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By email

Dear Denis

Our alternative remedy – SVT into SCT

In our response to the Competition and Market Authority's Provisional Decision on Remedies (**PDR**), we set out our concerns around the focus and timing of the proposed retail remedies, and, at a high level, an alternative remedy. We wanted to take this opportunity to provide the CMA with more detail.

Before providing that further detail, it is helpful to revisit the basis for the concerns around the GB energy market as set out in the state of the market analysis carried out in 2014. In that analysis, one of the key assessments was that, “the ‘stickiest’ customers, who are more likely to belong to vulnerable groups, pay higher prices for their energy than those that are able and willing to switch supplier for a better deal.”¹ These customers have effectively been left - or been encouraged to remain - on the default tariff. As the CMA has found, the detriment experienced by customers over the period 2012 to 2015 is some £1.7 billion a year, with a marked trend upwards, to some £2.5 billion in 2015.²

Whilst a default tariff mechanism is needed to ensure a place for those not taking action on fixed tariff expiry (**FTE**), many customers have remained on this tariff type for more than three years³ - surely more than a “default”. This mechanism has also led in effect to one “standard” variable tariff as customers are always rolled onto cheapest variable. This has obscured the need for active competition for, and effort towards, these unengaged

¹ https://www.ofgem.gov.uk/sites/default/files/docs/2014/03/assessment_document_published_1.pdf, paragraph 1.18

² Please see paragraph 59, PDR [https://assets.digital.cabinet-office.gov.uk/media/5706757340f0b6038800003b/Provisional-decision-on-remedies-EMI.pdf]

³ As the CMA found, 70% of customers have been on the SVT for more than three years and 55% for more than five years: please see paragraph 6.247, PDR.



customers. We think that this default needs a reset, to be made within the package of related measures aimed at fostering engagement. We set out our alternative views on certain remedies, and crucially from a non-engaged customer perspective, the timing for those remedies in our response.⁴

Further, in the active segment of the market – returning again to the “tale of two markets” – “[C]ustomers that are prepared to manage their accounts online, pay by direct debit, and fix the cost of their energy for 12-18 months are able to get the best deals.”⁵ As the CMA rightly noted, this is where many of the newer suppliers compete, although we are now seeing aggressive acquisition strategies by some of the Big Six. We highlighted some of these tactics in our response, e.g. at paragraphs 4.7 and 4.8. Our PDR response describes our very strong concerns that the remedies targeted at addressing lack of customer engagement amongst those on long-standing SVTs (which finding we agree with) are to come into effect a long time after those that seem geared towards the active segment of the market. As a result, we proposed an alternative timeline.

We also set out at high level a possible alternative remedy. Any remedies must support engagement for the non-engaged segment of the market and actually address in a timely manner the CMA’s finding of a lack of engagement amongst SVT (mainly Big Six) customers. This alternative remedy is intended to work as part of the re-phased package of remedies that we proposed. That alternative, to the proposed database (scheduled for late 2018), would be a “requirement effectively to replace SVT contracts with a contract for the cheapest tariff available, at specified times, to be focused on those suppliers with long-standing SVT customers (a three year or more SVT customer as proposed by the CMA as part of the Ofgem-managed database remedy) and to come into effect as soon as practicable, but well in advance of 2018.”⁶

To assist with timely implementation, this alternative proposal needs to work *with* the grain of existing rules and avoid unnecessary complexity (and thus unnecessary implementation costs). It must also avoid or otherwise address the potential for gaming.

⁴ <https://assets.digital.cabinet-office.gov.uk/media/5717468ded915d749d000004/first-utility-response-to-pdr.pdf>, please see p. 3

⁵ https://www.ofgem.gov.uk/sites/default/files/docs/2014/03/assessment_document_published_1.pdf, paragraph 1.17.

⁶ <https://assets.digital.cabinet-office.gov.uk/media/5717468ded915d749d000004/first-utility-response-to-pdr.pdf> - please see the summary on page 2-3 and the more detailed description in section 4, in particular p. 11 and paragraphs 4.48 – 4.52.



Our alternative proposal in more detail

Our alternative proposal is effectively a “reset” for the “Standard Variable Tariff” or SVT, including:

- For those customers on “SVT” for more than three years, their supplier would replace their tariff with the then cheapest fixed tariff at a defined point or based on length of time on the SVT over three years, at defined future points (this would mean that the average may change but the aim is to “reset” the tariff so as to ensure specific communications rather than to ensure parity of tariffs *per se*);
- No replacement tariff would have an exit fee applied to it (although any calculation around the cheapest tariff would factor in that tariffs may be subject to such fees);
- The “cheapest fixed tariff” would be an average of the cheapest fixed tariffs over the previous twelve months, or other appropriate period, and where these include exit fees, these are effectively added to the price of that “cheapest tariff” to prevent gaming. The ideal mechanism for this would be to take the supplier cheapest tariff as determined each month as part of the remedied SCT process for customer communications, with the average created from those tariffs⁷;
- The replacement method would use an adaptation of the “dead tariff” mechanism to effect this tariff change. This could work as follows: the standard variable tariff or SVT is effectively rendered “dead” and thus, all SVT customers could be sent a Dead Tariff Notice⁸: those under three years on the SVT are migrated to a “clone” of the previous tariff (which would be the same as the previous tariff, but “new” in order to kick-start the communications process) and those over three years are sent to the new fixed tariff. Customers over three years could opt to go on the cloned tariff and potentially, those customers under three years could opt to go on the new fixed tariff.
- The new tariff for this purpose would be a tariff with a fixed price and fixed term but with no exit fees of any kind. Customers should be free to switch tariff or supplier without penalty. Essentially, this provides the benefits of a variable tariff but with

⁷ For illustrative purposes, if Supplier X's best tariff is £750 at national average usage, with a £30/fuel exit fee - then a dual fuel SVT customer – on that SVT for more than 3 years - from their £1,075 SVT (now a “clone” tariff) to £810 tariff (created from the £750+£60 exit fee. Where Supplier Y's best tariff is £900 with no exit fee - then an SVT customer at £1075 would be moved to the £900 fixed tariff: this reflects that there is really no practical difference between the variable and the fixed in this case.

