cap would be calculated as the median of the annual bill costs of all tariffs with active customers except default or deemed tariffs. The calculation of this median would take account of customer numbers. The below illustration assumes just seven customers to demonstrate how this would work.

**Table 1: Illustration of determining the median tariff**

<i>Customer</i>	<i>Tariffs that have active customers</i>	<i>Projected annual bill at TDCV (£)</i>	
1	Tariff 1	950	
2	Tariff 1	950	
3	Tariff 2	975	
4	Tariff 3	1,000	← Median
5	Tariff 3	1,000	
6	Tariff 3	1,000	
7	Tariff 4	1,050	

Source: CMA analysis.

25. By defining the reference price in this way the cap would be representative of the market offerings prior to the reference date. Defining the reference price based on customer stock<sup>5</sup> at a point in time means that the level of the cap may be driven by historical trends in tariff prices and customer choices. We note that this would introduce the risk that the price cap is set at a level above or below the competitive price. In this way the stringency of the price cap may vary.
26. Calculating the price cap based on tariff prices on the reference date would require suppliers to collect and report to Ofgem a significant amount of data. This would also require appropriate controls to be put in place to ensure the integrity and security of the data and ensure that the price cap is correctly calculated. We have already obtained the necessary data as part of this market investigation and consider that it would be possible to work with suppliers and Ofgem to develop an information request template such that future information requests can be streamlined and completed more efficiently.

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<sup>5</sup> We use the term ‘customer stock’ here to refer to the number of customers on a particular tariff at a specific point in time.

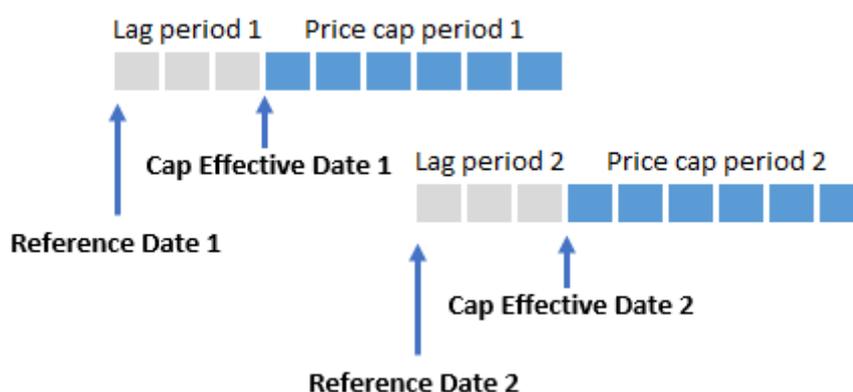
*How frequently would the level of the price cap be updated?*

27. For the purpose of assessing the Alternative Price Cap design, we have considered how frequently the price cap would have to be calculated. For the reasons set out below, we consider that an update every six months would have been appropriate.
28. We note that the length of price cap period contributes to the lag between the period over which prices informing the reference price are offered in the market and the period over which the price cap applies. This lag is inherent to having a price cap which is fixed for any length of time and is in addition to the lag that exists as a result of the level of the price cap being informed by historic prices.
29. We also considered whether more frequent updates (eg every three months) would increase the effectiveness of a price cap under this design. However, we reached the view that this would be impractical in the light of the prepayment meter infrastructure. Price updates for prepayment meter tariffs are transmitted to the meter each time the customer tops up their key card. When a supplier wishes to update their price (or any other feature of the tariff a customer is on) they transmit the message to the key card vendor and the message remains on the vendor's machine until the customer picks up the message at the next vend. There is a limit to the number of messages that can be stored on the vendor's machine and thus it is impractical to make frequent changes to a large number of tariffs. Since the SVT has historically been updated approximately twice each year, updating the price cap more than twice per year, whilst possible, would have incurred the risk of imposing a disproportionate burden on the prepayment meter infrastructure.
30. Conversely, within the context of the Alternative Price Cap design, annual updates would have been in our view inappropriate. Indeed, whilst this would have reduced the burden on the prepayment meter infrastructure, it would have resulted in a significant amount of lag which would have been undesirable. This is because it would have contributed to the price cap reflecting historic rather than current prices.
31. This does not apply to the proposed remedy approach, which will be updated annually, as the proposed remedy is based on a benchmark bill, rather than based on customer stock, resulting in a lower risk of inaccuracy due to a lag (see discussion below). In Appendix 7.2 of our provisional findings report we constructed one-year and two-year cost benchmarks and observed that 'the forward-looking benchmarks co-move closely over time and in most periods there is no material difference'.

### *Time lag between the Reference Date and Cap Effective Date*

32. Under the Alternative Price Cap design, there would be a lag between the point when tariffs used to calculate the price cap are available in the market and the point when the price cap, calculated on that basis, enters into force, as shown in Figure 1 below. The Reference Date is the day for which suppliers would provide tariff information in order to inform the Reference Price. The Cap Effective Date would be defined as the first day of the period for which a given price cap is in effect. There would be a lag of three months between these two dates:

**Figure 1: Illustration of the timings for the price cap determination and application**



Source: CMA analysis.

33. The time lag between the Reference Date and the Cap Effective Date should be as short in duration as possible so as to minimise the risk of costs changing significantly between the reference date and the price cap period. However, some time lag is necessary to obtain the data on customer numbers, determine the level of the cap and implement the cap.
34. Centrica<sup>6</sup> outlined in their response to the provisional findings that ‘it can take 6-12 weeks to agree and implement a price change – longer for price increases, due to the requirement to notify our customers of these changes in advance’.
35. The existence of a time lag between the Reference Date and Cap Effective Date may result in the price determined not being obtainable in the market at the point the cap would have come into effect, for example due to sharp rises in wholesale energy costs during the lag period. We expect this risk can be managed to some extent by suppliers adopting suitable energy purchasing strategies ahead of the Reference Date. We note that this risk could be

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<sup>6</sup> Centrica’s response to provisional findings and possible remedies, Appendix, p6, paragraph 27: <https://www.gov.uk/cma-cases/energy-market-investigation#responses-to-provisional-findings-and-notice-of-possible-remedies>

mitigated by the existence of headroom in the level of the cap and the application of the cap to a limited scope of customers for a limited period of time.

#### *Determination of the reference price*

36. Under the Alternative Price Cap design, Ofgem would calculate the projected annual bill assumption consumption equal to the TDCV for all tariffs (except for default or deemed tariffs) with active customers as at the Reference Date. 'Active' customer in this context means a customer who is currently on the tariff in question as at the Reference Date.
37. Ofgem would then identify the median priced tariff as described in paragraph 24. This median value would then be taken as the reference price for consumption equal to TDCV. Ofgem would then repeat the whole process for consumption equal to the upper and lower consumption thresholds. This calculation would need to be undertaken for each region and for each of the following meter-fuel type combinations:
  - (a) Single rate meter, electricity.
  - (b) Economy 7 meter, electricity.
  - (c) Single rate meter, gas.
38. By taking the median tariff price each month, as described above the cap, would be influenced by all tariffs that were sufficiently competitive to be chosen by customers. This also mitigates the possibility of suppliers gaming the reference price by introducing expensive tariffs, since tariffs would only influence the reference price to the extent that they were chosen by customers. As this calculation is performed separately for each region, this may give rise to significant regional variation in the caps, dependent on the effectiveness competition for direct debit customers in each region.
39. As outlined in paragraph 35, the three month lag between the Reference Date and the Cap Effective Date means the prices used to inform the cap may no longer be achievable in the market at the time the cap would have come into effect – presenting the risk of efficient costs being unrecoverable. Basing the Reference Price on the prices paid by customers as at the Reference Date mitigates this risk to some extent as suppliers would be able to observe these prices ahead of the Reference Date and could buy ahead to partially hedge the price risk.
40. We note that a strategy of buying ahead would still expose suppliers to some wholesale price risk as the price for buying for the period of the price cap may

be different to the price that is driving the Reference Price. In Appendix 7.2 of provisional findings we constructed one-year and two-year cost benchmarks and observed that ‘the forward-looking benchmarks co-move closely over time and in most periods there is no material difference’.<sup>7</sup> Thus we do not consider that suppliers are exposed to significant risk as a result of observing tariff prices that were largely informed by 12-18 month ahead wholesale prices<sup>8</sup> in order to set a price cap which would apply three to nine months later. However, this is one reason why we believe that a six month price cap period is more appropriate than a longer period. We note that even with a six month price cap period some risk still exists but consider this risk to be low.

41. We considered whether a mean average of customer bills, weighted by number of customers on each tariff, would be a more appropriate way of calculating the reference price. We noted that whilst the mean is also a measure of the centre of a data sample it is affected by outliers. In the context of a prepayment meter price cap we note that there are a relatively small number of premium tariffs, such as long-term fixed-priced tariffs, which are significantly above the competitive level. If the mean average were calculated including these tariffs then they would directly increase the level of the cap. Given that the price cap would be set for periods of six months at a time we consider that it is not appropriate to use the mean average. We also note that using the median rather than the mean results in the lower prices offered by the mid-tier suppliers not directly influencing the level of the price cap.

#### *Costs-to-serve differential between prepayment customers and customers on direct debit*

42. The prepayment meter uplift under the Alternative Price Cap design would be the same as for the hybrid reference price approach which we describe in paragraphs 7.85 – 7.87.

#### *Relevant suppliers’ tariffs for determining the reference price*

43. In determining the price cap at each six monthly iteration under the Alternative Price Cap design, it is necessary to identify an appropriate reference basket of tariffs from which to identify the reference price. This differs from our preferred approach where the benchmark bill is specified in advance of the cap being implemented, based on the detriment analysis outlined at Section 3, and then subsequently updated annually using indices. Consideration of

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<sup>7</sup> See paragraph 27 of [Appendix 7.2](#) of the provisional findings.

<sup>8</sup> Our analysis of the tenor of tariffs shows that a high proportion of eligible reference tariffs with active customers as at 31 March 2015 (weighted by customer numbers) had a tenor of between 12 and 18 months.

the key elements making up this reference basket of tariffs under the Alternative Price Cap design is outlined below.

44. Under the Alternative Price Cap design, all suppliers that are fully obligated under the Energy Company Obligations (ECO) would have their tariffs included in the calculation of the reference price. At the time of writing, a supplier is fully obligated under the ECO if they have more than 500,000 domestic customer accounts and provide more than 400 GWh of electricity or more than 2,000 GWh of gas, in any relevant year.<sup>9</sup> We note that there are similar thresholds for other obligations<sup>10</sup> and other obligations for which there is no threshold.
45. The aim would be to ensure that the population of tariffs driving the reference price is representative of the competitive market and large enough to mitigate the risk of suppliers attempting to game the cap. A key issue around the inclusion of smaller suppliers in the reference basket would be their exemption from certain environmental and social obligations. As a result, it would not necessarily be the case that a price which a small supplier (ie one which is not subject to the obligation costs) is able to offer, would be profitable for efficient larger suppliers. Exempt suppliers would therefore not be included within the reference basket.
46. We have considered the possibility of this approach producing a cap that is more testing for larger suppliers than smaller suppliers. Our assessment is that efficient suppliers should be able to offer profitable prices beneath the cap and that in the medium term the key driver of prices would be competition rather than the level of the cap. Prior to competition developing to that extent the level of the cap is likely to be a determining factor for the level of prices, though currently smaller suppliers have a relatively small share of prepayment customers.<sup>11</sup>
47. We considered the possibility of applying a different cap for smaller suppliers though consider that this introduces additional complexity without a commensurate benefit for customers given the small number of customers who would be affected.

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<sup>9</sup> See Ofgem's website: '[Information for suppliers](#)'.

<sup>10</sup> For example, the threshold for participation in the feed in tariffs scheme is that a supplier has more than 250,000 domestic electricity customer accounts though there is no stipulation relating to the quantity of energy delivered.

<sup>11</sup> In the [addendum to provisional findings](#) (*Revised AEC relating to the prepayment segment*) the CMA estimated non-Six Large Energy Firms' share of the direct debit segment as 16% compared to 6% in the prepayment segment.

