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Date: 6 November 2024

'Future of the Ban on Acquisition-only Tariffs (BAT) beyond March 2025'

Dear Daniel,

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.

We welcome the opportunity to comment on the future of the BAT. We agree with Ofgem's proposal to extend the BAT to March 2026 and its intent to consult on an enduring BAT. We also welcome Ofgem's intention to extend the BAT a further 12 months, if necessary. This is helpful in terms of formulating acquisition strategies for the medium term.

The analysis underpinning Ofgem's decisions is good. We have provided some additional analysis that supports Ofgem's analysis in our responses to the questions below. We note that there is no updated impact assessment. Our response to the BAT statutory consultation in June, alongside a report from Charles River Associates (CRA), raised a number of issues with the previous impact assessment. We ask that Ofgem takes this feedback into consideration whenever it next updates its impact assessment.

We look forward to engaging with Ofgem on what an enduring BAT could look like. We understand that operationalising the current BAT is a burden on Ofgem and we have identified some potential changes that could reduce this burden. However, a fundamental tension remains. As set out in the CRA report, suppliers will engage in price discrimination between loyal and new customers to the extent that they are allowed, as that is the profit maximising strategy. Whatever rules are in place, suppliers will seek to test the boundaries of what is allowable and the regulator will need to monitor and intervene as appropriate.

If an enduring BAT led to a loss of that 'testing of the boundaries', it is likely that a loophole has been introduced to the rules rather than the rules have been perfected. Introductory discounts is a potential example of this. ESB Group has first-hand experience of the impact introductory discounts can have on a retail market. In the Irish market, suppliers are allowed to provide these discounts to new customers for the first 12 months they are on supply. 20% discounts on the unit rate are common enough, with these customers paying substantially more if they remain after the discount runs out. This in effect amounts to price discrimination between loyal customers who are more likely to be vulnerable, and new customers. Introductory discounts of this kind would circumvent the intent of the BAT.

We would be keen to discuss introductory discounts with you and the enduring BAT more generally.

We set out our responses to each question below.

Q1. Do you agree that the BAT should be extended for another 12 months post 31 March 2025, i.e. until 31 March 2026?

Yes.

Q2. Do you agree with the reasons set out in this section supporting our proposal to extend the BAT until 31 March 2026?

Yes we agree with the reasons set out.

Ofgem highlight the risk of loyal customers, who tend to be more vulnerable, paying more in order to cross-subsidise new customers. The CRA report we provided alongside our response to Ofgem's last consultation presented extensive evidence and analysis demonstrating that this risk was substantial, even with a price cap in place.

Q3. Are there any other factors which Ofgem should consider, when determining whether or not the BAT should be extended post March 2025?

Yes. Ofgem has not provided an updated impact assessment alongside this consultation. When it is next updated, the assumptions underpinning that impact assessment need to be revisited. Our response to Ofgem's previous consultation and the CRA report set out the issues with the previous impact assessment.

Q4. Do you believe that the existence of the Market-wide Derogation, and the ability of suppliers to offer bespoke retention-only deals, is consistent with the principle of consumer fairness within the retail market?

Yes.

Q5. Do you believe that the Market-wide Derogation has (or is likely to have) a significantly positive or negative impact on consumer interests, or on competition within the retail market? Please provide supporting evidence wherever possible.

It has a positive impact.

Some reasonable conclusions can be drawn on the impact of the derogation on the market, based on what has been observed to date.

The Market Stabilisation Charge (MSC) substantially increased switching costs. While retention-only tariffs were more common in 2023 when the MSC was substantial, by the time Ofgem outlined their initial decision to remove the BAT in February 2024, only 3 of 16 tariffs publicised on Money Saving Expert website were retention-only. Once the MSC was 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 can draw some reasonable insights from what has been observed to date:

- While switching costs were extraordinarily high due to the MSC, the derogation allowed suppliers to continue to offer fixed tariffs to existing customers. If the derogation hadn't existed, suppliers would have had to price-in these switching costs, raising them above the price cap, making the tariffs commercially unviable.
- While switching costs dropped, these offers were extended to new customers as well. This aligns with conventional thinking on the profit-maximising strategies of businesses.
- In some circumstances, it could be reasonable to restrict tariff offerings to existing customers regardless of switching costs. For example, with more complex half-hourly tariffs, issues can arise with the retrieval of historic smart meter data for pricing offers to new customers making a restriction prudent.

In conclusion, the derogation has increased the availability of tariffs and had a positive impact on consumer choice and the market.

Q6. Are there any other factors which should be considered when looking at the impact of the Market-wide Derogation on the market?

Some reasonable conclusions can be drawn on the impact of the derogation on the market, based on what has been observed to date.

