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Statutory Consultation Response on the Future of the Ban on Acquisition-only Tariffs ("BAT")

Dear Dan,

So Energy is a leading energy supplier providing great value renewable electricity to homes across Great Britain. We supply over 350,000 customers and as one of the last challenger suppliers left in the market and one that is backed by ESB Group's resources and expertise, So Energy is able to provide a unique view of on the BAT.

Ofgem has made a serious and material error in the assumptions underpinning which, if left uncorrected, will lead to consumer detriment. Ofgem has assumed there will be no price discrimination as a result of the removal of the BAT. An independent report by Charles River Associates (CRA), submitted alongside this response, presents compelling analysis and evidence showing that, if the BAT is removed, suppliers will engage in price discrimination, even with a price cap in place. This has critical implications for this policy. CRA projects that, loyal customers, who are more likely to be vulnerable, will pay an extra £11-£74 for their energy. These customers will fund discounted Acquisition-only Tariffs (AoT). When price discrimination is incorporated into the modelling Ofgem has used to underpin their minded-to position, it turns their positive benefits case into a negative benefits case.

Ofgem's modelling has calculated the savings consumers can make by switching suppliers without factoring in switching costs. Direct switching costs, like PCW commission (in the region of £70 or more for a dual fuel customer) and indirect switching costs¹ have a substantial impact on consumer outcomes. When switching costs are incorporated into Ofgem modelling, it pushes the benefits case further into the negative.

Ofgem has made other clear errors and omissions, which we demonstrate in our response, backed up by analysis and evidence. Here is a summary of the main issues we have found:

Ofgem Assumptions	What BAT removal will deliver
Loyal customers will pay the same	Loyal customers will pay more
Active switchers will save money	Active switcher savings diminished by switch costs
Overall positive impact assessment	Overall negative impact assessment
No impact on vulnerable consumers	Vulnerable consumers, who are more likely to be loyal customers, will pay more
Consumer choice will increase	Consumer choice will decrease
Benefits of Market Stabilisation Charge removal passed through to customers once BAT is removed	Benefits of Market Stabilisation Charge removal have already been passed through to customers
Efficiency gains from removing BAT	Suppliers will pursue price discrimination before pursuing efficiency gains.

Simply put, Ofgem has made some incorrect assumptions, which is leading them to the wrong decision. Ofgem should retain the BAT until March 2025 and use the additional time to refine its analysis and consult on making the BAT permanent.

¹ A 2019 FCA investigation into pricing practices in the insurance market found these to be around £20 for either home insurance or motor insurance.

FCA "[General insurance pricing practices interim report](#)", paragraph 5.32, p32

1. Do you agree with our minded-to position that Ofgem should modify supply standard licence condition SLC 22B to remove the BAT from 1 October 2024?

No.

Consumers also do not agree. A survey of 2,000 consumers found that 68% of consumers disagreed with Ofgem's proposal to allow suppliers offer cheaper deals to new customers without offering the same deals to existing customers. When asked if existing customers should have access to the same tariffs as new customers, 87% of consumers agreed. This shows that there is strong support for retaining the BAT and strong opposition to Ofgem's proposal to remove the BAT from October 2024.

MPs also do not agree. A survey of 103 MPs found that 71% of disagreed with Ofgem's proposal to allow suppliers offer cheaper deals to new customers without offering the same deals to existing customers.

2. If you consider that the BAT should remain in force until 31 March 2025, do you think the market wide derogation from SLC 22B for fixed retention tariffs should also continue until 31 March 2025?

Yes, the market-wide derogation should also remain in force in order to provide flexibility to suppliers on tariff offerings.

We note Ofgem's narrative in the statutory consultation regarding the BAT reducing consumer choice. Ofgem state:

"3.8. On a related point, one effect of the current BAT (and the associated market wide derogation) has been an increase in 'retention-only' tariffs, where suppliers offer a deal to existing customers which is not available to new customers. As these deals are not open to all, information about them is not as widely available. This presents transparency issues; it is harder for a consumer to know if their current deal is uncompetitive if there are less whole-of-market deals available to compare it to. Similarly, consumers may find it more difficult to compare a new retention-only deal against alternatives in the market (if, for example, its details are not included in price comparison websites). This creates problems for consumers both when agreeing to their deal in the first place and also when considering alternatives to it at a later stage."