*Would tariffs with exit fees be eligible for inclusion in the reference price calculation?*

48. Under the Alternative Price Cap design tariffs with exit fees would be eligible for inclusion in the reference basket, with no adjustment.
49. Exit fees are a characteristic of some competitive tariffs and as such inclusion within the reference tariff basket is desirable, all else being equal. Inclusion of tariffs with exit fees supports the reference price being representative of the competitive market and large enough to minimise the risk of suppliers attempting to game the cap. A lack of adjustment would also support ensuring simplicity in the calculation of the price cap.

*Would online only tariffs be eligible for inclusion in the reference price calculation?*

50. Under the Alternative Price Cap design online only tariffs would be eligible for inclusion in the reference price calculation, with an adjustment of £5 to reflect the incremental costs to serve offline customers compared to online customers. This differential would remain constant throughout the price cap period as we do not anticipate that there would be a significant change in the cost savings associated with a customer being online only. This amount is consistent with the observed general supplier pricing discounts for online tariffs.
51. Online availability is a characteristic of some competitive tariffs and as such inclusion within the reference tariff basket is desirable, all else being equal. This supports the reference basket being representative of the competitive market and large enough to minimise the risk of suppliers attempting to game the cap.
52. As there are different costs-to-serve online and offline customers, an adjustment to reflect this is considered appropriate to create a price cap which would allow for recovery of efficient marginal costs. We note that to the extent that the incremental cost a supplier faces for offline customers is different to £5 the price cap would be more or less stringent for that supplier. We consider that this would nonetheless be a proportionate approach in the context of a narrow scope, temporary price cap which includes headroom. For the avoidance of doubt the same price cap would apply regardless of whether the customer is offered paper bills or not.

*Would green and other social tariffs be eligible for inclusion in the reference price calculation?*

53. Under the Alternative Price Cap design green and other social tariffs would be eligible for inclusion in the reference basket, with no adjustment.

54. Acquisitions to green and other social tariffs represent active choices by customers regarding their energy tariff. These decisions contribute to the overall competitiveness of the market and hence it appears appropriate that they are eligible for inclusion in the reference price calculation. This would support the reference price calculation in being representative of the competitive market and large enough to minimise the risk of suppliers attempting to game the cap.
55. As these tariffs are often offered at a premium to equivalent tariffs on the market, inclusion of these tariffs may increase the level of the price cap. The risk of unduly increasing the cap as a result of including these tariffs is mitigated through the calculation being based on the median of acquired customers' annual bills meaning premiums only indirectly inform the cap level.
56. The reference basket would also include white label and collective switching tariffs offered by fully obligated suppliers.

*Would tariffs with complex, contingent, or non-monetary discounts/benefits be eligible for inclusion in the reference price calculation?*

57. Under the Alternative Price Cap design tariffs with complex, contingent or non-monetary discounts/benefits would be eligible for inclusion in the reference price calculation, with no adjustments made.
58. Tariffs with complex, contingent or non-monetary discounts/benefits may become a characteristic of some competitive tariffs and as such inclusion within the reference tariff price calculation is desirable. This would support the reference price calculation in being representative of the competitive market and sufficiently large to minimise the risk of suppliers attempting to game the cap.
59. We considered making adjustment to the annual cost of these tariffs to take account of the associated benefits. For example, we could deduct £100 from the annual cost if the tariff includes £100 of gift vouchers. Tariff discounts may, however, become increasingly complex such that calculating the appropriate adjustment may become judgemental and represent a significant challenge to the price cap. As such, although these tariffs would be eligible for inclusion in the reference price calculation, these would not be adjusted to reflect the value of complex, contingent or non-monetary discounts. We note that there is a trade-off here between developing a reasonably simple price cap versus a price cap that takes account of all the different types of tariff and discount available in the market.

60. Change in the competitive market that results in tariffs with large potential discounts or products being bundled may reduce the effectiveness of the cap, as a result of the lack of adjustment to the reference basket. This risk may be mitigated by the limited duration of the price cap as we consider there to be a low probability of such a significant shift in the market occurring within the lifetime of the price cap.
61. There is also a risk that suppliers seek to game the cap by only, or predominantly, offering tariffs with substantial non-energy benefits. We expect that such behaviour would be restricted under Ofgem's existing principles based regulation requirement that suppliers treat customers fairly.

*Would restricted meter and time-of-use tariffs be eligible for inclusion in the reference price calculation?*

62. Under the Alternative Price Cap design restricted meter and time-of-use tariffs would not be eligible for inclusion in the reference price calculation. Our analysis of restricted meter tariffs<sup>12</sup> suggests that competition in this segment of the market is weak and thus these prices do not necessarily represent an efficient price, whilst inclusion of time-of-use tariffs may also give rise to additional complexity in terms of calculating annual bills at TDCV for the purposes of deriving the reference prices.
63. As these tariffs are not eligible for inclusion in the reference price calculation, movement in the competitive market towards time-of-use tariffs may reduce the effectiveness of the cap. This risk is mitigated by the limited duration of the price cap and expectation that wide application of time-of-use tariffs may not arrive until sometime after smart meter roll-out.

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<sup>12</sup> See Section 3.

## Annex A: Summary of responses to remedies notice in respect of remedy 11

### Introduction

1. In response to the consultation on our proposed remedy 11 in our provisional findings document we received 55 replies from interested parties.
2. We consider below many of the points raised in those responses and provide our views on these. We have grouped our responses thematically for ease of review.
3. Some respondents commented on the extent of their opposition to any cap.<sup>13</sup> Other respondents were supportive of the proposal.<sup>14</sup>

### Unintended consequences

4. Some respondents considered that any transitional safeguard regulated tariff (TSRT) may be likely to undermine innovation and/or developments in the market and have unintended consequences such as reduced consumer engagement.<sup>15</sup> Respondents suggested that a TSRT was likely to work in direct opposition to the package of remedies that were aimed at promoting competition by increasing availability of information for customers and triggers to promote customer engagement, and would make those remedies less likely to be effective by discouraging customers from engaging with the market.<sup>16</sup> Some respondents noted that this potentially creates a disincentive to switching.<sup>17</sup> uSwitch suggested a TSRT could result in some consumers paying more than they otherwise would had they engaged in their choice of supplier or tariff (by creating a disincentive to switch).<sup>18</sup>
5. Other respondents agreed and considered that the ‘safe haven’ effect was likely to ensure a large number of customers remained on the safeguard tariff (either actively or passively), despite the presence of more competitive

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<sup>13</sup> Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE, Engie, Gazprom, Green Energy UK, Chartered Institute of Procurement and Supply (CIPS), Drax, [REDACTED] Power Ltd, Energy Action Scotland, Energy UK, Flow energy, Haven Power, Inenco, Opus Energy, University of East Anglia, George Yarrow, Littlechild et al, Behavioural Insights Team, Dieter Helm, CBI, Energy Action Scotland, First Utility, Spark Energy.

<sup>14</sup> Federation of Small Businesses, Utility Warehouse, [REDACTED], Christians Against Poverty, Comhairle nan Eilean Siar (Western Isles Council), Ecotricity, Citizens Advice, Co-operative Energy, [REDACTED], Which?.

<sup>15</sup> Centrica, Citizens Advice, [REDACTED], EDF Energy, Energy Action Scotland, Energy UK, E.ON, Flow Energy, Gazprom, Good Energy, Haven Power, ICOSS, Invesco Perpetual, Labrador, MoneySuperMarket, Ofgem, Spark Energy, SSE, Total Gas and Power, University of East Anglia, uSwitch, Utility Warehouse, Age UK.

<sup>16</sup> EDF Energy, E.ON, SSE, Centrica, Scottish Power, Haven Power, uSwitch, Littlechild et al.

<sup>17</sup> EDF Energy, E.ON, Centrica, Scottish Power, Haven Power, uSwitch, Littlechild et al.

<sup>18</sup> uSwitch

offers.<sup>19</sup> Several respondents suggested that the apparent government endorsement could create a false sense of assurance for some consumers suggesting they do not need engage in the market to secure a better priced deal.<sup>20</sup> Ofgem said that there was a risk that the tariff could reduce incentives to engage and switch tariff or supplier.<sup>21</sup> Another respondent suggested that the safeguard tariff could act against the remedies that are designed to improve switching and engagement.<sup>22</sup>

6. Two respondents said that prices would rise and customer engagement would fall, which they described as an unintended but inevitable consequence of a TSRT.<sup>23</sup>
7. Some respondents suggested there was a risk to quality of service and that the quality of service received by the TSRT customers could be reduced.<sup>24</sup> RWE suggested that a safeguard tariff may result in a deterioration of service levels towards a minimum level acceptable standard to regulators / consumers, as suppliers seek to protect squeezed margins.<sup>25</sup> SSE further noted that lower quality of customer service is, however, a minor risk compared with the other potential unintended consequences in terms of reduced switching, reduced market entry, lower investment and the potential general softening of competition.<sup>26</sup>
8. Other respondents did not consider this to be the case.<sup>27</sup> In addition it was noted that as the proportion of customers on a default tariff dwindled, any remaining customers on it would likely be the most disengaged – these customers were more likely to remain on that tariff even if service levels were poor.<sup>28</sup> Ofgem agreed that a TSRT could result in pressure on service provision but noted that it regulated aspects of service provision and had taken enforcement action in the past.
9. Three respondents also noted the potential for the TSRT to influence the level of other tariffs in the market. For example, if set too low, there was a risk that they would drive up prices at the lower end of the market, reducing price differentials and reducing the incentive to switch/engage (due to lower

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<sup>19</sup> Centrica, EDF Energy, E.ON, Scottish Power, [redacted], Drax, Energy UK, Good Energy, Gocompare.com, University of East Anglia, MoneySuperMarket, Flow Energy.

<sup>20</sup> National Energy Action, Opus Energy, uSwitch, [redacted].

<sup>21</sup> Ofgem

<sup>22</sup> Which?

<sup>23</sup> Labrador, Drax, Haven Power.

<sup>24</sup> uSwitch, Total Gas and Power, Centrica, SSE,.

<sup>25</sup> RWE

<sup>26</sup> SSE

<sup>27</sup> E.ON, Scottish Power Scottish Power response to Remedies Notice p39, para 11.34

<sup>28</sup> Centrica.

available benefit from switching). If set too high, they could lead to clustering of prices at the top end of the market and reduce price competition.<sup>29</sup> SSE was concerned that it would be impossible for the CMA to set a tariff cap at the 'right' level.<sup>30</sup>

10. Two respondents were concerned with the possibility that tariff increases failed to keep pace with increasing costs.<sup>31</sup> One respondent suggested it could be difficult politically to increase tariffs by the necessary amount.<sup>32</sup> The other respondent said that this could lead to situations where there was insufficient headroom for unregulated tariffs to compete, or ultimately to a 'tariff deficit' position where costs exceeded the regulated price.<sup>33</sup>
11. One respondent said that the effects of any TSRT would not disappear when it was withdrawn.<sup>34</sup>
12. Other respondents noted that this would increase regulatory uncertainty<sup>35</sup> and reduce investor confidence.<sup>36</sup> One suggested that the presence of regulatory intervention may act as a deterrent to new entrants to the market.<sup>37</sup>
13. One respondent said that imposition of a safeguard tariff would [✂].<sup>38</sup> Two respondents suggested that the increased regulatory uncertainty would significantly increase regulatory uncertainty, hence would increase the cost of capital.<sup>39</sup>
14. Some respondents suggested that competition in the market under any TSRT would be reduced as it was highly likely to increase customer disengagement.<sup>40</sup> Scottish Power also provided the CMA with an economic model which provided quantitative predictions of this effect. RWE also noted that a TSRT could reduce competition as wider industry implications was a reduction in the ability and incentive for suppliers to discount. One respondent suggested that suppliers might subsidise disengaged customers and that this might impact on the ability of smaller suppliers to compete.<sup>41</sup>

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<sup>29</sup> Centrica, SSE. Good energy.

<sup>30</sup> SSE.

<sup>31</sup> Scottish Power, SSE.

<sup>32</sup> Scottish Power response to Remedies Notice p39, para 11.17

<sup>33</sup> SSE.

<sup>34</sup> George Yarrow.

<sup>35</sup> RWE, George Yarrow.

<sup>36</sup> SSE.

<sup>37</sup> Scottish Power response to Remedies Notice p43, para 11.57

<sup>38</sup> RWE.

<sup>39</sup> Invesco Perpetual, Littlechild et al.

<sup>40</sup> Scottish Power, SSE, E.ON, uSwitch, Good energy.

