Consultation on Medium Term Changes to the Price Cap Methodology

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Contact

Justina Miltienyte, Policy Manager

justina.miltienyte@uswitch.com

1. Introduction

1.1. Thank you for the opportunity to comment on Ofgem's proposals on medium term reforms to the default price cap.

1.2. Based on Ofgem's call for input and stakeholder responses to recent consultations, it is widely accepted that the price cap needs to be updated to reflect the changes in the wholesale energy market. With the current cap methodology, suppliers are unable to adapt to market volatility as they are limited to how much they can charge default tariff customers. While ideally the market would be able to self-regulate, we understand that Ofgem will not consider removing the cap - it delayed the sharp rises of the wholesale costs being passed on to customers over last winter, despite harming competition and leading to many suppliers exiting the market. As a result, the price cap methodology needs to change, as the wholesale market continues to be volatile and suppliers are at risk of further financial losses.

1.3. We therefore support Ofgem's proposal to reform the cap in the medium term. The changes need to not only allow suppliers the ability to recover losses in case of extreme volatility, but also gain customer acceptance as a necessary measure. Once the market is stable and the cap reflects the costs accurately, further conversation is needed about the future of price regulation in the longer term to consider what structure delivers the best outcomes for consumers. No medium term measures should impact the market long term and influence the discussion about the need for any further pricing intervention.

1.4. Therefore, we agree with Ofgem that a quarterly cap is the best option for the time being. While the concept of a price cap contract could work longer term, more testing is needed to evaluate its costs and benefits fully and it would be impossible to implement in the timescales Ofgem is working towards.

2. The needs to be a balance between benefit to suppliers and to customers

2.1. Supplier financial stability and their ability to recover their costs should not come at the expense of default customers, especially if it could damage their interests long term. Ofgem's proposals do not address customer concerns sufficiently and we are concerned that customer point of view will be missed when deciding which mechanism helps suppliers the best.

2.2. The customers are already feeling frustrated with the situation. As soon as the wholesale market became too volatile, suppliers removed all their tariffs from the market. Most still have not returned to the market or the tariffs they offer are very expensive, meaning customers are unable to take meaningful action when they are told about a big price increase. Ofgem's short term measures to come into effect in April will exacerbate the feeling of helplessness even more. We are concerned that this frustration could result in long-term disengagement.

2.3. To help strike the balance between customer engagement and supplier benefit, the measures introduced must resemble existing tariff structure customers are already used to as much as possible - it will encourage more customers to accept the change and understand what it means to them. Given the timeframes Ofgem is working towards, it cannot afford the luxury to experiment with new forms of default tariff, especially as there is not enough time to fully test its impacts on consumer and supplier behaviour. Therefore, we would support Ofgem to move to a quarterly cap as a medium-term measure. It will give suppliers the ability to respond quicker, should the wholesale prices change significantly, and allows customers to be able to engage with the changes in the market in a way they are accustomed to.

2.4. In addition, a quarterly cap could lead to future engagement benefits for customers. Four engagement points a year will give customers more opportunity to engage, when they are only used to thinking about energy once a year. If the energy market is to move towards a more dynamic tariff structure, with Time of Use tariffs becoming the norm, getting customers used to engaging with energy more frequently could act as a good transition to the future.

3. Medium term measures can only come into effect to replace short-term ones

3.1. Suppliers have already been given protection in the short term in a form of measures discouraging from acquiring new customers. These measures aim to ensure that suppliers recover the costs of supplying default customers without the worry of competitors offering them better deals. This is a big intervention from Ofgem that will result in short term losses for customers, who will not be able to benefit from competition while the measures are in place.

3.2. The medium term measure of reforming the cap aims to achieve a very similar objective - protecting suppliers from incurring losses in time of volatility. If suppliers are able to amend their default tariff in a more timely fashion, it should eliminate the concern that competition would increase their losses. Therefore, the amendment to the cap methodology can only be introduced as a replacement for the short-term measures. The combination of the two would completely stop any prospect of competitive retail energy market returning benefits to customers, which would be incompatible with Ofgem's stated objective of promoting competition.

3.3. Finally, Ofgem's reforms will be providing customers with additional prompts for engagement - for any price increase, suppliers will still have to send notifications. This could potentially lead to long term benefit of getting customers used to engaging in the market more frequently. However, that would not be the case if customers attempt to engage just to find there is nothing on offer for them. If suppliers are prevented from offering better value tariffs to customers at that time and customers could not find a way to take action to protect themselves from these increases, it would lead to further customer disengagement.