We also note that in its February 2024 decision, Ofgem stated the following:

"We will use the time provided by an extension to further analyse the impact of the BAT once the MSC has been removed from the market. This will be useful to verify whether the conclusions of our analysis were borne out by reality, as well as when considering the BAT if options to remove or replace the price cap are being considered."

It does not appear that Ofgem has monitored tariff offerings in the market. While retention-only tariffs were more common in 2023, by the time Ofgem outlined their decision to remove the BAT in February 2024, only 3 of 16 tariffs publicised on Money Saving Expert website were retention-only. Today, with the MSC fully removed, only two tariffs publicised on MSE are retention-only. Both are complex tariff offerings from Octopus - Octopus Tracker and Agile Octopus. Colleagues from Octopus have made clear that the BAT has nothing to do with these complex tariffs being available to existing customers and the removal of the BAT would not change the availability of these tariffs.

We see no evidence, therefore, that the BAT or the derogation is having an adverse effect on consumer choice. There appears to be no detriment.

3. Do you have any comments on the analysis presented in Section 2?

The analysis presented in section 2 contains many errors and omissions. We detail these below.

Price Discrimination

The analysis omits any mention of the impact price discrimination - charging loyal customers more in order to fund discounts for active switchers - will have on the market. A reading of Section 3 and Annex 3 makes clear that Ofgem has assumed that because the price cap is in place, this type of price discrimination will not happen, or, if it did, that it would not make any difference². The implication throughout the document is that suppliers would sacrifice margin in order to fund discounted AoTs instead.

An independent report by CRA, submitted alongside this response, presents compelling analysis and evidence showing that, if the BAT removed, suppliers will engage in price discrimination, even with a price cap in place. The report is summarised below:

If the BAT is removed, will suppliers choose to price discriminate³?

- **Yes**, given a choice, a supplier, as a rational economic actor, will choose price discrimination before sacrificing margin. This is especially true given Ofgem's financial resilience rules, which Ofgem says "will prevent a return to unsustainable price competition and excessive risk taking." Ofgem's statements on financial resilience in the statutory consultation and its assumptions around margin sacrifice in its analysis do not align.
- **Yes**, given a choice, a supplier, as a rational economic actor, will choose price discrimination before investing in efficiency.
- **Yes**, even if a supplier is not minded to price discriminate, competitive pressure may force them to do so in order to defend market share.

If the BAT is removed, will suppliers have the opportunity to discriminate, even with the price cap?

- **Yes**, certainly with Fixed Retention Tariffs (FRTs). This is especially the case when the wholesale market is falling, which is precisely the scenario Ofgem is modelling for their impact assessment. In this scenario, suppliers could price retention tariffs at a higher gross margin, but still below the cap, and use that money to fund cheaper PCW exclusives.
- **Yes**, it may also occur with SVT tariffs, despite the cap⁴. While in current times it is common for suppliers to price SVTs at the cap, this was not always the case. Pre-crisis, it was common for suppliers to price their SVT at a discount to the cap. Today, as the market has begun to normalise, the largest electricity supplier is now pricing their SVT below the price cap. We also note that the cap is continually under review, which could create further opportunities for pricing below the cap in the future.

Factoring-in price discrimination transforms our understanding of whether removing the BAT is the right or the wrong decision. When price discrimination is taken into account, it turns a reduction in supplier profit margins into a transfer of wealth from loyal, more vulnerable,

² Ofgem state in Annex 3 that price discrimination "...would reduce consumer benefits, it would also proportionately reduce supplier losses..."

³ CRA tackle this question in section 4 of their report.

⁴ However, there is still ample opportunity for price discrimination, even if all SVTs were priced at the cap.

consumers to less vulnerable active switchers. It turns a positive impact assessment into a negative impact assessment. We set out our analysis of the impact price discrimination has on consumers in our response to Question 4.

Consumer choice

Ofgem is under the mistaken impression that removing the BAT would improve consumer choice:

“2.20. We have openly acknowledged that some decisions during the gas crisis, not least the introduction of the MSC and the BAT, prioritised market stability over competition and limited consumer choice as a result...Now that we are largely through the crisis, we are mindful of the importance of restoring greater consumer choice...”