<sup>41</sup> Spark Energy.

15. One respondent said that any TSRT would reduce choice,<sup>42</sup> another that it would increase complexity,<sup>43</sup> and a third that it would reduce incentives to engage and thus undermine competition.<sup>44</sup>
16. One respondent said that no matter how good the TSRT was, it would be 'gamed' by suppliers.<sup>45</sup> One respondent said that any TSRT could be relatively easily circumvented by large suppliers,<sup>46</sup> whilst another said that any circumvention would breach Ofgem's standards of conduct.<sup>47</sup> Ofgem said that the design of any TSRT must attempt to mitigate this.
17. Some respondents suggested that any TSRT would adversely affect innovation or weaken the competitive pressure on firms to offer discounted prices thus reducing competition.<sup>48</sup>
18. One respondent said that any TSRT risked creating a temporary freeze on wholesale price reductions being passed on to consumers.<sup>49</sup>
19. Two respondents were concerned that once introduced it would be difficult for a regulator to remove with negative impacts on engagement, together with the significant risk of political pressure (and potentially direct political interference), which could lead to the safeguard tariff becoming a permanent feature of the market.<sup>50</sup> Another respondent said that there was a risk that a regulated tariff becomes a permanent feature of the market as it may be very difficult to exit from.<sup>51</sup> Another respondent welcomed the 'transitional' nature of the proposals as it agreed that the introduction of smart meters would have the potential to transform the market.<sup>52</sup> One respondent said that any TSRT should have clear sunset clause criteria to ensure it was only an interim measure.<sup>53</sup>
20. One respondent was concerned that non-exempt suppliers would have to fund the delivery of large environmental and social obligations from a reduced customer base, distorting competition.<sup>54</sup>

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<sup>42</sup> Energy Action Scotland.

<sup>43</sup> [REDACTED].

<sup>44</sup> Energy UK.

<sup>45</sup> Paul Hunt.

<sup>46</sup> Flow Energy.

<sup>47</sup> Citizens Advice.

<sup>48</sup> RWE, Scottish Power, Citizens Advice.

<sup>49</sup> Citizens Advice.

<sup>50</sup> Centrica, Scottish Power.

<sup>51</sup> Ofgem.

<sup>52</sup> DECC.

<sup>53</sup> Drax.

<sup>54</sup> RWE.

21. Two respondents commented on risks around hedging with respect to the safeguard regulated tariff set on a cost-plus basis. One suggested potential adverse effects on the wholesale market such as drying up longer term liquidity,<sup>55</sup> another that deviating from a hedging strategy prescribed by any TSRT would hold significant risks for suppliers and could lead to increased wholesale cost volatility.<sup>56</sup> Ofgem also commented that there would be a strong probability of suppliers pursuing the low-risk approach causing suppliers to converge on a single hedging strategy.
22. Some respondents drew attention to international examples of risks associated with price controls suggesting that these showed that price controls should be removed as they reduced price dispersion and weakened competition.<sup>57</sup> One respondent drew attention to regulatory thinking and practice internationally noting that in New South Wales, price controls with headroom, followed by a transitional tariff, were part of the process of removing price controls, not a means of reintroducing price controls in an already competitive and unregulated market. They noted that view in Australia generally was that price control may seem to protect certain customers, but in doing so it restricts rivalry, innovation and improvements in retail competition, to the disadvantage of customers generally. They further commented that the International Energy Agency took a similarly critical view.<sup>58</sup>
23. Other respondents drew attention to the additional cost of any TSRT pointing to excessive costs as a consequence of the complexity imposed by the process of establishing and monitoring the TSRT which would involve discussion, consultation and ultimately challenge and arbitration.<sup>59</sup>
24. One respondent said that any TSRT would be damaging to the reputation of both Ofgem and the CMA. Implementation by Ofgem would remove limited resources from other CMA remedies.<sup>60</sup>

## **Proportionality**

25. Many respondents were concerned that in view of the many potential unintended consequences as discussed above, the proposed TSRT was not a proportionate remedy. They asserted there was a lack of sufficiently robust evidence of harm, that the CMA had overstated the level of disengagement,

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<sup>55</sup> E.ON.

<sup>56</sup> RWE.

<sup>57</sup> Centrica, Scottish Power, SSE.

<sup>58</sup> Littlechild et al.

<sup>59</sup> RWE, Scottish Power, SSE.

<sup>60</sup> George Yarrow.

the proposal would not be proportionate, and that the case for such radical intervention was not made.<sup>61</sup> EDF Energy considered that the proposed TSRT would be a disproportionate intervention to the level of harm the CMA had provisionally found<sup>62</sup>. EDF Energy's view was that the lack of robustness in the CMA's assessment of the degree of any harm, including the weaknesses in the CMA's profitability analysis and the unsubstantiated provisional finding of Unilateral Market Power, was such that the implementation of any form of regulated tariff could not be considered a proportionate remedy.<sup>63</sup> RWE were concerned that if a safeguard tariff were applied to all SVT customers it would not be the least onerous effective measure to deal with the AEC the CMA has identified and would ignore the level of engagement that characterizes customers on SVT. They suggested that even a temporary price control would have significant adverse effects which are disproportionate to the CMA's aims.<sup>64</sup>

26. One respondent referred to the 'enabling' remedies and suggested improvements to other remedies which they suggested would reduce both consumers' real and perceived barriers to switching, and restore suppliers' incentives and ability to innovate.<sup>65</sup> Another suggested that an effective package of remedies, along with the removal of the regulatory distortion caused by the regulatory framework, could be developed which would have the same beneficial effects.<sup>66</sup>
27. One respondent suggested that the CMA had not been consistent in the consideration of price discrimination. RWE noted that whilst the CMA said that SLC 25A distorted competition by imposing regulatory constraints on suppliers' ability to charge prices to different customer groups, that could not be justified on grounds of cost reflectivity; the CMA also considered that evidence of price variation across customer groups was itself evidence of problematic unilateral market power.<sup>67</sup>
28. Opus Energy said that any TSRT failed the proportionality test because it was not being applied in a targeted way. Opus Energy suggested that there was a difference between those who did not have the capability to engage and those who made a rational choice not to.<sup>68</sup>

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<sup>61</sup> Centrica, Scottish Power, SSE.

<sup>62</sup> EDF Energy

<sup>63</sup> EDF Energy

<sup>64</sup> RWE

<sup>65</sup> Centrica, RWE.

<sup>66</sup> RWE

<sup>67</sup> RWE.

<sup>68</sup> Opus Energy.

29. One respondent said that any TSRT was a potentially draconian remedy that could only be proportionate if the underlying problem was commensurately substantial.<sup>69</sup>
30. Two respondents said that the presumption that suppliers' products are homogeneous was incorrect and suggested that there was clear survey evidence to the contrary.<sup>70</sup>
31. One respondent commented that the revision of Ofgem's duties under the Energy Act 2010 would place Ofgem in a stronger position to promote competition. The anticipated effects of any further revision to these duties as a result of the CMA's investigation ought to be reflected when considering the need for a safeguard tariff.<sup>71</sup>
32. One respondent referred to precedents from the private healthcare and home credit investigations by the CMA, where it was considered that the potential unintended consequences and risks to competition were such that a price control was not a proportional response. It said that, by effectively incentivising consumers to stay disengaged, and thereby diminishing competitive pressure in the market, a price cap remedy could harm, in the long term, the very people that it was meant to protect.<sup>72</sup>

## Legality

33. Respondents referred to various pieces of EU policy, regulation and legislation (EU Consumer Rights Directive, Internal Energy Market Directives, Energy Liberalisation Directive, EU Third Package) and in particular that any TSRT should not be applied only to the Six Large Energy Firms as this would be discriminatory.<sup>73</sup>
34. One respondent suggested that the CMA had not considered the requirements of EU law or presented any analysis of whether the remedy was necessary and proportionate.<sup>74</sup> Another identified the three conditions the EU focused on: proportionality, targeted and with careful examination of the differences between subgroups.<sup>75</sup>

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<sup>69</sup> George Yarrow.

<sup>70</sup> RWE, [38].

<sup>71</sup> RWE.

<sup>72</sup> Scottish Power.

<sup>73</sup> RWE, Scottish Power, SSE.

<sup>74</sup> Opus Energy.

<sup>75</sup> George Yarrow.

35. One respondent also commented on the inconsistency of any price cap with wider EU energy policy and the UK's historic position around the liberalisation of energy markets.<sup>76</sup> Another commented that price capping was not in line with EU or UK government policy or best practice in other jurisdictions.<sup>77</sup>

### **Scope – domestic customers**

36. Respondents were concerned at how any TSRT would be scoped. One respondent said that the CMA had not provided a clear definition of those customers it believed were 'inactive'<sup>78</sup> and that it was important not to equate SVT customers and inactive customers as many SVT customers were not properly considered inactive or disengaged.
37. One respondent said that the CMA survey results indicated a mixed and diverse picture of engagement across different categories of customers and a weak link to vulnerability indicators. Given these concerns, it said that it was important to be very clear about the exact problem that a price cap remedy would seek to address and was as targeted as possible in defining the groups of customers that it was intended to protect.<sup>79</sup>
38. SSE suggested that government policy was a more appropriate means to protect vulnerable customers.<sup>80</sup> E.ON suggested that it was a Government policy decision as to whether some customers needed further forms of consumer protection, in addition to the protection they received via competition in the market. If it were believed they did need this, it could be more simply delivered via Government policy in a similar approach to that already used for Warm Homes Discount (WHD).<sup>81</sup>
39. One respondent said that, no matter how competitive the market was, it was important to safeguard those in vulnerable situations.<sup>82</sup> Another respondent said that a TSRT should only be used to protect the most vulnerable.<sup>83</sup> Another respondent said that disengaged customers or those struggling to meet their fuel bills should be targeted.<sup>84</sup>

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<sup>76</sup> Scottish Power.

<sup>77</sup> George Yarrow.

<sup>78</sup> RWE.

<sup>79</sup> SSE.

<sup>80</sup> SSE.

<sup>81</sup> E.ON

<sup>82</sup> Christians Against Poverty.

<sup>83</sup> MoneySuperMarket.

<sup>84</sup> Comhairle nan Eilean Siar (Western Isles Council).

40. One respondent said that some customers on SVTs were there by choice and this distinction should be understood.<sup>85</sup>
41. Opus Energy said that whilst price intervention damaged competition, for vulnerable consumers this was outweighed by the benefit of the remedy. It thought that it could be said that a TSRT for these consumers was sufficiently targeted and proportional.<sup>86</sup>
42. Recognising that customers should be chosen carefully, there were various suggestions from respondents on which customers should be targeted:
  - (a) Eligible consumers should be those that are on standard variable type arrangements that do not have a fixed end date.<sup>87</sup>
  - (b) All customers that have not chosen their tariff, not just those that come to the end of a fixed-term tariff.<sup>88</sup>
  - (c) All default tariff customers should have the opportunity to transfer from their suppliers to an independent/local/regional supplier, specifically set up for default tariff customers.<sup>89</sup>
  - (d) The inactive portion of the market, ie unengaged customers who have not ever switched supplier.<sup>90</sup>
  - (e) Disadvantaged disengaged customers through a safeguarding 'loyalty' rebate. This would be available to those on the Priority Services Register (PSR) for example, those in receipt of Warm Home Discount (WHD) or those customers known to suppliers to be struggling with their bills and using prepayment meters.<sup>91</sup>
  - (f) Ensure vulnerable people – those not operating within the competitive marketplace – are safeguarded. This could be defined as someone who has not switched in the last three to five years.<sup>92</sup>
  - (g) Customers who have defaulted onto a tariff they did not actively choose.<sup>93</sup>

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<sup>85</sup> Good Energy.

<sup>86</sup> Opus Energy.

<sup>87</sup> Drax, Haven Power.

<sup>88</sup> Ecotricity.

<sup>89</sup> Energy Policy Group (University of Exeter).

<sup>90</sup> ICOSS.

<sup>91</sup> National Energy Action.

<sup>92</sup> [8].

<sup>93</sup> Good Energy.

