

Emailed to: [pricecapchanges@ofgem.gov.uk](mailto:pricecapchanges@ofgem.gov.uk)

5 January 2022

Dear Sir/Madam,

## **Adapting the Price Cap Methodology for Resilience in Volatile Markets – Call for Input**

Thank you for the opportunity to respond to Ofgem's proposals for adapting the price cap methodology. We have provided some general comments and more specific thoughts on Ofgem's identified options from our perspective as the Energy Ombudsman.

### **Overview**

As we indicated in our response to Ofgem's price cap consultations in December 2021, we think it is the right time for Ofgem to consider the purpose and practicalities of the price cap – for both the short- and long-term. In our previous response we gave our view that, for as long as the price cap remains in place, it seems appropriate that suppliers should be able to expect to recover reasonable costs in a timely way, and that the option of being able to re-open the price cap in exceptional circumstances seemed the most balanced way to do this. As we set out below, our view remains that this is the best option, and that additional clarity on the mechanics of such a change would help to bring transparency to the process.

### **Comments on Ofgem's identified options**

In the context of the proposals set out, we support Option 1 which would allow Ofgem to respond more quickly and adjust the price cap outside of the standard review cycle in exceptional circumstances. We think it is right that suppliers should be able to expect to recover reasonable costs in a timely way – but this needs to be balanced with suppliers' responsibility to also manage commercial risk. By restricting additional intervention to exceptional events, we think this role of suppliers remains clear.

One identified downside of Option 1 is that it inevitably leaves suppliers exposed during periods of less severe change. This is of course no different to the effect of the price cap today, and it is worth noting that suppliers can also experience short-term upsides as well as periods of exposure.

As we said in our last response, we would support Ofgem setting out in advance the criteria for such a change. As well as providing more certainty for suppliers, it would go some way to avoiding legal or regulatory arguments when situations arise when some think a change to the cap should (or shouldn't) be made. Arguments over this would not be helpful during what would by definition already be challenging times for the industry.

Option 2 (the quarterly cap) reduces the lag of wholesale prices to five months, so does not eliminate completely the volume risk for suppliers. As Ofgem has identified, we would also be concerned that more frequent price changes could create additional uncertainty for consumers. Certain types of consumers, such as



those on prepayment meters, would not benefit from actions suppliers could take to address this, such as smoothing direct debits. It would increase budgeting difficulties for some consumers, with changes possibly happening over winter months. It could lead to consumers more often drifting in and out of fuel poverty as prices change more frequently, which must make solving that challenge even more difficult.

We think the fixed term default tariff option set out in Option 3 presents some challenging concerns around the consumer experience. Notwithstanding Ofgem's suggestion that it could require suppliers to prompt consumers to switch ahead of each contract renewal, applying exit fees to consumers who previously were (or had reason to believe they soon would be) free to switch supplier at any time does not intuitively feel like an intervention that would support healthy competition in the market. This is particularly important to consider at a time when both the number of suppliers and rate of switching have declined significantly.

We know that consumers who are on standard variable tariffs – in energy, and on equivalent tariffs in other sectors – are less likely to engage with the market and could be more likely to have vulnerable characteristics. Consumers who are prevented from switching once may be less likely to do so in the future, even when the window re-opens. More broadly, we think the ability of these consumers to switch supplier easily is an important protection for them and an equally important incentive for suppliers to treat consumers fairly. The loyalty of these consumers should need to be earned by suppliers.

In summary, of the options set out we think Option 1 is the most balanced, in that it should help protect against events like those recently seen in the market, while at the same time being symmetrical (in allowing downward as well as upward adjustments) and the least disruptive to consumers. However, we stand ready to play our part in supporting consumers, suppliers and Ofgem whichever way forward is decided.

Your sincerely,



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