

17 December 2021

Address / Via Email to: retailpriceregulation@ofgem.gov.uk

Price Cap – Consultation on the potential impact of increased wholesale volatility on the default tariff cap

Dear Sir or Madam,

The Federation of Small Businesses (FSB) is a non-profit making, grassroots and non-party political business organisation that represents 160,000 members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

An unprecedented rise in wholesale gas prices in 2021 has led to over twenty-five suppliers failing in the autumn and an increase in energy prices for small businesses. Worryingly, this trend is expected to continue into 2022.

This comes at a time when small companies are still struggling to cope with the economic fallout from the COVID-pandemic while facing unprecedented cost increases. Over three-quarters of small businesses that reported a rise in costs in the FSB Voice of Small Business Index (SBI), cited utility costs as a key pressure.¹

But this has to be set against the background of a 14 per cent increase in input costs over the past year² and the high levels of debt that businesses find themselves in coming out of the pandemic. Two in five businesses in debt, describe that debt as unmanageable according to our research.

¹ FSB, FSB Voice of Small Business Index, Quarter 3, 2021, <https://www.fsb.org.uk/resource-report/sbi-q3-2021.html>

² Producer price inflation, UK: November 2021,

<https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/producerpriceinflation/november2021>

In addition, compared with the previous year, the private sector business population also decreased by 6.5 per cent, from 5.9 million to 5.5 million businesses³.

The current situation has demonstrated the limitations of the default tariff cap, introduced in 2018 as part of the Domestic Gas and Electricity (Tariff Cap) Act. The cap was introduced to protect domestic customers on default tariffs from high energy prices. However, the unprecedented increase in wholesale energy prices means that following an increase in October, a more significant increase of 30 per cent is expected in April 2022.⁴

The energy price crisis furthermore demonstrates the urgent need to review the methodology behind the default tariff cap calculation. A revision of the methodology should ensure that customers continue to be protected from price hikes in the future and that the sector's resilience is strengthened.

As highlighted by Ofgem in the Microbusiness Strategic Review, micro-businesses are more similar in characteristics to domestic consumers⁵. Yet, they do not benefit from the regulatory protections that domestic consumers have. This is also the case for the price cap, which does not protect microbusiness consumers and which left small businesses with significant price increases over the recent months.

The revised regulatory framework needs to be put on a sustainable footing with the recommendations in our response, and micro-businesses need to be protected in a way that is analogous to domestic consumers.

Yours sincerely,

Paul Wilson

Paul Wilson, Policy Director
Federation of Small Businesses

³ <https://www.gov.uk/government/statistics/business-population-estimates-2021>

⁴ <https://www.cornwall-insight.com/press/energy-price-cap-predicted-to-rise/>

⁵ https://www.ofgem.gov.uk/sites/default/files/docs/2020/07/microbusiness_strategic_review_policy_consultation.pdf

FSB response to the consultation on the potential impact of increased wholesale volatility on the default tariff cap

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Market movements

We believe that any changes introduced to the default tariff cap should be proportionate to market movements and should appropriately reflect either increasing or decreasing prices.

The methodology behind the default tariff cap should include a mechanism that ensures that customers also benefit from lower energy wholesale prices. Ofgem should consider tracking wholesale energy prices monthly and adjusting the price cap accordingly in the case of significant movements on the market in either direction. While Ofgem should clearly define those extraordinary circumstances, suppliers should also have enough time to inform their customers about the changes to the price cap.

A gradual adjustment of the price cap may also have its benefits. FSB research shows that the most important factor for small businesses when choosing an energy provider is price stability (75%).⁶ A default tariff cap increase expected in April 2022 will be a sudden and significant increase in energy costs for customers. Such dramatic changes could have been gradually introduced over several months and should also be able to reflect a decrease in wholesale energy prices were such a fall to occur.

Debt

Ofgem should allow customers with debts to switch suppliers. Any (reasonable) debt a customer holds should not prevent them from switching to a more efficient supplier. Additionally, allowing customers with debt to switch to a lower tariff or provider should enable them to pay back debts at a quicker rate. Whereas keeping them on an artificially high tariff is only likely to increase the debt accumulation.

Hedging

Hedging will continue to be an important guarantee for suppliers to respond to future crises. Any changes to the default tariff cap methodology should not disincentivise hedging.

Future market

We are concerned that the current market is not ensuring the financial stability of new suppliers entering the market, which can have a negative impact on small businesses who are forced to find another supplier or passported onto a new one automatically. We would like Ofgem to be more vigilant in assessing new market entries.

⁶ FSB, "Time and Energy", May 2020, <https://www.fsb.org.uk/resource-report/time-and-energy.html>

Meanwhile, we also recognise that smaller and innovative companies, which may not have the financial means to hedge enough to ensure they are protected from market shocks, may be the ones to put forward innovative ideas for the decarbonisation of the energy market. Ovo and Octopus Energy are testament to this. The future energy retail market should ensure that financial stability and innovation are on par.

Mutualisation

A review of the default tariff cap should also aim to find a solution to rising mutualisation costs resulting from supplier failures. We are concerned that the current mutualisation policy makes further supplier failures more likely. Instead, Ofgem may want to consider providing loans to suppliers to be able to cover mutualisation costs incurred to them due to supplier failures. Suppliers should be able to repay those loans over time alleviating the burden of the SOLR process. Furthermore, we are concerned that mutualisation costs are passed on to customers, for instance through the price cap, ultimately hurting more vulnerable customers.

Conclusion

We are witnessing exceptional circumstances in the energy market. The default tariff cap was not designed to cushion the significant price hike seen this year. While quick action is required, it will also be vital to scrutinise solutions before changing the current methodology.

We recognise the difficult situation Ofgem is facing and the challenge to protect customers from unprecedented price increases while simultaneously ensuring that the UK will continue to have a resilient and innovative energy retail market fit for the future.

According to FSB research, only one-third of small businesses operate from home⁷. While a small proportion of businesses operating from home may benefit from the price cap protection, we would like to highlight that most small businesses are not protected from the increase in energy prices.

In addition, to protecting domestic customers, it will be vital to ensure that the 5.5 million small businesses are equally protected. FSB has long believed that small and microbusinesses are more akin to domestic customers when deciding on their energy provider, ranging from lack of expertise in purchasing energy to poor bargaining power.

Over the course of the pandemic, the UK has lost over 400,000 small businesses. These small firms play a vital role in their community – offering services, support, and employment.

⁷ FSB, “The Price of Power”, January 2017, <https://www.fsb.org.uk/resources-page/the-price-of-power-report-pdf.html>

For further information

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