- (h) More vulnerable consumers.<sup>94</sup>
43. The University of Exeter noted that its requirement for acceptance of a default tariff is that it is set up as a rising block tariff.<sup>95</sup>
44. One respondent said that all customers should be eligible for this protection.<sup>96</sup>
45. One respondent said that if the aim was to protect one set of customers, for example vulnerable customers, then it is important to identify clearly those customers to whom it would apply and to ensure that this is consistent across all suppliers. In these circumstances it is not clear whether any TSRT would be transitional or result in a permanent regulated tariff for these customers.<sup>97</sup>
46. A respondent suggested, whilst not agreeing with the need for a TSRT, that one approach with potentially fewer adverse effects may be to:
- (a) identify the primary identifiable indicator of vulnerability; and
  - (b) ensure that each and every eligible customer received a discount.
47. The respondent suggested that such an approach was achievable through reframing the WHD by:
- (a) removing the ineligibility of customers who were with exempt suppliers;
  - (b) using the data that the Department for Work and Pensions had, and had used in the past with suppliers; and
  - (c) funding from general taxation or raising VAT on energy supply.<sup>98</sup>
48. Another supplier, whilst not accepting a need for a TSPC for all SVT customers, recognised that prepayment customers had fewer tariff options than other customers due to the technical limitations of the prepayment systems. It said that it could see some merit in a regulated tariff to prepayment customers as an interim solution until the availability of the data and communications company, together with the roll-out of SMETS2 meters, gave them access to the full range of tariffs. However, following further analysis in response to the second supplemental notice of possible remedies they strongly opposed the use of a cap in this way.<sup>99</sup>

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<sup>94</sup> uSwitch.

<sup>95</sup> University of Exeter

<sup>96</sup> [X].

<sup>97</sup> EDF Energy.

<sup>98</sup> RWE.

<sup>99</sup> EDF Energy.

49. One respondent said that if a safeguard regulated tariff was applied to a subset of customers then suppliers would need to provide another default SVT which could lead to times when the default SVT was cheaper than the safeguard regulated tariff (eg due to timing of wholesale purchases).<sup>100</sup>
50. Two respondents said that customers on deemed contracts should not be eligible for any TSRT and that any TSPC should be restricted to consumers on standard variable tariffs that do not have a fixed end date.<sup>101</sup>
51. One respondent suggested that the remedy could affect 70% of domestic customers and should therefore be targeted at a smaller group eg vulnerable customers. This would also be challenging but the most reliable means of doing so would require some kind of data sharing arrangement, whereby the Department for Work and Pensions could identify the right group.<sup>102</sup>
52. One respondent said that the tariff should benefit those who:
- (a) were least able to engage in the market; and
  - (b) suffered the greatest detriment due to not engaging.

The respondent therefore favoured a subset of those on default tariffs getting a bigger benefit, rather than a large group of consumers getting a smaller benefit. This would start to address the fundamentally regressive nature of current arrangements and avoid safeguarding consumers who had made a rational decision not to engage in the energy market. Ideally this should be based on ability to pay.<sup>103</sup>

53. Ofgem said that any TSRT should be targeted narrowly at those most likely to be negatively affected by the highly priced SVT tariffs. One option would be to target all SVT customers. A narrower alternative would be to target only the very stickiest consumers; for example those that had never switched gas or electricity supplier. Ofgem also said that any TSRT could be targeted at vulnerable consumers who remained on SVTs. A proxy for vulnerable consumers could include those in receipt of Cold Weather Payments.

### **Scope – suppliers**

54. One respondent said that any TSRT should apply to all suppliers, including white labels. The instance of evergreen tariffs being significantly more

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<sup>100</sup> E.ON.

<sup>101</sup> Drax, Haven Power.

<sup>102</sup> SSE.

<sup>103</sup> Citizens Advice.

expensive than fixed deals was most prevalent among large suppliers but was by no means restricted to them.<sup>104</sup>

55. Another respondent suggested that any TSRT should be applied to all suppliers.<sup>105</sup>
56. Many non-SLEFS said that any TSRT should be restricted to the Six Large Energy Firms since that was where the disengaged customers on standard variable tariffs were.<sup>106</sup>
57. Ofgem suggested that if 'sticky' domestic customers were targeted then it should be limited to the Six Large Energy Firms.

### **Tariff structure**

58. Two respondents commented on the complexity of cost recovery through tariffs, as the choice of tariff would introduce considerable complexity for those tasked with tariff design<sup>107</sup>, and the need to determine for any TSRT what proportion of fixed costs should be recovered through the unit rate and which through the standing charge.<sup>108</sup> RWE suggested that the implications of such considerations are that: (i) a safeguard tariff design would be complex since it would involve setting not a single price, but instead at least a standing charge and one or more unit rates on a regional basis and for a variety of payment types; and (ii) decisions on tariff design could not all easily be made purely on economic efficiency grounds, since they would have significant distributional consequences.<sup>109</sup>
59. One respondent said that whichever organisation operated the TSRT, it would have the task of balancing volatile wholesale commodity market prices with the frequency of tariff changes. It suggest that it could be operated on a principle of CfDs.<sup>110</sup>
60. Another respondent said that for customers on time of use tariffs it would be very difficult to determine an appropriate cost base as well as to determine whether they should roll on to the safeguard tariff or stay on their current time of use tariff.<sup>111</sup>

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<sup>104</sup> Citizens Advice.

<sup>105</sup> [REDACTED].

<sup>106</sup> Drax, Gazprom, Haven Power, Total Gas and Power, ICOSS.

<sup>107</sup> RWE

<sup>108</sup> RWE, SSE.

<sup>109</sup> RWE

<sup>110</sup> [REDACTED].

<sup>111</sup> E.ON.

61. One respondent said that suppliers must provide benchmark tariffs for both heating and non-heating elements of the bill and these should be published and audited annually by Ofgem.<sup>112</sup>
62. Another respondent queried the consumption level that was used to set the tariff price and, for all time of use and dynamic teleswitched tariffs, what split should be assumed between peak and off-peak consumption.<sup>113</sup> The same respondent also said that a choice needed to be made regarding regional price differentials, suggesting that a TSRT effectively imposed a prohibition on regional price discrimination on SVTs.
63. Ofgem commented that suppliers had different costs and that setting one price cap had the potential to benefit one supplier more than others.

### **Other complexities**

64. One respondent said that because of the structural differences in supplier (cost base, customer mix, hedging approach, etc) a 'one size fits all' tariff would create a non-level playing field for suppliers, unless a separate safeguard tariff was set for each supplier.<sup>114</sup>
65. Another respondent outlined potential issues associated around customers with special metering or tariff arrangements, which would need specific consideration and separate tariffs, as a fully cost reflective tariff may actually increase costs for some customers.<sup>115</sup>
66. One respondent noted that costs continually changed and so any fixed tariff would quickly become cost unreflective resulting in windfall gains or losses.<sup>116</sup> Another went further and suggested that because of the complexity it did not consider any TSRT as a workable option.<sup>117</sup>
67. One respondent said that if set with reference to current average SVT levels, the requirements would be much less onerous. It suggested that this would need to be indexed to major cost movements and consolidated segmental statements (CSS) outturns would need to be carefully monitored to ensure that there was not a systematic bias in the calculation.<sup>118</sup>

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<sup>112</sup> Changeworks.

<sup>113</sup> SSE.

<sup>114</sup> Centrica.

<sup>115</sup> RWE.

<sup>116</sup> ICOSS.

<sup>117</sup> [redacted].

<sup>118</sup> SSE.

68. One respondent was concerned that it would be too complex in terms of the underlying variable costs of supply and an otherwise competitive market.<sup>119</sup>
69. Another respondent said that the number of issues for consultation reflected the complexity in the design of any TSRT and may facilitate coordination of pricing in the more active part of the market.<sup>120</sup>

### Issues around cost-plus approach

70. The majority of the Six Large Energy Firms (all excluding SSE) outlined their preference for a cost-plus approach due to the reduced risk of unintended consequences as a result of this approach compared to a relative price cap. Other respondents were broadly in favour of the cost-plus approach whilst noting various difficulties that this might cause.<sup>121</sup>
71. One respondent (preferring their own suggested alternative approach) said it would be better to use reference tariffs already in the market citing many difficulties with the cost-plus approach:
- (a) Regulators' imperfect knowledge of costs.
  - (b) Apportionment between those on safeguard and other tariffs could create issues.
  - (c) A cost-plus approach reduced incentives to be efficient.
  - (d) Suppliers would price at the cap (ie up to the headroom) and not compete.<sup>122</sup>
72. One respondent said that it would be incredibly difficult to set a fair cost<sup>123</sup> under a cost-plus approach and another said it would be too difficult to monitor.<sup>124</sup>
73. One respondent suggested that the tariff could be set at 5% above the average of the cheapest tariffs available from all suppliers in the previous quarter.<sup>125</sup> Another suggested any TSRT should always be cheaper than the

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<sup>119</sup> Spark Energy.

<sup>120</sup> University of East Anglia.

<sup>121</sup> [REDACTED], Energy Policy Group (University of Exeter), Haven Power, ICOSS, Total Gas and Power, University of East Anglia, [REDACTED], Drax.

<sup>122</sup> Citizens Advice.

<sup>123</sup> Gazprom.

<sup>124</sup> Ecotricity.

<sup>125</sup> Utility Warehouse.

SVT and no more than 20% more than the cheapest tariff on offer from that supplier, either directly or via any collective or sub-brand.<sup>126</sup>

74. One respondent said that a cost-plus approach could mean that the regulator sets price controls for 70% of all consumers which would be severely detrimental to competition.<sup>127</sup>
75. Some respondents also outlined the difficulties in identifying appropriate cost bases and benchmarks for a cost-plus approach. Respondents also had particular concerns around the challenges of cost determination (and therefore cost plus) for wholesale costs, non-energy costs, the impact on the wholesale market and ex post costs, as well as the increasing risk and increased costs of managing these positions.<sup>128</sup> EDF Energy also outlined the difficulty in setting of the headroom, whereby a tariff set too low could significantly reduce the attractiveness of the market for new entrants and challengers, reducing competition in the market, and would also reduce potential gains from switching for customers with detrimental impacts on short and long term engagement. Conversely, setting a relatively high price could attract political and media criticism and, if sufficient consumers failed to engage quickly, could provide a competitive advantage to suppliers with disproportionately high levels of disengaged customers.<sup>129</sup> RWE noted that . for other costs such as supplier opex and capex, there are clearly substantial differences in phasing and amount across suppliers.<sup>130</sup>
76. One respondent commented on the difficulties of knowing what competitive costs would be over the short life of the transitional cap to which headroom could be allowed.<sup>131</sup>
77. Respondents discussed the issues around the level of headroom included within a cap. As an example, if set too low this tariff increases the risk of significant market failure during volatile wholesale market conditions (eg 2001 California blackouts). In contrast, a high tariff cap may have limited impact on supplier pricing or even distort supplier pricing, potentially leading to tariff 'bunching' at, or very near to, the cap.<sup>132</sup> Centrica also argued that, regardless of the level of headroom, a regulated price would create a safe haven effect

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<sup>126</sup> [REDACTED].

<sup>127</sup> Centrica.

<sup>128</sup> Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE.

<sup>129</sup> EDF Energy

<sup>130</sup> RWE

<sup>131</sup> George Yarrow.

<sup>132</sup> Centrica.

as was observed in New South Wales where customers tended to stay on a regulated tariff even when there were significant gains from switching.<sup>133</sup>

78. One respondent, recognising the difficulty in setting the headroom, suggested a staged approach to setting an appropriate level (starting at a cautious (high) level and reducing).<sup>134</sup> Another respondent, citing the experience in New South Wales, was in favour of a more generous cap.<sup>135</sup> A third respondent proposed that the headroom should be 'consistent with the level of discounts required by customers to switch'. Minimising the headroom would reduce switching.<sup>136</sup>
79. One respondent said that the inclusion of headroom represented an excess above cost-plus profit which would make this a penalty tariff.<sup>137</sup>
80. One respondent noted that a cost-plus approach that included wholesale costs would be more difficult to monitor and assess. Noting that suppliers would be likely to adopt the same hedging profile that the CMA had assumed, even if they considered it to be suboptimal, the approach could blunt the incentives of suppliers to minimise hedging costs and lead to higher costs.<sup>138</sup>
81. The same respondent noted that where the wholesale cost was treated as a pass-through component of cost-plus the task of setting the tariff was easier. It said that there were precedents for suppliers making an estimate of the cost to be passed through which was subsequently compared with the out-turn audited cost and the difference, adjusted for time value of money, applied to the future price cap. But it added that the CMA would need to set the rules for allocating wholesale energy costs between different tariffs (which may be relatively complex) and specify the scope and methodology for the audit. It suggested that one possible approach would be for Ofgem to approve an economic purchasing plan put forward by the supplier and for pass-through to be guaranteed for wholesale costs incurred in accordance with that plan or incurred under existing arm's length contracts.<sup>139</sup>
82. One respondent said that the headroom would allow suppliers to make excess profits and could legitimise a situation where a large number of customers were being charged a significant rate above the cost to serve.<sup>140</sup>

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<sup>133</sup> Centrica

<sup>134</sup> RWE.