As we have set out in our response to Question 2, we do not see any evidence in today's market that the BAT and its associated derogation is limiting consumer choice. With regards to tariffs that are only available to existing customers, suppliers would still have the discretion to offer these tariffs were the BAT removed. To the extent that we are aware of such tariffs (Octopus Tracker and Agile Octopus), our understanding is that these would continue to be available to existing customers only.

On the other hand, price discrimination provides suppliers with the opportunity to restrict the availability of its tariff offerings – charging loyal customers more through FRTs so that it can charge active switchers (who are more price sensitive) less AoTs. In reality, the decision splits one market into two, where:

1. Loyal customers are consistently paying more through their FRTs than if the BAT were in place.
2. Price sensitive customers are compelled to move from supplier to supplier on an annual basis in order to get a price they like.

This is not ‘*greater consumer choice*’. If removing the BAT truly improved consumer choice it would have the backing of consumer advocacy organisations such as ‘Citizens Advice’ and ‘Which?’. Both these organisations have publicly opposed the removal of the BAT⁵.

Efficiency Gains

Because Ofgem assumes suppliers will not price discriminate, it concludes that removing the BAT will drive efficiency gains:

“2.16. The scenario where the net efficiency benefit would be negative, which would suggest the strongest case to extend the BAT, would be where the existence of the BAT means that suppliers offer the same tariffs to new and existing customers, i.e. that existing customers benefit from lower prices that would otherwise only be available to new customers. In this scenario, in the absence of the BAT, we assume only new customers benefit from more attractive tariffs. Our view is that the historical evidence does not suggest that the market would

⁵ <https://www.which.co.uk/policy-and-insight/article/which-response-to-ofgems-statutory-consultation-on-the-future-of-the-ban-on-acquisition-only-tariffs-bat-aJqhH0Y6QvnJ>
<https://www.citizensadvice.org.uk/policy/publications/citizens-advice-response-to-ofgems-statutory-consultation-on-the-future-of/>

plausibly behave as such. We discuss this further in the section on 'price and non-price competition' below."

The CRA report makes clear that price differentiation will happen and points towards historical evidence where this occurred prior to the energy crisis, through practises such as 'tease and squeeze'⁶. Price discrimination presents an option that suppliers could choose to remain price competitive in lieu of investing in efficiency gains. Of those two options, price discrimination is profit maximising – therefore, suppliers will chose to price discriminate before investing in efficiency gains. Therefore, removing the BAT makes efficiency gains less likely as it provides other routes to price competitiveness.

Customer Satisfaction

Suppliers have throughout the consultation process emphasised the importance of moving away from a 'tease and squeeze' market to one in which suppliers can build longer-term relationships and trust with their customers. This is especially important in the context of the changes customers will see as they navigate the Net Zero transition.

In justifying their decision to remove the BAT early, Ofgem has stated that the BAT has made customer satisfaction worse:

"2.44. We reach a similar conclusion when considering the argument, put forward by some respondents to our October 2023 Call for Input, that the reduction in price competition could encourage greater focus on non-price competition and better overall service. To date, this has not materialised and there is no compelling evidence that the retention of BAT would be likely to drive better non-price market outcomes. Indeed, in the pre-crisis period higher levels of customer satisfaction coincided with higher levels of switching, which suggests that price and non-price competition are more likely to be complementary rather than alternatives. We recognise that since the crisis there has been a positive relationship between the firms that are gaining new customers, and customer satisfaction. However, we have not seen evidence that the nature of price competition while BAT is in place has driven overall positive impacts on non-price customer outcomes, or that there have been improvements in customer satisfaction driven by weaker price competition."

Ofgem is drawing a specious correlation which ignores key issues that affect customer satisfaction. First, the BAT was introduced in response to an energy crisis where prices increased to record levels, driven by international events⁷. It is expected that when prices rise to record levels, customer satisfaction will decline. This is especially the case when consequential issues, such as rising levels of debt are taken into account.

Second, switching collapsed as a consequence of rising prices and how these interacted with regulatory and government interventions such as the price cap and the Energy Price Guarantee. It is not reasonable to conclude that the BAT caused a collapse in supplier switching when these other issues are accounted for. For Ofgem to take the pre-crisis market as their baseline and compare it to a crisis and post-crisis market, where prices are still elevated and debt remains a substantial issue for consumers⁸, is not a fair or honest correlation to draw.

⁶ Section 4.2.3 of the CRA report.

⁷ If Ofgem wants to make the argument that by introducing the BAT, they made the energy crisis worse, they are welcome to do so.