4. Wider considerations

4.1. While the proposed changes to the cap will benefit suppliers, there are wider considerations that Ofgem needs to take about how customers engage in the market, as at the moment the engagement is centred around an assumption that the engagement is primarily limited to an annual event. Introduction of Ofgem's preferred option - a quarterly cap - will make it a lot more difficult to provide accurate information to customers in annualised figures.

4.2. Therefore, we believe Ofgem should also look at the following rules to ensure customers are protected and are given the most accurate information at the point of engagement:

- **Annual pricing.** At the moment suppliers (and, by extension, Price Comparison Websites) are required to display customers their energy costs as an annual figure. The 6 month review of the price cap already makes the estimation somewhat inaccurate. A quarterly change is likely to push the estimation too far. Therefore, Ofgem needs to review the rules around Estimated Annual Cost and test alternative approaches in how to display costs and savings to customers. We would welcome the opportunity to engage with Ofgem further on this point to ensure something workable and easy to understand for consumers is developed.
- **Customer communications.** When reviewing customer communications rules, Ofgem set an expectation that as a minimum supplier has to communicate to its customers once a year. Now that the price cap could be reviewed quarterly and could lead not only to price increases but also decreases (which do not necessarily trigger a communication), Ofgem should consider changing the threshold for minimum communications to ensure customers are well informed.
- **Direct Debit reassessments.** Many suppliers have moved towards less frequent Direct Debit reassessments over the last few years. With a change in price cap, it could become increasingly difficult for customers to manage their costs if their Direct Debits do not account for price changes immediately. This could lead to big bill shocks for many customers. Ofgem therefore may want to consider reinforcing the principles that suppliers have to help customers manage their costs.

4.3. You can find our answers to specific questions raised in the consultation in the annex below. This is an important reform not just for suppliers but also for customers. We look forward to engaging with Ofgem in the future on these changes and how to help best explain them to customers.

Annex - Responses to specific consultation questions

Question 1: Are there any other costs and risks to consumers and suppliers that we should consider?

We have no concerns about the risks identified to suppliers - Ofgem has listened to the feedback from suppliers and, in our opinion, captured their risks well.

However, we do not think that the risk to customers has been fully identified, if multiple options are still being considered. The risks to customers are only being framed through a lense of potential future supplier failure and the associated costs it might bring. Ofgem does not take into account the further risk of long-term customer disengagement.

Sustained customer engagement with energy is crucial for UK's long term goal of Net Zero and reforms needed in the market to achieve that. Customer behaviour change will be needed for network flexibility and Time of Use tariffs to bring full benefits. Therefore, even a medium term reform that risks disengaging customers long term should be fully assessed with a view of what is needed for the market long term.

Ofgem must also consider these risks as a package with the other measures it has implemented (or is still considering) and ensure it does not, in aggregate, pursue a greater softening of price competition than is necessary to achieve stability, as it would result in a loss to consumers over the medium to long term.

Question 4: Please provide further evidence on the impact of quarterly updates and price cap contracts on households and their finances, and how these could be mitigated.

Any price changes will be a cause for concern for many customers, especially the most vulnerable. More frequent changes, such as a quarterly cap, will likely prompt customers to engage with the market, therefore it is very important to ensure that suppliers are able to offer competitive deals at the time of engagement. Timing of announcements is particularly crucial and the two additional notifications are likely to fall at the time customers are historically least engaged - around Christmas and mid-summer. There is a real risk that due to the timings, customers could sleepwalk into a price rise and suppliers need to do more to ensure their customers are notified promptly and are able to take action. Ofgem should consider reminders being sent to customers post cap re-assessment to give customers more time and opportunity to act.

Price cap contracts could add an additional element of frustration, unfairness and, in turn, disengagement. Customers may not fully understand the changes and their impact on their finances. Advising customers would also become a lot more difficult as it may not be possible to know how much each customer is paying and, therefore, whether staying on the default tariff is right for them.

Question 5: Do you think it is unfair that consumers would sometimes have higher or lower prices depending on the wholesale cost at the time their cohort starts the price cap contract? Do you think over the longer run this would even out?

Yes, it would be unfair on customers if they are being penalised for going on default tariff at a particular time. The staggered contracts would also unfairly price customers in different circumstances that they have no control over. For example, would someone be charged a different amount depending on when they move into a new property (which is supplied on default tariff)?

While it is unclear if the costs would even out over the course of time for individual consumers (they would for suppliers), even if they do, it would be difficult to prove that and the immediate impact on consumers would be seen as unfair. The fact that customers would be given different prices in the short term would create a very negative perception and it would be near impossible to change that.