<sup>135</sup> Scottish Power.

<sup>136</sup> SSE.

<sup>137</sup> [redacted].

<sup>138</sup> Scottish Power response to Remedies Notice p39 para 11.31

<sup>139</sup> Scottish Power response to Remedies Notice p38 para 11.27 and p40 para 11.32

<sup>140</sup> Which?.

83. Ofgem noted the intensive data requirements of a cost-plus model and that suppliers might challenge the assumptions and methodologies used. Ofgem suggested that some form of agreed indexation to a starting position could minimise such challenge.
84. Ofgem said that the tariff structure that is used for the safeguard tariff was likely to be important when determining wholesale energy costs. A one-year fixed-term (with no exit fees) tariff may be the most appropriate for the safeguard tariff, and customers that did not engage following an end of contract notice would be rolled over onto a subsequent one-year fixed-term tariff.

### **Issues concerning the relative approach**

85. Centrica suggested that there might be behavioural change by suppliers in response to any TSRT, including gaming, which might be hard to predict.<sup>141</sup> Centrica also said that this approach would fail to account for the structural differences in supplier cost bases and also lead to challenges for supplier risk management (e.g. due to impact of different hedging approaches and lack of price change predictability). This may result in a more limited range of products on offer to customers in the competitive part of the market, as suppliers would not be able to offer a tariff based on a different hedging strategy (for example) without that having damaging implications for the regulated tariff.<sup>142</sup> RWE suggested that there might be behavioural change by suppliers in response to setting the safeguard tariff relative to other energy products in the market which might be difficult to anticipate.<sup>143</sup>
86. Two respondents suggested that a relative approach should be set at a percentage of a supplier's most competitive tariff. This would reduce the gap between new and existing tariffs.<sup>144</sup>
87. Another respondent said that the methodology risked linking the price of a default variable priced product with energy products that currently had very different characteristics, causing volatility of price of any TSRT.<sup>145</sup>
88. One respondent said that how the benchmark retail price was calculated would require frequent review and strong governance to keep pace with evolving product structures and regulatory risks.<sup>146</sup>

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<sup>141</sup> Centrica.

<sup>142</sup> Centrica.

<sup>143</sup> RWE.

<sup>144</sup> Ecotricity, Utility Warehouse.

<sup>145</sup> RWE.

<sup>146</sup> RWE.

89. One respondent suggested that reference prices should be taken from the actual market place meaning it could be certain that it was economically feasible for at least some suppliers. If the reference price tracked those of a competitive tariff, it should create strong incentives for suppliers to keep their costs down, while simultaneously ensuring that the disengaged were not forced to pay a substantial premium for their energy.<sup>147</sup>
90. One respondent, whilst noting that care needed to be taken in the design, said that if any TSRT took the form of a 'price dispersion limit', (which caps the difference in price between, say, a supplier's cheapest and most expensive tariff) it would avoid the risk of tariff deficit occurring but might restrict competition.<sup>148</sup>
91. The same respondent suggested that an alternative approach might be to set the TSRT at a suitable margin over some weighted average measure of market-wide non-standard tariff (NST) prices. This would have the advantage that generally a tariff deficit would be unlikely to arise but it could lead to unexpected and unsatisfactory results in volatile wholesale markets.<sup>149</sup>

### Frequency of reassessment

92. One respondent suggested that reassessment would be needed sufficiently frequently to reflect any changes in underlying cost bases, as well as assumptions made around the wholesale energy hedging strategies.<sup>150</sup> Whilst agreeing with this, another supplier suggested that, in the context of a *relative* price control, if a limit were to be set against other price levels (eg, premium to each supplier's cheapest fixed rate), it could be allowed to automatically adjust.<sup>151</sup>
93. Another respondent noted that the target group for this remedy was customers who had been on SVT for some time and were used to prices moving infrequently, normally once or twice per year.<sup>152</sup> With regards to the safeguard regulated tariff another respondent advocated a clear rule that balanced avoidance of bill shock (if costs rise), delay to passing on benefits (if costs fall), the costs of administering price changes and the impact to customers from increased frequency of price changes.<sup>153</sup>

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<sup>147</sup> Citizens Advice.

<sup>148</sup> Scottish Power.

<sup>149</sup> Scottish Power response to Remedies Notice p38 para 11.28

<sup>150</sup> Centrica.

<sup>151</sup> SSE.

<sup>152</sup> EDF Energy.

<sup>153</sup> E.ON.

94. Three other respondents also highlighted potential issues around the frequency of changes, both in terms of too often (eg volatile prices can have damaging financial consequences for customers) and not often enough (raising issues such as customer preference for stability, management of suppliers' underlying costs, consumer protection, inability to pass on rising costs potentially leading to supplier losses and inability to pass on falling costs harming customer trust).<sup>154</sup> EDF Energy suggested that changing infrequently would provide price stability for customers but result in higher risks for suppliers that would need to be reflected in the level of the tariff (due to the increased uncertainty on customer numbers and volumes for forward purchasing energy increasing the risk associated with wholesale price movements, together with increased risk around non-energy cost movements). By contrast changing the price more frequently would reduce the risk for suppliers but increase the volatility of customer bills, affecting customers' ability to budget for bills and potentially leading to negative commentary in the media around the ability of the TSRT to protect customers.<sup>155</sup>
95. One respondent suggested that the TSRT would need to be reviewed twice a year with the option to review in the event of market shocks.<sup>156</sup> Another commented that consumers wanted cost certainty but that the current basis of twice yearly would be sufficient.<sup>157</sup>
96. Another respondent suggested that the hedging strategy of each supplier would determine the need for review.<sup>158</sup>
97. One respondent noted that for prepayment meter customers frequent changes of the price cap of the safeguard regulated tariff would increase prepayment meter charges (pre smart metering) due to the cost of applying changes and the consequences of the price change messages not being picked up promptly by customers.<sup>159</sup>
98. Another respondent said that any TSRT needed to reflect costs that changed daily and so should change on a daily basis.<sup>160</sup>

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<sup>154</sup> Centrica, EDF Energy, RWE.

<sup>155</sup> EDF Energy

<sup>156</sup> Drax.

<sup>157</sup> Citizens Advice.

<sup>158</sup> Gazprom.

<sup>159</sup> E.ON.

<sup>160</sup> ICOSS.

## Duration

99. Seven respondents<sup>161</sup> recognised that a clear plan as to how any TSRT would be phased out was required whilst one added that a regular review process, given the uncertainties about the impacts and effectiveness of this remedy in practice<sup>162</sup> was also required. ICOSS made the same point in relation to need for regular review.<sup>163</sup> EDF Energy stated that the criteria for withdrawal of the TSPC needed to be very clear from the outset as otherwise there is a risk that it would become a permanent regulated tariff for a set of permanently disengaged customers.<sup>164</sup> Centrica stated that the safeguard tariff would take several years to introduce and would be extremely difficult to remove at all, for reasons of low engagement and political risk. They said that rather than being a transitional measure, the safeguard tariff would inevitably be in place for an extended period of time. If the remedy was introduced as proposed.<sup>165</sup> E.ON stated that any TSRT should have a sunset clause of around three years which, given the time for design and implementation, should be around 2020, by which time smart meters should be universal.<sup>166</sup> RWE considered that it is essential for any remedy of this nature to be clearly defined in terms of its duration, with no potential for the remedy to become open-ended. Duration would be key to proportionality, and so the period should be as short as possible.<sup>167</sup> SSE suggested that a sunset date would be essential.<sup>168</sup>
100. Centrica suggested the end of any TSRT could potentially be tied to the implementation of smart meters.<sup>169</sup> SSE suggested that it should be tied to a strict condition, such as reaching a milestone associated with the implementation of smart meters.<sup>170</sup>
101. Centrica suggested that a sunset clause is essential (potentially tied to smart meter roll out) to ensure that the intervention is time limited and creates regulation of the market (to the detriment of competition) for the shortest time possible. SSE suggested that linking the sunset clause to smart meter roll-out was more appropriate than linking to other measures of success due to the risk that the unintended consequences of a TSRT resulted in success not being achieved in those terms.

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<sup>161</sup> Centrica, Scottish Power, SSE, uSwitch, Which?, Haven Power, Ofgem.

<sup>162</sup> Centrica.

<sup>163</sup> ICOSS.

<sup>164</sup> EDF Energy.

<sup>165</sup> Centrica.

<sup>166</sup> E.ON.

<sup>167</sup> RWE.

<sup>168</sup> SSE.

<sup>169</sup> Centrica.

<sup>170</sup> SSE.

102. One respondent said that the proposal ignores the practical and political considerations associated with price controls. They also said that there was no simple – or even complex – way to determine a ‘right level’. There would be great pressure to set and reset the price control ‘toughly’, to demonstrate that it was of benefit to customers. The existence of prices in the market lower than the default price would be taken as a sign that the regulator had not been tough enough. There would be pressure to continue and tighten the control, little or no pressure to remove it.<sup>171</sup>
103. One respondent said that it should be clear what any TSRT was transitioning from and to where so that the effectiveness could be judged. Extensive consumer testing should be carried out to find the most appropriate mix of solutions.<sup>172</sup>
104. One respondent said that any TSRT should fall away as soon as a customer had engaged with the market.<sup>173</sup>
105. One respondent suggested 2018<sup>174</sup> as an appropriate exit date (smart meters underway) whilst another said 2020<sup>175</sup> (but with a review after two years).
106. Another respondent suggested the exit criteria could be to set a target for the maximum percentage of a supplier’s customers (or a subset of the portfolio such as identified vulnerable customers) that were on the regulated tariff. Once the target is reached then the regulated tariff could be removed for that supplier.<sup>176</sup>
107. Ofgem said that it must be clear this was a transitional measure, with clear criteria for review and exit. Ofgem also said that the tariff should fall away when sufficient competitive pressure on suppliers existed.

## Transition

108. Parties outlined various thoughts around transition arrangements, with the requirements being highly dependent on the type of safeguard tariff introduced.
109. Some respondents<sup>177</sup> described the workload surrounding the migration of millions of customers to new tariffs, the significant customer disruption, and

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<sup>171</sup> Littlechild et al.

<sup>172</sup> Which?.

<sup>173</sup> Gazprom.

<sup>174</sup> Scottish Power response to Remedies Notice p42 para 11.48

<sup>175</sup> E.ON.

<sup>176</sup> EDF Energy.

<sup>177</sup> Centrica, SSE.

communication issues. One respondent said that, in light of these concerns, any TSRT should be phased in over a period and suggested three years would be appropriate,<sup>178</sup> and another said around 12 months (elapsed time from concept to delivery) was required, although such work could impact on other remedies.<sup>179</sup> Scottish Power suggested the TSPC may need to be phased in over a period of time sufficient to allow suppliers time to rebalance, where necessary, their standard and non-standard tariffs, and to allow sufficient time for the necessary detailed business processes to be defined and the IT implementation completed.<sup>180</sup>

110. In view of the foregoing one respondent said that the remedy would be overtaken by events before it could deliver.<sup>181</sup>
111. Two respondents suggested that if it only applied to a subset of customers no transition was needed although at least 12 months' notice would be expected to allow for IT, billing and other changes.<sup>182</sup>
112. Another respondent said that customers should be moved on to the new tariff as soon as the structure and form was known.<sup>183</sup>
113. One respondent (in respect of microbusinesses) said that it should take effect for new contracts only.<sup>184</sup>
114. One respondent did not suggest a period but noted that suppliers might phase change-over of customers based on levels of engagement. For consumers, it suggested that communications should target consumers before they were moved.<sup>185</sup>

## Implementation

115. Respondents recognised that where the tariff may need constant monitoring and adjustment, this would best fall to Ofgem.<sup>186</sup>
116. Other respondents said that the methodology and conditions for withdrawal should be set by the CMA at the outset.<sup>187</sup>

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<sup>178</sup> Centrica.