⁸ <https://www.ofgem.gov.uk/call-for-input/affordability-and-debt-domestic-retail-market-call-input>

4. Do you have any comments on the draft impact assessment presented in Section 3?

Ofgem has made a number of fundamental mistakes developing in its draft impact assessment⁹. These mistakes are fundamental because they will lead to different and worse outcomes for consumers compared to what the IA anticipates. The key mistakes are:

- A. Ofgem assumes that suppliers will not engage in price discrimination as a result of removing the BAT, despite the fact that this is exactly what the BAT is designed to prevent. The CRA report makes clear that we should expect to see price discrimination should the BAT be removed.
- B. The analysis does not account for 3rd party sales commission. To the extent that suppliers price discriminate, some of the additional revenue gained from loyal consumers will actually accrue PCWs, rather than consumers who switch to AoTs. This creates a net negative impact on consumers. At upwards of £70 per dual fuel sale, this material detrimental impact has been left out of Ofgem's analysis. The analysis is also missing additional search costs on behalf of consumers which the FCA found to be the region of £20 per switch for home or motor insurance¹⁰.

The analysis presented with the consultation makes no comment on where suppliers will get the money to fund cheaper AoTs. Three potential sources are identified elsewhere in the consultation:

1. Margin destruction: Firstly, Ofgem make clear in their executive summary that *"Financial resilience rules will prevent a return to unsustainable price competition and excessive risk taking."* We have no indication otherwise from Ofgem that it believes suppliers are pricing their existing fixed tariff margins sufficiently high that they can forego margin without creating financial resilience issues, especially in the context of strict capitalisation requirements and bad debt issues within the market. Secondly, the CRA report makes clear that foregoing margin is the last possible option a supplier will take when pricing a tariff.
 - Conclusion – this is an unlikely source of AoT savings.
2. Savings from the withdrawal Market Stabilisation Charge: As made clear in our response to question 3, these savings have already been passed through to customers.
 - Conclusion – this will not be a source of AoT savings.
3. Price Discrimination: As the CRA analysis make clear, a rational supplier will engage in this before considering foregoing margin. The falling market scenario Ofgem scrutinises under its model presents the greatest opportunity for suppliers to engage in price discrimination as suppliers can offer FRTs below the cap and at a high margin, then use this money to fund cheaper AoTs.
 - Conclusion – this by far the most likely source of AoT savings, *especially* in the falling market scenario scrutinised under Ofgem's modelling.

Assuming that price discrimination will take place is the only rational choice Ofgem is in a position to make, especially as Ofgem is modelling falling market scenarios. When price discrimination is factored into Ofgem's analysis, it becomes clear that there is a negative overall impact to consumers using Ofgem's chosen analytical framework. We set out the impact below:

1. Benefits arising from savings made by consumers who switch tariff:
 - Ofgem baseline assumption is that any cheaper AoT tariffs are in addition to existing Fixed Tariffs (FTs) on offer, presumably funded by suppliers foregoing margins. Therefore, the more AoTs sold, the greater the benefit to consumers.
 - If you carry forward the most reasonable assumption that suppliers will choose price discrimination over foregoing margins, then the benefit accruing to consumers falls to zero. The gains of customers taking AoTs are entirely offset by increased prices for customers taking FRTs.
 - If you factor in the impact or direct switching costs, such as PCW commission on top of

⁹ Including the associated analysis in Annex 3.

¹⁰ FCA *"General insurance pricing practices interim report"*, paragraph 5.32, p32

this, the benefit becomes a loss. For every £200 additional revenue a supplier collects from FRT customers for price discrimination purposes, if there was a PCW fee of £70 then only £130 would go to an AoT customer. Ofgem's projected gains to consumers have now become a net *loss*. Adding in consumer search costs of a £20 would further negatively impact the analysis.