Question 6: What opportunity and impact could each proposal have on consumer engagement? And where there may be negative impacts, please provide options to address these. (Please provide evidence.)

Quarterly cap should have a net positive impact on consumer engagement, as it would trigger more frequent engagement points, even if the incremental changes in price will be lower. It would also help customers transition to a more frequent interaction with their energy use - something that is fundamental to achieve Net Zero.

We believe that price cap contracts, on the other hand, would lead to significantly reduced engagement, as consumers will find them unfair and/or difficult to understand. However, as the intervention would be completely unfamiliar to customers, more testing should be done to fully understand the impact on customers before it could be introduced. Therefore, we do not think it is feasible to consider this measure as a medium-term intervention.

With either option, Ofgem should nonetheless closely monitor metrics of consumer engagement within suppliers and the market more broadly. This would enable Ofgem to consider course correction should any harmful unanticipated behavioural trends emerge as a result of the remedy.

Question 8: Are there any challenges in transitioning to quarterly updates or the strengthened status quo? If so, please provide details.

While they are not challenges as such, we do believe there are certain areas Ofgem should review to ensure customers are protected and get most accurate information about their costs. We have outlined the main considerations in the cover letter below, which are:

1. The use of Estimated Annual Costs - with prices potentially changing four times a year, annual cost becomes too difficult to predict.
2. Increased customer engagement points (rather than just minimum threshold of annual engagement)
3. More frequent direct debit reassessments

Uswitch is willing and would welcome the opportunity to engage further with Ofgem on a bilateral basis, including in the provision of aggregated consumer behavioural data, where it is helpful in assessing these points.

Question 10: If we were to implement the price cap contract, how should we implement it - with an immediate start and single cohort on a price cap, or with a staggered start and six or twelve different cohorts?

We do not agree that a price cap contract is a good option as a medium term measure. Ofgem has not given itself enough time to properly test the impact of such a change in the market and evaluate its long term effects. Whichever way it is implemented, the price cap contract is very likely to lead to negative consumer perception that will be difficult to overcome.

That being said, we are not against Ofgem testing the intervention as a longer term measure. Price cap contract could be one of the options for long term disengaged customer protection, provided Ofgem conducts tests on customer behaviour before the intervention is fully considered.

Question 11: What is a fair and practical way to allocate consumers to different cohorts?

Whatever way customers are allocated, it will most likely still be perceived as unfair as some may get an unfair advantage over others.

If Ofgem is serious in considering the proposal of staggered default contracts, it needs to be extensively tested with consumers to understand their reactions. This would not be compatible with the timelines Ofgem is working to, therefore we suggest adopting a quarterly cap as a medium term measure and test staggered default contracts as longer term pricing intervention.

Question 12: Should we consider any of these variations further? If so, which one(s) and on what basis? (Please provide evidence)

To make sure the changes are ready in time for October 2022, it would be preferable to narrow down to one option, quarterly price cap, and ensure it is implemented in time.

Question 13: Do you have any evidence or data that supports or challenges our assessment of the benefits this? What are the practical considerations for price changes over winter and Christmas?

We do not have concerns about reducing notice period to suppliers, as long as notice period for customers is not significantly reduced as a result. Even though suppliers are notified of the price change two months in advance, most inform their customers about 30 days before the price change takes effect - giving them one month to organise communications. 30 days is widely accepted as the right amount of time to allow customers to act on the change and is in line with what happens in other markets.

Reducing the notice period to suppliers to 28 days is fine as long as suppliers can mobilise themselves and pass on the information to customers without any delay. As part of the consultation process, Ofgem should specifically request time estimates from suppliers when would they be informing their customers about the change as a result, if that is not provided in the responses to this consultation.

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Ofgem is predicting that if a quarterly cap is introduced, price rises will be expected mid-winter - so the January cap notification is extremely important for customers to be aware of. Therefore, there has to be an additional prompt for customers to remind them of the changes coming into effect that should be mandated in the Supply Licence. This would likely be the most cost effective way to ensure customers are protected, without moving cap observation periods, which would be a lot more complicated operationally.

Question 14: Do you have evidence or data to support a move to a shorter implementation window – such as 14 days? What are the potential risks to consumers of a shorter notice period? And what are the operational considerations?

Shorter than 28 day notice period would be too short for customers. Customers need to be given enough time to see the notification and act on it. This has to work both online and offline. Normally that period is around 28 days, to account for the time to see notification and any life events that may prevent customers from acting straight away.

14 day notice for suppliers would most likely lead to customer notifications being sent within a week of taking effect, which would be too short for most customers, especially those that receive paper/offline notifications, as they may not receive the notification at all before the price change takes place.