<sup>179</sup> SSE.

<sup>180</sup> Scottish Power response to Remedies Notice p42 para 11.51

<sup>181</sup> SSE.

<sup>182</sup> Haven Power, Drax.

<sup>183</sup> ICOSS.

<sup>184</sup> Total Gas and Power.

<sup>185</sup> Ofgem.

<sup>186</sup> ICOSS, Gazprom, Citizens Advice.

<sup>187</sup> Haven Power.

117. Another respondent said that it should initially be set by the CMA, which should review Ofgem's performance.<sup>188</sup>
118. Two respondents said that Ofgem should set the level of any TSRT.<sup>189</sup>
119. One respondent thought that the CMA should implement any TSRT since the reputational risks and costs should be taken by those accountable for the decision.<sup>190</sup>

## **Alternatives**

120. Many respondents suggested alternatives or variations to any TSRT and some of these have been mentioned in earlier sections (we do not repeat them here).
121. One respondent said that any TSRT should be based on the 'rising block' approach (first block is cheap, second is more expensive and third even more so). A variation could be vulnerable customers get the first block free.<sup>191</sup>
122. One respondent suggested that there should be staged reduction targets for SVT numbers by supplier. It said that the presence of these staged targets would improve the effectiveness of the other remedies as suppliers would be encouraged to innovate in their approach to engaging customers in order to meet the targets.<sup>192</sup>
123. Another respondent suggested that whilst the introduction of a benchmark tariff would be an alternative to a regulated tariff it would have a similar impact on suppliers as a directly regulated tariff due to political and media pressure. As a result the same care is required as the same challenges as described above apply when setting either a benchmark tariff or a TSPC.<sup>193</sup>
124. On the practicalities of a regulated tariff, one respondent said that if the CMA were to decide to proceed with this remedy, then it would be important to find an approach that minimised the impact on other remedies and on the competitive market; and that a less intrusive approach, which would have the least consequence for the market, would be to set a nationwide maximum average revenue for energy, in p/kWh, as measured on a typical size of customer for each fuel in the domestic and non-domestic markets. However,

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<sup>188</sup> Labrador.

<sup>189</sup> Total Gas and Power, University of East Anglia.

<sup>190</sup> George Yarrow.

<sup>191</sup> Energy Policy Group (University of Exeter).

<sup>192</sup> EDF Energy.

<sup>193</sup> EDF Energy.

the respondent recognised that this approach may not provide the kind of protection that the most vulnerable customers may genuinely need.<sup>194</sup>

125. One respondent suggested that the rule introduced by Ofgem that suppliers must move customers who do not express an alternative preference to SVT at the end of a fixed offer, could be relaxed and instead allow suppliers to move customers to any successor tariff that did not have an exit fee.<sup>195</sup>
126. A respondent suggested that Ofgem should have power to regulate the tariffs of any supplier if it believed the differential between the most expensive and cheapest tariff was wider than a set rate.<sup>196</sup>
127. One respondent suggested that an extension of the WHD scheme to include vulnerable customers would be an alternative.<sup>197</sup>
128. One respondent said that rather than (or in addition to) any TSRT, suppliers should improve their debt management of premises to remove the unfairness of customers who paid deemed rates subsidising previous tenants.<sup>198</sup>
129. Another respondent said that stronger incentives to change consumer and supplier behaviour to improve engagement could be introduced. If this failed, a TSRT in the form of a social tariff with a cost-plus cap should be introduced.<sup>199</sup>

## Other

130. In commenting on whether Ofgem or the CMA should set the regulation one of the Six Large Energy Firms considered that Ofgem regulation may be preferable.<sup>200</sup> One also outlined that Ofgem would also be best placed to conduct the ongoing review of costs and hence of prices.<sup>201</sup>
131. One respondent considered that the CMA should set the initial parameters for the control, including the necessary headroom, before handing the detail of actually setting the level of the TSRT over to Ofgem.<sup>202</sup> Another respondent

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<sup>194</sup> SSE

<sup>195</sup> Scottish Power response to Remedies Notice p40 para 11.37

<sup>196</sup> Good Energy.

<sup>197</sup> Citizens Advice.

<sup>198</sup> Make it Cheaper.

<sup>199</sup> Which?.

<sup>200</sup> Centrica, E.ON.

<sup>201</sup> E.ON.

<sup>202</sup> Scottish Power.

believed that the CMA should take full responsibility for all decisions in this area.<sup>203</sup>

132. One respondent suggested that there should be an investigation into the effective monopoly position of the Scottish Hydro THTC tariff and raised concerns with the competitiveness of the Economy 10 tariffs.<sup>204</sup>
133. One respondent said that the proposed solution of encouraging consumers to make the effort to engage whilst protecting those consumers who did not engage was inconsistent and unsustainable. This failed to recognise the underlying dynamic that suggested the challenge of disengagement was actually going to get worse rather than better.<sup>205</sup>
134. In terms of the naming of the tariff, two respondents expressed concern that the word 'safeguard' was used.<sup>206</sup> EDF Energy suggested it could result in customers believing they are on a cheap tariff and as a result be less likely to consider switching. It recommended that the CMA undertakes research on names that would invoke the desired reaction from consumers whilst accurately reflecting the key features of the tariff.<sup>207</sup>
135. Two respondents said that any decisions in relation to the setting of the safeguard tariff levels should be subject to normal rights of appeal.<sup>208</sup>
136. One respondent said that all suppliers should publish benchmark tariffs that enable price comparisons to be made for both the heating and non-heating element of bills, with tariffs audited annually by Ofgem to ensure transparency and fairness.<sup>209</sup>
137. One respondent expressed concern that the CMA puts its own preferences as to how customers should behave over the preferences of customers themselves. They suggested that the CMA was in effect seeking to bring about a change of customer lifestyle, and putting one aspect of a competitive market (searching for better alternatives) over another (building lasting customer relationships).<sup>210</sup>

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<sup>203</sup> SSE.

<sup>204</sup> Lochalsh and Skye Housing Association.

<sup>205</sup> E3G.

<sup>206</sup> EDF Energy, Energy Policy Group (University of Exeter).

<sup>207</sup> EDF Energy.

<sup>208</sup> RWE, E.ON.

<sup>209</sup> Highlands and Islands Housing Associations Affordable Warmth Group.

<sup>210</sup> Littlechild et al.

## Annex B: Summary of responses to remedies notice in respect of remedy 22

### Introduction

1. In response to the consultation on our second supplemental notice of possible remedies we received 14 replies from interested parties about remedy 22.
2. We consider below many of the points raised in those responses and provide our views on these. We have grouped our responses thematically for ease of review.
3. Most respondents were suppliers that were strongly opposed to the safeguard price cap.<sup>211</sup> First Utility was opposed to the safeguard cap<sup>212</sup> and Robin Hood Energy do not support it.<sup>213</sup> One supplier was in favour but only for Six Large Energy Firms.<sup>214</sup> Another respondent (also a supplier) was broadly in favour.<sup>215</sup> Another respondent favoured a cap but only targeted at vulnerable customers.<sup>216</sup> One respondent had reservations but suggested that, if introduced, it should be narrowly focused.<sup>217</sup>

### Proportionality

4. Seven respondents said that they did not consider a price cap to be a justified or proportionate response to the harm identified.<sup>218</sup> In particular Centrica claim that there are a number of flaws in the CMA's analysis which undermine the case for intervention and highlight how disproportionate this remedy would be. One respondent said that in the context of a prospective package of other remedies that go to the root cause of any AEC, a safeguard tariff would be more onerous than was required to achieve its legitimate aim.<sup>219</sup>
5. One respondent said that smart prepayment meters would bring a number of service improvements, reduce costs and enable more effective competition in the prepayment market and this would resolve many, if not all, problems.<sup>220</sup>

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<sup>211</sup> Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE, Good Energy, Utilita Energy.

<sup>212</sup> First Utility.

<sup>213</sup> Robin Hood Energy.

<sup>214</sup> Ecotricity.

<sup>215</sup> Ovo Energy.

<sup>216</sup> Citizens Advice.

<sup>217</sup> Ofgem.

<sup>218</sup> Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE, First Utility.

<sup>219</sup> RWE.

<sup>220</sup> Centrica.

6. One respondent said that extending the protection of SLC 7a was sufficient to allow Ofgem to appropriately protect customers that needed protection. It also proposed a package of remedies and support to engage prepayment meter customers and noted that most customers would benefit from the remedies to increase engagement.<sup>221</sup>
7. Centrica suggested that a cap would be fundamentally incompatible with the CMA's principles of improving the framework for competition and facilitating widespread customer engagement (and that it would in fact reduce engagement).<sup>222</sup> They said that that price regulation would have unintended consequences, even when applied to a segment of the market such as prepayment.

### ***Identification of an appropriate level of prices***

8. Centrica said that if the CMA does set prices relative to other prices, then it should be done with reference to other prepayment tariffs in the market (and not to direct debit or credit tariffs). Centrica also argued that the level of the cap would be difficult to monitor in volatile wholesale markets where companies employing different hedging strategies would see diverging wholesale costs.<sup>223</sup>
9. Centrica also said that they do not consider it would be possible to set the price cap at a level that adequately reflected the different prepayment cost bases that exist in the market, or how this could be sufficiently flexible to manage variations in those costs, including for new entrants. They also said that pricing "based on other retail prices" creates a significant risk of unintended consequences and they highlighted significant complexities. As a result they believe it would necessarily be a detailed and lengthy process requiring constant monitoring and frequent updates (which could present a further technical challenge given the inflexibility of the infrastructure in delivering new prices to non-smart prepayment meters).
10. One respondent believed that the benchmark price needed to be competitively priced in order to protect consumers and suggested that the cap should be set with reference to other tariffs available on the market, including non-prepay. The same respondent also said that it was important that a sufficiently large basket of reference tariffs, including the most competitive

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<sup>221</sup> EDF Energy.

<sup>222</sup> Centrica

<sup>223</sup> Centrica.

tariffs offered by independent suppliers, was included to avoid the risk of gaming.<sup>224</sup>

11. One respondent considered that if the CMA implemented this proposal, the most appropriate reference level should be SVTs and not heavily discounted 'acquisition' tariffs.<sup>225</sup> Another respondent said that it should have consideration of both fixed and variable tariffs.<sup>226</sup>
12. One respondent considered that any cap must strike a reasonable balance between simplicity and allowing for different tariff types – for example fixed and variable contracts should not be subject to the same cap.<sup>227</sup>
13. One respondent said that to be representative of more competitive conditions it could reasonably be based on fixed-term tariffs offered in the DD segment. The reference level could either be defined in terms of a specified basket of tariffs or as some form of average price paid by consumers. The same respondent suggested that the detriment from setting the price too low was likely to outweigh the detriment from setting it too high, and it would be prudent to err on the side of a more generous cap.<sup>228</sup>
14. One respondent said that the CMA should consider variations to standard tariffs that suppliers may offer – for example tariffs that included bundled items, additionality tariffs or time of use tariffs. The respondent said that it was vital that suppliers were not discouraged from offering such products which enabled suppliers to innovate and differentiate in order to improve engagement in the market.<sup>229</sup>
15. One respondent said that it would be very difficult to set a price relative to other prices in the retail market as these were constantly changing and were subject to different restrictions such as fixed terms, termination fees and different types of customer service offering. In this respondent's view, the difficulty in setting and keeping a safeguard price cap at an appropriate level was a strong argument against introducing one.<sup>230</sup>
16. Another respondent did not agree that any price cap should reference 'competitively priced acquisition tariffs'. The respondent suggested that in a competitive market, any individual supplier's prices would vary depending on

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<sup>224</sup> Citizens Advice.

<sup>225</sup> SSE.

<sup>226</sup> Robin Hood Energy.

<sup>227</sup> Utilita Energy Limited.

<sup>228</sup> Scottish Power response to Second Supplemental Remedies Notice p17 para 22.22

<sup>229</sup> Ovo Energy.