2. Losses incurred by suppliers as a result of selling out hedges when they lose customers:

- Ofgem baseline assumption is that the more switching owing to AoT tariffs, the greater the losses incurred by suppliers. Ofgem's modelling showed that, using these baseline assumptions, benefits to consumers outweighed these losses to suppliers in most scenarios.
- Ofgem state that if they were to incorporate price discrimination into their model, "*it would reduce consumer benefits, it would also proportionately reduce supplier losses*". As we made clear in point 1, above, benefits to consumers are actually reversed and become losses. With regards to supplier losses under the model, as it only considers the cost of losing suppliers of having to sell out their hedges, then the losses are solely determined by levels of switching rather than the source of the funding for AoT savings. The more money a supplier can gain through price discrimination in the falling market scenarios tackled by Ofgem's model, the greater the AoT savings, the greater the level of switching and the greater the level of supplier losses under the model. Therefore, AoT offers which are funded through price discrimination still result in supplier losses from selling out hedges – there is no 'netting out' effect.

Ofgem's previously identified benefits become losses and Ofgem's previously identified losses remain losses. The negative overall impact on consumers and the market is clear.

There are other issues with the impact assessment, which we detail below.

Distributional Analysis

In 2020, Ofgem committed to factoring in the impact of their decision making on particular groups of customers who may be in vulnerable situations¹¹. Ofgem's assumption that no price discrimination will take place should the BAT be removed has had knock-on implications for their analysis of the distributional impacts of their decision. Because Ofgem ruled out the possibility of price distribution, no consideration was given to the possibility of some consumers paying more for their energy. The current distributional analysis is not fit for purpose because it does not consider key questions, such as:

- Are consumers who renew with their existing supplier more to have vulnerability characteristics, such as being elderly, disabled or low income than customers that actively switch suppliers on a regular basis?
- To the extent that the above is true, is the negative impact on vulnerable consumers outweighed by the benefits to consumers in general¹²?

Given the vast majority of AoTs have historically been available through online PCWs and particular vulnerable groups are more likely to be digitally excluded¹³, it is highly likely that customers that can regularly renew with their existing supplier over the phone are more likely to be vulnerable than the consumers switching supplier through PCWs. Absent of any other data, all indications are that customers on FRTs are more likely to be vulnerable than customers on AoTs. Ofgem need to do further analysis to determine the distributional impact of removing the BAT.

¹¹https://www.ofgem.gov.uk/sites/default/files/docs/2020/05/assessing_the_distributional_impacts_of_economic_regulation_1.pdf

¹² Note, we consider the removal of the BAT to be detrimental to consumers in general.

¹³ P. 17 [https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20\(1\).pdf](https://www.citizensadvice.org.uk/Global/CitizensAdvice/Consumer%20publications/Super-complaint%20-%20Excessive%20prices%20for%20disengaged%20consumers%20(1).pdf)

Counterfactual Issues

Ofgem's assumption around price discrimination has led to some skewed conclusions in their analysis. For example, Ofgem state:

"3.15. The scale of any disbenefit that might be faced by individual customers is a different question. With the BAT in place, we were keen to observe whether disengaged customers would pay less as a result – in other words, with suppliers unable to offer subsidised deals for incoming customers, whether that 'subsidy amount' would be returned to their existing customer base instead via cheaper prices. We have not seen that happening in practice - so far disengaged customers are not paying notably less under the BAT (whereas active customers are paying more)."

Ofgem has not considered that prices for disengaged customers are likely to rise, should the BAT be removed. It's also unclear where this 'subsidy amount' is supposed to be coming from, if not from price discrimination. Presumably from suppliers sacrificing their profit margins while somehow remaining financially resilient in a context of an Ofgem requirement for suppliers to recapitalise their businesses following the energy crisis. If Ofgem is going to promise savings to consumers, then they should be clear about where the money is coming from. The CRA report makes clear that the most likely source is other loyal customers, who are more likely to be vulnerable.

Similarly, the statutory consultation appears to imply that savings from the removal of the MSC, removed in April, will only be passed to consumers once the BAT is removed in October:

"In the short timeframe we are considering here, the removal of the MSC (whose price varied around £20-40 per switch in the weeks prior to its removal) also provides both a reduction of supplier costs for each switch and greater certainty when planning acquisition strategies for coming months (by removing the variable cost of the MSC as a factor). This could benefit engaged and disengaged customers alike – providing a route for cheaper acquisition tariffs which does not involve penalising existing customers."

It cannot be the case that the removal of the MSC in April could be considered as 'a factor' by October. These savings from the removal of this switching tax have already been passed through to consumers. This can be seen through the disappearance of retention-only tariffs as a feature of the market. With no switching tax, the vast majority of tariffs are now available to new and existing customers.

Yours Sincerely,

Paul Fuller
Head of Regulation