The MSC substantially increased switching costs. While retention-only tariffs were more common in 2023 when the MSC was substantial, by the time Ofgem outlined their initial decision to remove the BAT in February 2024, only 3 of 16 tariffs publicised on Money Saving Expert website were retention-only. Once the MSC was 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 can draw some reasonable insights from what has been observed to date:

- While switching costs were extraordinarily high due to the MSC, the derogation allowed suppliers to continue to offer fixed tariffs to existing customers. If the derogation hadn't existed, suppliers would have had to price-in these switching costs, potentially raising them above the price cap and making the tariffs commercially unviable.
- While switching costs dropped, these offers were extended to new customers as well. This aligns with conventional thinking on the profit-maximising strategies of businesses.
- In some circumstances, it makes sense to restrict tariff offerings to existing customers regardless of switching costs. For example, with more complex half-hourly tariffs, issues can arise with the retrieval of historic smart meter data for pricing offers to new customers making a restriction prudent.

In conclusion, the derogation has increased the availability of tariffs and had a positive impact on consumer choice and the market.

Q7. Do you agree with our proposal to retain the Market-wide Derogation until March 2026, and our reasons therein supporting this proposal?

Yes.

Q8. Would you recommend any changes to the operation of the Market-wide Derogation (assuming that it was being retained for the longer term)?

In the longer term, the derogation should be incorporated into the wording of the BAT itself within the supply licence. Having regulations spread across multiple documents increases the regulatory burden on industry and increases the risk of non-compliance. This is especially a risk with regards to new entrants who may not be as familiar with the evolution of the BAT. Ofgem does not maintain a repository of active derogations.

Q9. Are there practical and/or operational difficulties with how the BAT functions at present? Where possible, we would also welcome any perspectives on how these may be resolved in any future enduring BAT.

As set out in the CRA report, suppliers will engage in price discrimination to the extent that they are allowed as that is the profit maximising strategy. Whatever rules are in place, suppliers will seek to test the boundaries of what is allowable and the regulator will need to monitor and intervene as appropriate.

That is not to say all forms of price discrimination are bad:

- Direct Debit (DD) is a less expensive payment method to operate than Standard Credit. Providing less expensive DD tariffs incentivises consumers to adopt a less expensive payment method and allows suppliers to pass on these savings to consumers. Door-to-door is a more expensive sales channel to operate than website sales.
- Providing more expensive tariffs through the door-to-door sales channel allows suppliers to cover these higher costs, reach less web-savvy consumers and offer them savings versus staying on the price cap. Ofgem should provide clarity to the market on it being acceptable to tailor tariff offerings to suit their sales channels, so long as the tariffs are available to existing customers. More sales channels means more engagement in the market and greater savings for consumers.

However, the form of price discrimination the BAT seeks to limit *is bad*, as it penalises loyal customers, who tend to be more vulnerable, in order to fund discounts for new customers. All other things being equal, a loyal customer should have a lower cost to serve than a new customer as switching costs are avoided. Therefore, rather than reflecting potential efficiency gains or differences in underlying costs, acquisition-only tariffs represent a cross-subsidy. The CRA report made clear that this was possible even with a price cap in place.

The CRA report also made clear that this form of price discrimination delivers worse outcomes for the market in the form of:

- Reduced consumer choice;
- Reduced incentives to invest in efficiency;
- Higher prices for vulnerable consumers, who tend to be more loyal.

From this we can draw some principles from which we can consider an enduring BAT:

1. If price discrimination can be traced to efficiencies or cost to serve then it's likely to be acceptable.
2. If price discrimination cannot be traced to efficiencies or cost to serve then it's not likely to be acceptable.
3. All other things being equal, a loyal customer should have a lower cost to serve than a new customer as switching costs are avoided. Therefore, scenarios where loyal customers who engage with their supplier end up paying more than new customers are not likely to be acceptable.

Introductory discounts

Looking ahead to concepts like introductory discounts we advise caution. For example, in the Irish market, 20% discounts on unit rates for the first year a customer is on supply are common.[1] This does appear to create the same undesirable cross-subsidy between loyal customers and new customers that the BAT is trying to prevent. It should not be allowed.

Collective switching

Similarly, consideration would need to be given to collective switches being exempt from the BAT. Our understanding is this exemption is a carryover from the Retail Market Review '4 Tariff Rule' – so that collective switches didn't count as one of a suppliers 4 core tariffs. In today's context, we can't think of a good reason why, if a tariff is made available to a collective switch provider, it can't also be made available to existing customers through that collective switch scheme. On the other hand, there is the risk that this exemption could be utilised to circumvent the intent of the BAT. From a customer perspective, a 'collective switch' that is only available on a PCW for a very short period is not very different from a traditional PCW-exclusive tariff.

Refer a friend

Finally, it may be useful to clarify the role of 'Refer a Friend' in the context of an enduring BAT. Refer a friend can help drive engagement in the market through word of mouth. We consider it

[1] The price comparison website www.bonkers.ie is a good source of information in tariff offers in the Irish market.

to be in keeping with the spirit of the BAT so long as the amount of credit awarded to the referrer (a loyal customer) is proportionate to the amount of credit awarded to the referee (a new customer). Ofgem should provide clarity to the market on it being acceptable to offer refer a friend under these conditions. More sales channels means more engagement in the market and greater savings for consumers.

Yours Sincerely,

Paul Fuller
Head of Regulation
SO ENERGY