<sup>230</sup> EDF Energy.

wholesale input costs, supplier aspirations to grow or maintain its customer base and the quality of its product or service. Therefore the cheapest 'competitively priced acquisition tariff' on offer in the market would vary between suppliers throughout the year. Using this as a reference could result in suppliers whose costs happen to be higher being forced to sell products at a loss.<sup>231</sup>

17. One respondent considered that if a TSPC tariff for prepayment meter customers were set relative to other prices in the domestic retail energy markets the CMA should disregard tariff offers from small suppliers as these were exempt from ECO costs.<sup>232</sup>
18. Another respondent agreed that setting the level of the cap in relation to the prices of other tariffs was a practicable way of enabling the regulated price cap to follow developments in suppliers' costs, but noted that this risks creating an additional incentive for suppliers to increase the prices of other tariffs.<sup>233</sup>

### ***Quality of service impact***

19. Four respondents saw it as unlikely that a supplier would actively reduce the quality of service offered to customers on a regulated prepayment meter tariff but suggested other impacts.<sup>234</sup>
20. Another respondent said that they believe that provisions under condition 25 and 25C should provide sufficient protection.<sup>235</sup>
21. Two respondents expressed the view that it was unlikely that suppliers would reduce the level of service made available to prepayment meter customers unless the reference price was based on a similarly reduced level of customer service.<sup>236</sup>
22. Two respondents suggested that there was risk to quality of service towards levels that were of a minimum acceptable standard, as suppliers seek to protect squeezed margins. This could clearly be the case if the safeguard tariff, as an unintended consequence, fails to allow for efficient recovery of costs.<sup>237</sup>

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<sup>231</sup> E.ON.

<sup>232</sup> RWE.

<sup>233</sup> Ofgem.

<sup>234</sup> Scottish Power, First Utility, SSE, E.ON.

<sup>235</sup> Utilita.

<sup>236</sup> EDF Energy, Good Energy.

<sup>237</sup> Centrica, RWE.

## **Calculation of headroom**

23. One respondent suggested that suppliers would not have adequate incentive to minimise prices and hence it may not be appropriate to have any 'headroom' in the price cap.<sup>238</sup> Another respondent was concerned that there was no method of calculating the headroom that would guarantee no serious adverse effects on the current healthy levels of competition.<sup>239</sup>
24. One respondent said that headroom on the safeguard cap should allow for a profit margin that was sufficient to ensure a price point that incentivised customers to engage with the market, (although they also noted that even in this case there is likely to be a "safe haven" effect as occurred in New South Wales).<sup>240</sup>
25. One respondent said that setting a cap with sufficient headroom would be vital and that headroom should be sufficient to give customers an incentive to engage in the market and switch tariff. The headroom would also need to provide sufficient scope for suppliers to manage the risk of changes in costs.<sup>241</sup>
26. One respondent suggested headroom at a percentage of the supplier's most competitive tariff<sup>242</sup> whilst another said that in setting headroom it would be difficult to implement this proposal without introducing further disparity in the competitive landscape.<sup>243</sup>
27. One respondent agreed that some level of headroom would be required if a cap were introduced but said that doing this would be extremely challenging and that there was a fundamental conflict in setting a price cap above the level which was determined to be competitive.<sup>244</sup> Another respondent said that the difficulty of finding the optimum headroom and the risks of getting it wrong was one of the key reasons why it believed the CMA should not adopt such a remedy.<sup>245</sup>
28. One respondent suggested that the CMA might consider a staged approach to establishing the appropriate headroom within any safeguard price cap tariff, so that the headroom might be set at a cautious level at the outset, and then reducing subsequently. The same respondent said that the level of headroom

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<sup>238</sup> Citizens Advice.

<sup>239</sup> SSE.

<sup>240</sup> Centrica.

<sup>241</sup> EDF Energy.

<sup>242</sup> Ecotricity.

<sup>243</sup> Good Energy.

<sup>244</sup> E.ON.

<sup>245</sup> Scottish Power.

needed to ensure that unintended consequences such as not allowing for recovery of efficient costs was mitigated.<sup>246</sup>

### ***Information required***

29. Respondents gave a variety of views on what information would be required.
30. One respondent suggested that the information required to set a cap would be deep knowledge of existing prepayment suppliers' and prospective new entrant costs. For example, there would need to be a detailed understanding of full hedging requirements, and balancing costs including liquidity constraints. The respondent also said that if the cap was to reflect regional cost differences, detail on cost bases by region would also be required. They also stressed the importance of ensuring that such a calculation is not simply done at 'average' consumption as to do so would fail to take account of how different standing charge and unit rate configurations impact low or high consuming customers, and how that may make any such cap too high or too low for all but 'average' customers. Taking this in to account in each of the fourteen different regions, for each of the various fuel and meter type combinations would be complex.<sup>247</sup>
31. Another respondent identified that the key information required would be prices charged for the reference tariffs, and the number of accounts, in total, associated with those reference tariffs. This data would need to be regularly updated to reflect pricing changes.<sup>248</sup>
32. One respondent said that if a cap was based with a reference to other tariffs in the market it did not believe additional regulatory information would be required beyond a justification for the incremental cost to serve for prepayment meter customers.<sup>249</sup>
33. One respondent believed that any price must be set with a full understanding of the costs of serving the customers, including the risks associated with volume uncertainty, and volatility of wholesale and non-energy costs.<sup>250</sup>

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<sup>246</sup> RWE.

<sup>247</sup> Centrica.

<sup>248</sup> Citizens Advice.

<sup>249</sup> E.ON.

<sup>250</sup> EDF Energy.

34. Another respondent considered that tariff prices for credit meters were the key information required. They stated that cost figures would make the pricing model likely to be complex to the point of unworkable.<sup>251</sup>
35. One respondent said that the information requirements on costs required for the setting of a cost-plus cap would be highly problematic although setting of a cap based on price information would be less onerous.<sup>252</sup>
36. One respondent said that the regulatory information requirements would depend on the design of the tariff cap, but were likely to include:
- (a) the relative costs of prepayment meter and DD payment methods;
  - (b) details of tariffs to be used in setting the reference price (eg fixed-term DD tariffs); and
  - (c) details of customer numbers on different tariffs, if the reference price was to be based on a median or weighted average.<sup>253</sup>
37. A further respondent said that the prices of all the ‘competitive tariffs’ of all suppliers listed in the formula and the cost to serve of both customers on these ‘competitive tariffs’ and prepayment customers would be required in order to determine the appropriate cost differential. There would need to be awareness, also, of any changes in these tariffs and the relative timings of changes versus the timing of resetting the safeguard tariff itself.<sup>254</sup>

### ***Duration***

38. One respondent said that if a price cap was introduced, it should lapse after a specified and reasonable period of time, and at the latest towards the end of the smart meter roll-out.<sup>255</sup> Another respondent agreed saying that it should include a sunset clause, of 2020 at the latest, linked to the roll-out of smart meters, with a review in 2018.<sup>256</sup> Another respondent agreed that there should be a sunset clause such that the price control lapses at a particular date (or when a well-defined milestone has been met) and also suggested the end of 2018 (linked to smart meter roll-out).<sup>257</sup>

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<sup>251</sup> Robin Hood Energy.

<sup>252</sup> SSE.

<sup>253</sup> Scottish Power.

<sup>254</sup> RWE.

<sup>255</sup> Centrica.

<sup>256</sup> E.ON.

<sup>257</sup> Scottish Power.

39. One respondent said that prior to smart meter roll-out, the price cap should be reviewed regularly and at specific points, such as when a range of indicators (eg, internal and external switching rates and customer satisfaction) fell below a certain threshold. The respondent said it should be a short-term remedy, with a defined termination date aligned with the availability of SMETS2 prepayment meters and with a six monthly review of the level of the cap.<sup>258</sup>
40. Another respondent agreed that the roll-out of smart meters should improve circumstances for prepayment meter consumers and therefore suggested that any price cap be kept in place until 2020, or however soon after that date the roll-out was, in practice, deemed to be completed.<sup>259</sup> Another respondent supported a sunset clause and also suggested that this should be set at the end of the smart meter roll-out of 2020 with a single date for all companies.<sup>260</sup>
41. One respondent noted the risk of a price cap resulting in customers becoming less engaged and suggested therefore that the price cap should be in place for as short a period as possible.<sup>261</sup>
42. Two respondents suggested that once a customer was on a smart meter they should no longer be subject to the price cap.<sup>262</sup>
43. Another respondent considered that it should include a specific sunset provision but also that the termination date should be universal and apply to all prepayment customers regardless of whether they had a traditional or smart meter.<sup>263</sup>
44. One respondent suggested that the timescale for removing a safeguard price cap could be linked to the smart installation programme, and so should not extend beyond the roll-out timescale. It also said that customers with smart prepayment meters would benefit from the increased flexibility of the new infrastructure, and so the installation of such meters could be a trigger point for removing a safeguard price cap or perhaps a set time afterwards.<sup>264</sup>
45. Two respondents differed in view and said that they did not consider that the termination of any price cap should be linked to the introduction of smart meters as they considered that having a smart meter was no guarantee that a

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<sup>258</sup> SSE.

<sup>259</sup> Citizens Advice.

<sup>260</sup> Ecotricity.

<sup>261</sup> First Utility.

<sup>262</sup> Centrica, E.ON.

<sup>263</sup> RWE.

<sup>264</sup> EDF Energy.

prepayment customer was engaged<sup>265</sup> or because this may increase the number of prepayment customers who refuse smart meter installation.<sup>266</sup>

### ***Frequency of reassessment***

46. Views on the frequency of reassessment varied from three months to a year with most respondents considering six months or a year to be necessary.
47. One respondent considered that the level of any cap would need to be reassessed at least annually to keep the prepayment safeguard tariff cap aligned to prevailing costs, but not much more frequently than annually.<sup>267</sup>
48. One respondent highlighted the link between the period between reassessment of the price cap and the hedging strategy implicit in the cap. It said that longer periods would require more 'buffer' and would increase the need for mechanisms in order to pass through cost shocks.<sup>268</sup>
49. One respondent was concerned that there was a considerable challenge in keeping a safeguard price cap reflective of retail market prices. Frequent changes would allow prices to reflect changes in retail market conditions and costs. Less frequent changes would require greater headroom to manage the risk of changing costs and volumes of customers. The respondent said that the level of the cap should be reviewed six monthly or annually to give consumers some price certainty.<sup>269</sup>
50. Another respondent said that the absolute level of the cap should be reviewed at a minimum each quarter to ensure that the cap was not set inappropriately relative to costs.<sup>270</sup>
51. One respondent said that the cap should be subject to a full annual review and re-justification, ideally with a specific sunset clause. The frequency with which reassessment is needed would also depend on the level of headroom in the initial estimates.<sup>271</sup>
52. One respondent said that the frequency with which a review of a safeguard price cap would be required would depend on the level of headroom allowed in the price. In addition, the capabilities of the current prepayment meter infrastructure may be a potential restraining factor on how frequently the

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<sup>265</sup> Robin Hood Energy, RWE.

<sup>266</sup> RWE.

<sup>267</sup> RWE.

<sup>268</sup> First Utility.

<sup>269</sup> Citizens Advice.

<sup>270</sup> Centrica.

<sup>271</sup> Utilita.

headroom can be reviewed and price changed.<sup>272</sup> Another respondent said that it would need to be reassessed relatively frequently (say monthly or quarterly), so that any rapid movements in underlying wholesale prices could be passed through sufficiently quickly.<sup>273</sup>

53. One respondent believed that any cap should not be updated more frequently than every six months but said that even quarterly updates may not be sufficient to reflect changes in such a dynamic, competitive market. It pointed out that this would increase costs and could become complex for customers.<sup>274</sup>
54. One respondent considered that any price cap should be reviewed on a quarterly basis. Firstly to see if the remedy was being effective, and secondly to reflect any change in costs requiring a change in the cap.<sup>275</sup>
55. One respondent said that a six-month review period would be a practical solution to balancing the risks but noted that such reviews would cause the market to synchronise tariff changes around a particular date.<sup>276</sup>

#### **Scope – domestic customers**

56. One respondent said that this remedy should apply to all SVT prepayment customers.<sup>277</sup> Another respondent said that it was not proportionate for any prepayment meter customers.<sup>278</sup>
57. One respondent said that it was in favour of protecting vulnerable customers but that prepayment meter customers were an extremely poor proxy for these and the proposed remedy would have high costs of monitoring.<sup>279</sup>
58. One respondent said that the cap should be limited to a subset of vulnerable PPS customers who were disengaged. It suggested that the revised criteria for the WHD could be a suitable basis for targeting the remedy within the prepayment meter sector.<sup>280</sup>
59. One respondent said that whilst its favoured approach would be for the tariff to benefit those who (a) were least able to engage in the market and (b) suffered the greatest detriment due to not engaging, it appreciated that the

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<sup>272</sup> EDF Energy.