⁸ The Dead Tariff Notice includes SVT messaging and prompts the customer to take action if they don't want to automatically move to this tariff.



the added benefits of a fixed price and automatic inclusion of all the communication prompts that go with fixed tariffs. There is no additional commitment to that made on an SVT - no exit fee and no charge for changing. The aim is to ensure continued engagement with the wider market not further disengage by auto-applying a price decrease.

- This could also be in the form of a “price guarantee until [DATE]”, based on the average of that supplier’s cheapest tariff, to allow the customer to take action to preserve the lower tariff through choice (note they are now within the FTE communications pipeline) or a reset back onto a refreshed variable;
- These changes could be made by a change to the customer T&Cs on a unilateral basis but because it is not to their detriment, it could be effective immediately. The relevant SLCs would also need to be amended, (i) making the new tariff a “fix” for the purpose of dead tariff rules so that the under 3 year customers aren't defaulted to it but (ii) directing the over 3 year customers to be sent to it (iii) not having any lock in to avoid restriction on suppliers rolling a customer on to fixed tariffs; and
- If the average of the previous fixed tariffs is in fact higher than the “clone” SVT, the reset would be including within an adapted type of FTE communications pipeline, the highlighting of SCT (and MCT when implemented) in the usual way.

This alternative remedy is to help unengaged customers, not to decide for them - they must be able to opt out or revert to the “clone” SVT if they want to.

Potential benefits

We believe there is a number of benefits to our alternative proposal, in the form of improved competition:

- **It provides a clear point at which customers on the SVT will be required to engage with the opportunity to switch and assess the relative merits of different suppliers/tariffs.** This model has been applied, to a certain extent, in the financial services sector where investment products are in place for a particular time-period and at the end of the period the customer is reminded of the need to assess their options and consider alternative products. With nearly 70% of customers remaining on the SVT for more than three years, any additional level of engagement could have an impact on the total levels of switching and engagement with the market, bringing competitive benefit.



Having a point at which SVT customers are put onto the fixed term tariff journey would mean customers are engaged with the market. This would address some of the customer awareness issues identified by the CMA in its customer research in which it found that 34% of customer survey respondents had never thought to switch supplier and 72% of respondents have never switched tariffs with an existing supplier or did not know it was possible.⁹ Given the material gains from switching not being realised (some £2.5 billion in 2015 as the CMA highlighted), this is key to ensuring that benefit can be unlocked.

- **The availability of information regarding the Supplier Cheapest Tariff (SCT) and the Market Cheapest Tariff (MCT) would support with engagement at the point of switching as well.** The greater transparency over available tariffs and costs is an important factor in supporting customer engagement with the market as it can demonstrate the value available to customers from either switching tariff with an existing supplier or switching supplier. The availability of this information, in particular at the point in time when the customer's fixed term contract expires, would reduce the search costs of gathering the information and provide information regarding the energy deals available to customers at the time of seeking a new fixed term deal.

We also believe our proposals - which are based on existing processes all suppliers have implemented - can be implemented by the industry in a year rather than the three years proposed by the CMA for specific remedies (e.g. the database and the implementation of the various messages following evidence-gathering) in the PDR. As a result of our proposed shorter implementation time frame, the benefits of bringing the potential for greater competition to customers currently on the SVT will be achieved two years earlier than those currently proposed by the CMA.

A potential challenge that may be raised against our proposals is that with the end of limitations on the number of tariffs available, brought forward by Ofgem recently along the lines proposed by the CMA in the PDR, the amount of information required to support fixed term deals MCT and SCT could be confusing or open to gaming by suppliers (e.g. through offering cheapest deals for limited time periods, to specific groups of customers etc.). There is little to suggest this challenge would undermine the overall argument to proceed with our suggested remedy, particularly in the context of the customer engagement benefit that can be secured as described above. There are two main considerations:

⁹ See CMA (2015), paragraph 7.64



1. The industry has demonstrated that it can make such information available as part of the implementation of RMR: suppliers have been able to prepare and distribute for customers SCT and some supplier offer deals that identify MCT at various points in time – the approach exists already and could be applied more widely.
2. In our 11 April 2016 submission, we stressed the importance of Ofgem retaining its enforcement duties, powers and capabilities which would be fully consistent with the management of comparative tariff information such as SCT and MCT data. It is also important to note that the CMA energy market review has operated in the context of rebuilding trust in the energy sector and companies will feel incentivised to produce information that supports that transparency as part of improving relationships with customers, building trust and to avoid regulatory enforcement.

We recognise that our alternative proposals are being raised at a late stage in the CMA process. However, given the importance of the potential benefits to be secured in giving previously disengaged customers the opportunity to review the economics for them of being on the SVT we believe consideration of our proposals is merited. In terms of implementation, a potential route for the CMA to consider may be to task Ofgem to work with the industry on the delivery of the proposals we have outlined, thereby minimising the further requirement for CMA input on the detailed design of our suggested approach. We would be happy to discuss any aspects of this letter, or our submission more generally, with you and colleagues if that would be helpful.

Yours sincerely

[not signed]

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