<sup>273</sup> Scottish Power.

<sup>274</sup> E.ON.

<sup>275</sup> Good Energy.

<sup>276</sup> SSE.

<sup>277</sup> RWE.

<sup>278</sup> EDF Energy.

<sup>279</sup> SSE.

<sup>280</sup> Scottish Power.

proposal to focus a safeguard price cap on domestic prepayment meter consumers had clear benefits, as it would both:

- (a) benefit directly those consumers in fuel poverty who used that payment method; and
- (b) more widely, benefit those whose circumstances meant that prepayment was the most suitable payment method, but who were being penalised because of the lack of competitive pressure in the sector at present. The respondent suggest that the lack of competition was clearly demonstrated in the background material the CMA had published.

It therefore considered that it would be both simpler and justifiable to apply this remedy to all prepayment meter customers.<sup>281</sup>

- 60. One respondent said that it did not believe that customers on smart prepayment meter should be covered by the cap, and thus any customer switching from traditional to smart prepayment meter should fall out of any cap regime.<sup>282</sup>
- 61. Another respondent said that there were two criteria that both should be met before the price cap is applied: the customer must be disengaged (not responded to prompts within three months), and the customer is also being overcharged.<sup>283</sup>
- 62. Another respondent favoured setting the cap to only those customers without a smart meter. The respondent considered that the smart meter roll-out should serve to reduce or remove many of the additional barriers to engaging that prepayment meter customers faced over and above those paying by credit.<sup>284</sup>
- 63. In one respondent's view, if introduced, the safeguard price cap remedy should apply only in respect of prepayment meter customers who do not have smart meters and could not access other tariffs in the market.<sup>285</sup>
- 64. Another respondent said that the tariff cap should only apply to non-smart prepayment customers who could not change suppliers, for example because they had a debt balance of more than £500.<sup>286</sup>

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<sup>281</sup> Citizens Advice.

<sup>282</sup> Good Energy.

<sup>283</sup> Ovo Energy.

<sup>284</sup> Ofgem.

<sup>285</sup> E.ON.

<sup>286</sup> Centrica.

## **Scope – suppliers**

65. Seven respondents said that, if implemented, this remedy should apply to all suppliers.<sup>287</sup> EDF Energy suggested that otherwise the customers of exempt suppliers would not be offered the same level of protection as those with non-exempt suppliers.<sup>288</sup>
66. One respondent said that if implemented they should apply only to customers of incumbent suppliers who had never switched and only to the incumbent suppliers as this could encourage independent suppliers to come up with innovative solutions.<sup>289</sup>

## **Transition**

67. Parties outlined various thoughts around transition arrangements, with the requirements being highly dependent on the type of safeguard tariff introduced.
68. One respondent said that a transition period (unspecified) would be required to establish reference levels for the cap and determine timeframe to minimise tariff administration costs.<sup>290</sup>
69. One respondent said that it should be phased in over a period of time sufficient to allow suppliers time to rebalance, where necessary, their standard and non-standard prepayment meter tariffs.<sup>291</sup>
70. One respondent noted that suppliers had bought some of their energy several years ahead and consequently suggested a glide path when implementing to avoid creating winners and losers. The respondent proposed that the cap would therefore initially be set at the SVT level and decrease linearly until it reached the target level.<sup>292</sup>
71. One respondent said that any safeguard tariff should be phased in over a period of time to smooth out operational constraints and considered that three months from the date on which the TSPC tariff rate was published would allow suppliers sufficient time to determine their safeguard tariff rates and notify consumers.<sup>293</sup>

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<sup>287</sup> RWE, Centrica, Scottish Power, EDF Energy, SSE, E.ON, Citizens Advice.

<sup>288</sup> EDF Energy

<sup>289</sup> Good Energy.

<sup>290</sup> SSE.

<sup>291</sup> Scottish Power.

<sup>292</sup> First Utility.

<sup>293</sup> RWE.

72. One respondent said that in their experience any mass roll-out of prepayment messages would take a long time and this should be considered in setting any transition period.<sup>294</sup>
73. Another respondent thought that the transition process should be as quick as possible to ensure consumers received the financial benefits.<sup>295</sup>
74. One respondent said that any transition arrangements would need to take into consideration the already committed costs of suppliers (such as hedged energy costs), and the ability of customer service centres and the prepayment meter infrastructure to manage the transition. A more detailed examination of these factors is required to assess a suitable timescale.
75. One respondent suggested that no transition was necessary, this would just add complexity for those suppliers affected.<sup>296</sup>
76. Another respondent believed that it could take many months to design the tariff and allow an implementation period. It was therefore likely that a transition would not be until 2017 and would then continue through 2017 and 2018.<sup>297</sup>
77. One respondent said that as it considered smart prepayment meters should be excluded, then any phased transition was likely to be superseded by the transition to smart.<sup>298</sup>

### ***Circumvention***

78. Five respondents did not believe suppliers would be able to circumvent tariff regulation by encouraging customers to switch onto less favourable unregulated tariffs as they considered that the existing Standards of Conduct licence conditions should provide sufficient protection.<sup>299</sup> Two others considered this low risk for the same reason.<sup>300</sup> Robin Hood Energy stated that they believe suppliers would circumvent the remedy unless it includes both fixed and variable credit tariffs. They consider that the existing payment method regulations are being circumvented because Ofgem does not take

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<sup>294</sup> Centrica.

<sup>295</sup> Citizens Advice.

<sup>296</sup> Robin Hood Energy.

<sup>297</sup> E.ON.

<sup>298</sup> Good Energy.

<sup>299</sup> Utilita, Citizens Advice, RWE, SSE, EDF Energy.

<sup>300</sup> First Utility, Scottish Power.

consideration of fixed credit tariffs. If the regulations were enforced in their spirit, they should provide sufficient protection.<sup>301</sup>

79. One respondent considered that suppliers might be able to circumvent the remedy but it believed it would be challenging, brand damaging and potentially in breach of the existing standards of conduct.<sup>302</sup>
80. One respondent did not see the risk of circumvention being any more than already exists and highlighted the effective deterrent in Ofgem's enforcement of the Marketing and Standards Conduct Licence Conditions (SLC25 and SLC25C).<sup>303</sup>

### ***Responsibility for implementation***

81. One respondent noted that which party was best placed to set the cap would depend on the context in which it was set, with the CMA being well placed for a one-off setting but Ofgem being better placed for subsequent updates.<sup>304</sup>
82. One respondent said that this could be implemented by the CMA or Ofgem.<sup>305</sup>
83. One respondent suggested that there may be a role for Ofgem in administering any price cap but that independent review would be necessary to ensure the cap was fair to all suppliers.<sup>306</sup> Another respondent suggested that Ofgem was better placed to set a cap in consultation with suppliers.<sup>307</sup>
84. Two respondents considered that (if a cap is implemented), given the requirements for monitoring and review, the CMA should set the methodology and initial parameters for the cap, including the necessary headroom and review requirements, before handing the detail of actually setting the level of the price cap over to Ofgem.<sup>308</sup> SSE considered that, as the cap would be a transitional measure, the CMA should set the level.<sup>309</sup>
85. One respondent considered that, without prejudice to their strong opposition to this remedy, Ofgem should set any price cap tariff but said that the mechanism for setting the price cap must be clear, detailed, and fully

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<sup>301</sup> Robin Hood Energy.

<sup>302</sup> Centrica.

<sup>303</sup> E.ON.

<sup>304</sup> Citizens Advice.

<sup>305</sup> EDF Energy.

<sup>306</sup> First Utility.

<sup>307</sup> Good Energy.

<sup>308</sup> Scottish Power, Utilita,

<sup>309</sup> SSE.

transparent and any decisions in relation to the setting of the safeguard price cap levels should be subject to a fair process including rights of appeal.<sup>310</sup>

86. One respondent suggested that mandating Ofgem to impose a cap that would have adverse effects on competition could compromise the regulator's duty to promote competition.<sup>311</sup>
87. One respondent said that the obligation to comply with the cap could be absolute (ie suppliers must comply at all times) or could be measured on an average basis, eg over the course of a year, or on a rolling 12-month basis.<sup>312</sup>

### ***Unintended consequences***

88. Some respondents identified a variety of unintended consequences including:
  - (a) A price cap is likely to distort competition in the rest of the market with companies being deterred from entering the prepayment meter segment because of the presence of price regulation.<sup>313</sup> E.ON noted that a price cap is likely to distort competition in the rest of the market with the commercial opportunity which is currently attracting suppliers like E.ON to offer new solutions to companies being deterred from entering the prepayment meter segment reducing because of the presence of price regulation.<sup>314</sup> Ofgem suggested that a price cap risks distorting competition in the rest of the market for example by eroding the incentive for eligible customers to engage in the market.<sup>315</sup>
  - (b) Could reduce switching as customers' potential savings are reduced and customers may be attracted to a tariff with regulated prices (believing that it is 'safe') rather than engaging in the market.<sup>316</sup> EDF Energy suggested that a price cap could conflict with the other remedies aimed at increasing engagement.<sup>317</sup>
  - (c) If the headroom is set too low, new entrants and existing competitors would struggle to persuade customers to leave the protection of regulated prices, reducing the market for new entry and ultimately the amount of competitive deals available to prepayment meter customers.<sup>318</sup> E.ON

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<sup>310</sup> RWE.

<sup>311</sup> SSE.

<sup>312</sup> Scottish Power.

<sup>313</sup> Centrica, EDF Energy, RWE, Scottish Power, SSE, Good Energy, First Utility.

<sup>314</sup> E.ON.

<sup>315</sup> Ofgem.

<sup>316</sup> Centrica, EDF Energy, E.ON, RWE, Scottish Power, SSE, Good Energy, First Utility.

<sup>317</sup> EDF Energy.

<sup>318</sup> Centrica, EDF Energy, RWE, Scottish Power, SSE, Good Energy.

noted that if the headroom is set too low this would undermine competition, create disengaged customers and could result in suppliers selling at a loss.<sup>319</sup>

- (d) A relatively high safeguard price cap allows suppliers with high levels of default prepayment meter customers to maintain a competitive advantage over suppliers with low numbers of these customers.<sup>320</sup>
- (e) Could work in direct opposition to the other proposed remedies.<sup>321</sup>
- (f) Could negatively impact on other remedies aimed at stimulating engagement.<sup>322</sup>
- (g) Could reduce innovation.<sup>323</sup> Ovo Energy was supportive of a price cap but had concerns that such a measure might harm innovation to a greater extent than an alternate proposal such as a cost reflective principle.<sup>324</sup>
- (h) Risks reducing the focus of the smart meter roll-out on prepayment meter customers. Customers may fear losing their protected prices if they have a smart meter fitted and so resist the roll-out programme, thus increasing the costs of the programme.<sup>325</sup> E.ON noted that there is the risk that customers moving from the capped product could see an increase in price. This highlights the danger of introducing a cap. There is also the risk that existing credit meter customers request prepayment meters to access the protected tariff, impacting the smart meter roll-out programme.<sup>326</sup>
- (i) As more prepayment meter customers benefit from smart meters there would need to be consideration of the fair allocation of the cost of the existing prepayment meter infrastructure. As fewer customers utilise the infrastructure the fixed costs per customer would increase, and this requires further consideration.<sup>327</sup>
- (j) The level of the safeguard price cap is not capable of changing as rapidly as the market and so insufficient headroom could mean suppliers are unable to manage market risks.<sup>328</sup>

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<sup>319</sup> E.ON.

<sup>320</sup> EDF Energy.

<sup>321</sup> E.ON, Centrica.

<sup>322</sup> Ofgem.

<sup>323</sup> Citizens Advice.

<sup>324</sup> Ovo Energy.

<sup>325</sup> RWE, EDF Energy.

<sup>326</sup> E.ON.

<sup>327</sup> EDF Energy.

<sup>328</sup> EDF Energy.